# 1999

## Annual report and Form 20-F

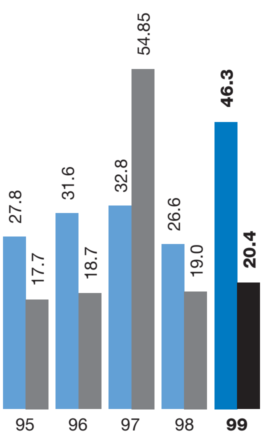
British Telecommunications plc is a public limited company which has listings on the London, New York and Tokyo stock exchanges and is registered in England.

This is the annual report for the year ended 31 March 1999. It complies with UK regulations and is the annual report on Form 20-F for the Securities and Exchange Commission to meet US regulations.

This annual report has been sent only to shareholders who have elected to receive a copy. A separate annual review and summary financial statement for the year ended 31 March 1999 has been issued to all shareholders.

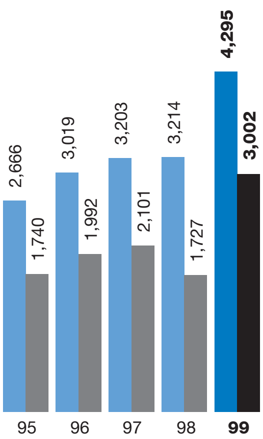
# Financial highlights

**Earnings and dividends per share (pence)**
YEARS ENDED 31 MARCH

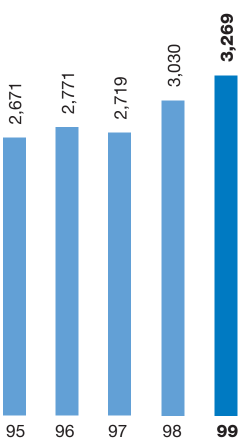



The 1997 dividends included a special dividend of 35 pence per share.

**Profit before and after tax (£m)**
YEARS ENDED 31 MARCH




**Capital expenditure (£m)**
YEARS ENDED 31 MARCH




| YEARS ENDED 31 MARCH | 1999 | 1998 | 1997 |
|---|---|---|---|
| **Total turnover – ongoing activities** | **£18,223m** | £16,039m | £15,021m |
| **Exceptional operating income (costs)** | **£(69)m** | £238m | – |
| **Total operating profit** | **£3,474m** | £3,461m | £3,429m |
| **Profit on sale of fixed asset investments** | **£1,107m** | – | – |
| **Profit before taxation** | **£4,295m** | £3,214m | £3,203m |
| **Windfall tax charge** | **–** | £510m | – |
| **Profit after taxation** | **£3,002m** | £1,727m | £2,101m |
| **Basic earnings per share** | **46.3p** | 26.6p | 32.8p |
| **Basic earnings per share before exceptional items** | **34.7p** | 31.7p | 32.8p |
| **Dividends per share – ordinary** | **20.4p** | 19.0p | 19.85p |
| **– special** | **–** | – | 35.00p |
| **Net cash flow from operating activities** | **£6,035m** | £6,071m | £6,185m |
| **Capital expenditure** | **£3,269m** | £3,030m | £2,719m |
| **Investment in associates and joint ventures** | **£1,326m** | £1,380m | £148m |

- **Global venture with AT&T announced**
- **£1.3 billion invested in strategic alliances and joint ventures in Europe and Asia Pacific**
- **12 per cent growth in demand for BT's products and services, driven by rapidly-expanding Internet traffic and mobile usage**
- **BT Cellnet's customer connections up by 1.4 million to 4.5 million**
- **7.4 per cent increase in dividends per share**
- **Net gain of £1,133 million on sale of MCI shares**

# *Chairman's message*

**This past financial year has been an exciting one for the communications industry, and particularly for BT. For some while, we have been hearing about the impact that new communications technologies like mobile and, more recently, the Internet will have on our lives at work and at home. Now we have begun to experience that impact first-hand.**

BT's UK network, for example, now carries more data than voice traffic. And Internet usage accounts for some 18 per cent of our local UK network traffic.

In response to such changes, your Board has reviewed BT's vision statement – the single sentence that sums up our aims and aspirations. For the past several years, we have aimed "to become the most successful worldwide telecommunications group". That was an ambitious objective when we set it – in fact many people found it startling – but it is increasingly clear that it is no longer sufficiently comprehensive. Our aim now is "to be the most successful worldwide *communications* group".

I believe the past year has shown that we are well placed to succeed.

- Our European alliances and ventures are beginning to punch their weight.
- We have laid the foundations of our global venture with AT&T.
- We increased our activities in the Asia-Pacific region, and the momentum has continued into the current financial year with the three-way BT, AT&T, Japan Telecom alliance.
- And, in the UK, innovative marketing, price cuts and the rapid increase in Internet usage and mobile communications all contributed to a strong performance, despite increasing competition.

The figures tell the story. Your group's turnover, including BT's share of its ventures' turnover, grew last year by 13.6 per cent to £18.2 billion. Our new ventures in Europe and Asia Pacific accounted for over £800 million of this increase in turnover, and both mobile and fixed network calls in the UK made strong contributions.

BT's share price grew by 55 per cent in the financial year, compared with only five per cent for the FT-SE 100 index. Earnings per share before exceptional items were 34.7 pence. Your Board is pleased to recommend a final dividend for the year of 12.3 pence per share, which brings the total dividend for the year to 20.4 pence per share, an increase of 7.4 per cent over 1997/98.

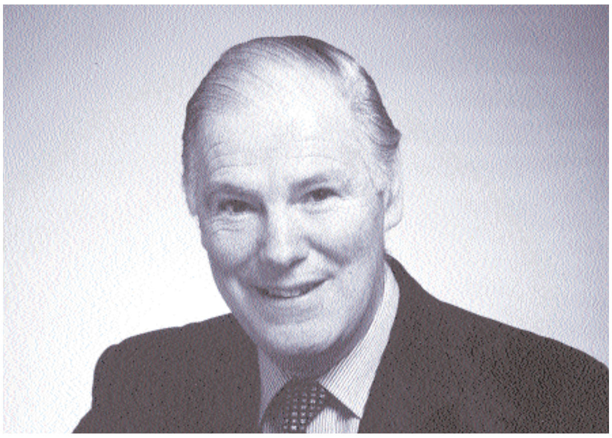
Yet a company can only achieve great things through the actions of its people and I would like to record here my thanks to BT people for all their efforts.

I would also like to thank two directors who retired from the Board during the year, Malcolm Argent and Sir Ewen Fergusson. Both made a notable contribution during their terms of office. Sir Ewen joined the Board as a non-executive director in 1993. Malcolm was appointed to the Board in 1989, becoming a non-executive director in 1994, and played a major part in BT's transformation into the global communications company it is today.

During the year, we welcomed Helen Alexander, Neville Isdell and Sir John Weston to the Board.

BT has made great progress over the past two decades. Now, with our new vision, we will continue to move forward, building on our success and positioning ourselves for the challenges and opportunities of the new Millennium.

**Sir Iain Vallance**
*Chairman*
25 MAY 1999



# *Chief Executive's statement*

**BT is a company experiencing major change, in an industry that is changing the way people live and work around the world.**

**Transformation**

With your support, BT is transforming itself from a UK telecommunications company into a global communications company.

This may seem to be a small change linguistically, but it represents a huge leap strategically.

"Telecommunications" is now, we believe, too narrow a word to sum up the wide range of things we do and want to do.

We have grown from a national telecommunications operator, dealing mainly in fixed-voice telephone calls, to a global communications company with operations that span the world, and services that, in addition to fixed-voice telephony, include the Internet, mobile and data communications, and business systems and solutions.

**Our strategy**

And the strategy which underpins this transformation and these successes is a simple one – to seize the opportunities for growth in our chosen communications markets worldwide.

I hope that this report will give you some indication of how we are translating our strategy into action.

**Data**

Data communications, which covers almost all network traffic that is not voice – including e-mail, the Internet, electronic commerce, and files sent from computer to computer – is growing at more than 30 per cent per year. Data has overtaken voice communication over BT's networks, a phenomenon often referred to as the "datawave".

**Investment in our networks**

In 1998/99, we launched the UK's largest and most advanced data network. And we have earmarked £5 billion for future investment in data and multimedia services.

And, with our partners in mainland Europe, we launched a state-of-the-art pan-European optical fibre network connecting 200 cities.

**Concert**

BT is already a world-leader in the growth area of global managed services through Concert Communications, which has 40 per cent of the *Fortune* top 500 companies as customers. And Concert is to become a key part of BT's contribution to the global venture we are forming with AT&T.

**Liberalised markets worldwide**

Our growth in the recently-liberalised markets worldwide has continued. In the European market, which is growing by ten per cent per year, we currently have more licences than any other operator. In 1998/99, our European ventures increased their customer numbers by more than 150 per cent to over nine million.

In Asia Pacific, we have made carefully targeted investments in high-growth companies, such as Binariang of Malaysia, LG Telecom of the Republic of Korea and SmarTone of Hong Kong. And, in April 1999, we announced, together with AT&T, a partnership with Japan Telecom. Japan is a key market and this move takes our global strategy an important step forward. During the year, revenues from our new ventures in mainland Europe and the Asia-Pacific region amounted to over £1.1 billion.

We have also made our first foray into Latin America, with a £90 million investment in ImpSat, which provides major corporate customers with an advanced range of voice, data, Internet and e-commerce services in key cities.

**Mobility**

The market for mobile communications is growing at 20 per cent per year and our mobile operations now have more than 14 million customers worldwide – including over four million each for BT Cellnet in the UK and Cegetel's subsidiary, SFR, in France and over two million for Spain's Airtel.

**Business systems**

And, in the market for business systems, BT's Syncordia Solutions, which manages networks for corporate clients, and Syntegra, which designs integrated business systems, together grew by more than 20 per cent in 1998/99.

**Innovation**

Our work in all of these growth areas draws on our world-class research and development. Innovation is vital for a successful communications company, and we are working at the leading-edge in technologies such as the Internet protocol (IP) – the technology behind the Internet – and mobile communications.

To date, our researchers have won the Queen's Award for Technological Achievement on five occasions.

**The future**

In 1998/99, our focus on the major growth areas of communications delivered results for all our stakeholders – for our shareholders, our customers, our people and for the communities in which we operate.

I look forward to your continued support as we step up to face the challenges and opportunities of this fast-moving market, and as we drive for further growth in 1999/2000.

**Sir Peter Bonfield CBE**

*Chief Executive*

25 MAY 1999

# Business review

The Business review describes the business of BT and its activities during the 1999 financial year.

The review is divided into the following sections:



## Introduction

**BT's aim is to be the most successful worldwide communications group. To achieve this, we have to generate shareholder value by seizing opportunities in the communications market worldwide, building our current business and focusing on high growth segments, while playing our part in the community and achieving the highest standards of integrity, customer satisfaction, and employee motivation.**

We aim to do this by continuing our strategy of recent years of:

- serving the needs of multinational companies, wherever they are based;
- moving into growth markets around the world, such as Europe, the Asia-Pacific region and Latin America;
- building our activities in high growth areas such as mobile communications, network-based communications solutions for businesses, and the "datawave", i.e. data, multimedia and the Internet;
- continuing to develop and grow our business in the UK, which we believe to be the most open and competitive telecommunications market in the world.

Outside the UK, our strategy is to work with local partners. We now have a number of key alliances around the world and have made a significant investment in international services. Mobile services form an important and increasing part of these activities.

The group's operating profit is derived predominantly from UK local and national calls and international calls. Within the UK, our major services and products are local and national calls, the provision of exchange lines to homes and businesses, international calls made from and to the UK, the supply of mobile communications services and equipment to businesses and individuals, the provision of private circuits to businesses and the supply of telecommunication equipment for customers' premises.

The principal components of BT's turnover during each of the last five financial years are shown in the table on page 9. In the 1999 financial year, approximately 96% of BT's group turnover arose from operations in the UK.

## Global venture with AT&T

The major event of the year was the announcement on 26 July 1998 that BT and AT&T, the major US long-distance telecommunications operator, were to form a global venture to serve the communications needs of multinational companies and organisations and the international calling needs of individuals and businesses around the world.

| **Turnover summary – ongoing activities**<br>YEARS ENDED 31 MARCH | 1995<br>£m | 1996<br>£m | 1997<br>£m | 1998<br>£m | **1999**<br>**£m** |
|---|---|---|---|---|---|
| Inland calls | 4,941 | 4,882 | 4,874 | 4,924 | **5,178** |
| Exchange lines | 2,753 | 2,900 | 3,033 | 3,180 | **3,337** |
| International calls | 1,935 | 1,980 | 1,809 | 1,553 | **1,501** |
| Mobile communications | 657 | 856 | 949 | 1,089 | **1,400** |
| Private circuits | 1,024 | 1,056 | 1,124 | 1,149 | **1,165** |
| Customer premises equipment supply | 1,041 | 946 | 914 | 896 | **870** |
| Receipts from UK operators | 246 | 265 | 319 | 496 | **645** |
| Yellow Pages and other directories | 371 | 408 | 438 | 466 | **491** |
| Other UK sales and services | 737 | 831 | 994 | 1,332 | **1,770** |
| Non-UK operations | 188 | 322 | 481 | 555 | **596** |
| Group turnover | 13,893 | 14,446 | 14,935 | 15,640 | **16,953** |
| Share of associates' and joint ventures' ongoing turnover *(a)* | 7 | 24 | 86 | 399 | **1,270** |
| Total turnover – ongoing activities | 13,900 | 14,470 | 15,021 | 16,039 | **18,223** |

*(a)* Excludes associates and joint ventures no longer part of the group.

Owned equally by BT and AT&T, the venture will combine trans-border assets and operations of both companies, including the majority of our cross-border international networks, our international traffic, and our international products for business customers, including an expanding set of Concert services. Concert Communications Services (Concert) is one of the world's leading providers of seamless, global communications services.

BT will transfer the majority of its international communications activities, including Concert and our business with selected multinational customers, to the global venture.

Through the venture, BT and AT&T aim to serve the fast-growing global communications services market. The venture, together with partners around the world, will provide an extensive range of global trans-border services, greater than either company could provide alone or with their current partners.

The deal has gained regulatory approval from the European Commission. We have applied for approvals from the US Department of Justice and the Federal Communications Commission and these are expected later in 1999, prior to the launch of the global venture.

It is proposed that the venture will have three key businesses:

- a global voice and data business to develop network-based communications solutions for multinational companies and organisations around the world;
- a global sales and service business to serve directly the communications needs of multinational customers from selected industries;
- an international carrier services business to manage all of the international correspondent relationships.

Supporting these businesses the venture will have a correspondent international network which will reach 237 countries and territories and its own managed network with 6,000 nodes in 52 countries covering nearly 1,000 cities.

The venture will have its own board of directors, which will comprise executives from both companies, and its own management team. Sir Iain Vallance will be the venture's first Chairman and David Dorman its Chief Executive Officer. Mr Dorman, who was appointed on 1 April 1999, has extensive US experience in communications gained with Pacific Bell, Sprint and PointCast.

With its operational headquarters in the eastern United States, the venture will employ initially about 5,000 people worldwide. It will have its own sales force to serve corporate customers.

### Concert Communications Services

Concert is wholly owned by BT. It was created in 1993 to serve multinational customers with trans-border and global communications needs. Since its inception, Concert has developed and launched a strong portfolio of managed global services.

With more than 4,700 customers in 52 countries, Concert has become one of the world's leading providers of managed global services. Concert services are offered through 47 distributors around the globe, many of which are companies within the BT group, or joint venture companies of BT.

In the United States, Concert services are now available through three non-exclusive distributors, AT&T, BT North America Inc., and MCI WorldCom. AT&T has offered Concert services under the brand AT&T Concert since November 1998. MCI WorldCom will continue to offer Concert services until September 2000.

With approximately 1,600 employees in 13 countries, and one of the world's largest managed ATM backbone networks, Concert will be a key contributor to the global venture being established by BT and AT&T. ATM is the industry standard for integrated broadband communications.

**Europe**

Europe continues to present major opportunities for BT. We are moving to take advantage of these opportunities on two fronts: by continuing to grow, strengthen and develop our joint ventures and alliances and by investing in technologically-advanced networks.

We now, alone or in partnership, run or have licences to run fixed-line services in Belgium, France, Germany, the Republic of Ireland, Italy, the Netherlands, Spain, Sweden and Switzerland and mobile services in France, Germany, the Netherlands and Spain. We have a stake in Internet companies in France, Germany, the Netherlands, Sweden and Switzerland and own Arrakis, an Internet service provider in Spain.

Our partnerships in each of these countries distribute Concert services. In Europe, excluding the UK, BT now has, through its joint ventures and alliances, more than 7.5 million customers for mobile communications and almost 800,000 Internet customers.

Cegetel, in which BT has a 26% stake, is already the main competitor to France Telecom. Cegetel provides the full range of telecommunications services in France, with mobile services through its subsidiary, SFR. SFR now has more than four million customers and its GSM digital network covers 97% of the French population.

BT's joint venture in Germany is Viag Interkom in which BT has a 45% stake. In 1998, Viag Interkom successfully launched a full range of fixed, mobile and Internet services for the business and residential markets. Viag Interkom plans, during the coming year, to expand its mobile network to cover 70% of the German population, and recently launched its advanced Home Zone product, which combines both fixed and mobile services from a single provider. We believe that Viag Interkom is positioned as a strong provider of the full range of telecommunications services in the largest market in Europe.

Telfort, BT's Dutch 50/50 joint venture with national railway company Nederlandse Spoorwegen, has moved into the mobile market with the launch of Telfort Pak&Bel (Take & Talk). Initially, the service was available in the Raandstad area, including Amsterdam, Rotterdam, Utrecht and the Hague. Coverage is planned to increase during 1999. BT Payphones have signed a ten-year contract to provide more than 800 payphones, branded as Telfort, in Dutch railway stations.

In April 1998, our joint venture in Italy, Albacom, was awarded a fixed-network licence enabling it to negotiate interconnect agreements to offer fixed services throughout Italy. Albacom's main target clients are the 230,000 small and medium-sized companies in Italy. It is the national distributor of the Concert portfolio, with main offices in Rome and Milan.

In Spain, BT operates through Airtel, BT Telecomunicaciones SA (BT Tel) and Arrakis. Airtel, in which at 31 March 1999 BT had a 17.8% interest, is the second mobile operator in Spain and has a 31% share of the Spanish market. BT Tel is the distributor of Concert services and, in December 1998, was awarded a full fixed network licence. It intends to launch basic voice services by June 1999. In February 1999, we acquired Arrakis, a leading Internet service provider in Spain, with a 15% market share.

BT's other joint ventures in Europe include Ocean in the Republic of Ireland, which offers a wide range of services to business and commercial customers, Telenordia in Sweden, whose Internet service provider has over 250,000 customers and Sunrise Communications in Switzerland, which offers fixed services and carries over half of all Swiss Internet traffic. BT also has operations in the Isle of Man and Gibraltar.

BT UK, Albacom, BT Belgium, Sunrise, Telfort, Viag Interkom and Cegetel have combined to form the largest pan-European network, with points of presence in more than 200 cities. This enables us to meet customers' rapidly increasing demand for high quality, low cost Internet and high-speed telecommunications services. Phase two of the network build will include roll-out in the Republic of Ireland, Spain and the Nordic countries later this year and phase three will extend the network to other parts of southern and eastern Europe.

By linking the in-country networks and using the latest technology, BT, our joint ventures and Concert should enjoy substantial operating efficiencies and economies of scale.

### Asia Pacific

BT believes that, despite recent economic difficulties in the area, the Asia-Pacific region continues to be an important market that offers great opportunities in the medium and long term. We have offices and ventures in Australia, China, Hong Kong, India, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, South Africa, Taiwan and Thailand.

Japan Telecom, one of Japan's largest telecommunications groups, BT and AT&T announced in April 1999 a strategic and operational partnership, aimed at further enhancing Japan Telecom's ability to deploy new services and technologies to serve customers in Japan. The companies have entered into an agreement for BT and AT&T to acquire a 30% stake in Japan Telecom for about £1.2 billion (Yen 220 billion).

Regulatory clearances for BT and AT&T's investment in Japan Telecom are currently being sought from the European Commission, the Department of Justice and the Federal Communications Commission in the United States. Subject to these clearances being obtained, the transaction is expected to close by autumn 1999.

Japan Telecom, with some 17 million customers, serves the full range of business and consumer customers and operates in the international, long-distance, data, Internet and local markets in Japan. It also has significant interests in digital mobile telecommunications companies which have more than six million customers.

Under the agreement, BT and AT&T will each subscribe for 15% of the equity in Japan Telecom. Through a holding company, BT and AT&T will have economic interests of 20% and 10%, respectively. BT and AT&T will jointly manage their investment.

Japan Telecom will also become the sole distributor of BT and AT&T global venture branded services and a preferred supplier of services to the proposed global venture.

During the year, BT Communications Services Limited (BTCS), our existing venture in Japan owned jointly with the Marubeni Corporation, was granted a telecommunications licence and broadband radio licences allowing the company to build and own its own infrastructure. BTCS will be integrated into Japan Telecom.

In November 1998, we launched the Harmonix brand to unify all of our products and services in Japan under one name. The Harmonix portfolio offers services from voice, data and Internet services to advanced multimedia and electronic commerce (e-commerce).

In Malaysia, we made a £279 million investment to acquire a 33.3% stake in Binariang Berhad, a major Malaysian telecommunications group operating a mobile communications business and providing fixed and international gateway services in Malaysia. Binariang's mobile company, Maxis, has a 22% market share and Binariang's broadband network can be accessed by 70% of Malaysian corporate customers and multinational companies. The network is fully compatible with Concert services, of which Binariang is now a non-exclusive distributor, together with Telekom Malaysia.

In Hong Kong, we acquired a 20% stake in SmarTone, a leading mobile telephone operator, for around £240 million in May 1999. SmarTone has half a million customers and an 18% market share.

In the Republic of Korea, we acquired, for £234 million, a 23.5% stake in LG Telecom, a leading mobile telephone operator, with 2.4 million customers.

In Singapore, BT is part of StarHub in partnership with ST Telecommunications Pte Limited, Singapore Power and Nippon Telegraph and Telephone Corporation. StarHub plans to provide broadband services to the home, a regional first. StarHub has started providing Internet services through its subsidiary, CyberWay.

### Latin America

In April 1999, BT acquired a 20% stake in ImpSat, a leading telecommunications company with networks in major cities in Argentina, Brazil, Colombia, Ecuador, Mexico and Venezuela. The company provides large corporate customers with an advanced range of voice, data, Internet and e-commerce services. Under the terms of the deal, ImpSat will also become a distributor of Concert services.

### Syntegra

Syntegra is a market-leading systems integration business with customers in more than 50 countries. More than half of Syntegra's turnover comes from outside the UK. It offers a range of services, including the design, support and development of information and communication systems and their underlying network and service platforms, as well as electronic solutions for business customers.

### The UK

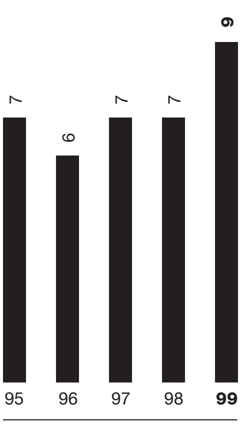
#### UK fixed network

Within the UK, BT has 28 million customer lines (exchange line connections) of which approximately 20 million are residential lines and eight million are business lines. On average, approximately 100 million

UK local and national calls are made each day. These comprise voice and non-voice calls, such as facsimile and data transmission, including calls to the Internet.

UK inland local and national calls accounted for approximately 31% of the group's turnover in the 1999 financial year.

**% annual inland call volume growth**
YEARS ENDED 31 MARCH




Call growth in recent years has been stimulated largely by price reductions and by growth in the UK economy. The estimated growth rates in call volumes increased more this year than in each of the last five financial years, largely because of the expanding use of the Internet (around 18% of our UK local call minutes in March 1999 was Internet-related traffic) and a significant increase in calls to mobile phones.

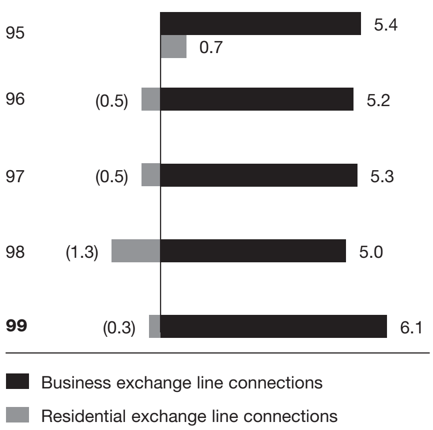
The price structure for call charges varies with distance, duration, time of day, usage and the applicability of discount schemes. BT charges for the exact duration of the call, subject to a minimum charge.

### Exchange lines

In the 1999 financial year, UK exchange line rental and connection charges accounted for approximately 20% of the group's turnover. Our exchange line customers are generally charged a uniform quarterly rental per line. The charge for business lines is higher than for residential lines. The increase in exchange line turnover reflects mainly the growth in business lines in general and high-speed digital Integrated Services Digital Network (ISDN) lines in particular. Residential lines declined slightly, mitigated by the large number of customers installing second lines.

However, since the beginning of 1995, BT has experienced a small net reduction in residential line connections as a result of the continuing competition from cable operators which offer integrated television and telephony services. Business connections have shown a steady increase over the same period.

**Exchange line connections**
**% growth (fall) over previous year**
YEARS ENDED 31 MARCH




### International calls

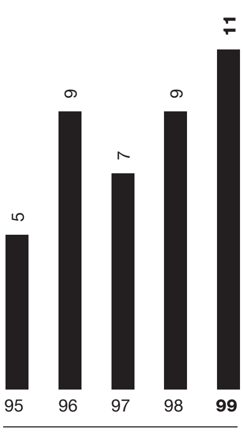
International calls accounted for approximately 9% of the group's turnover in the 1999 financial year.

International call revenues are derived from outgoing calls made by customers in the UK and from receipts from non-UK telecommunications operators for incoming and transit calls that use BT's facilities. In turn, BT makes payments to non-UK operators for the use of their facilities, primarily for terminating calls.

The UK remains one of the world's principal telecommunication transit centres, enabling calls originating and terminating outside the UK to be routed through it. International direct dialling from BT's UK network is available to virtually all countries and almost all international calls originating from BT's UK network are direct dialled. In the 1999 financial year, the greater part of BT's international call traffic was generated from a limited number of routes and 75% of outgoing call volume was to 15 countries.

BT continues to seek reductions in interconnection rates, the charges that telecommunications providers in other countries make for carrying international calls originating in the UK. Historically, these have not kept pace with reductions in the underlying costs of providing international service except on the more liberalised routes. We welcome the decision of the European

**% annual international call volume growth**
YEARS ENDED 31 MARCH




Commission, taken in August 1998, to exclude BT from its continuing investigations into the high level of interconnection rates in Europe. We believe that the Commission's decision to concentrate its investigations on arrangements involving seven other European operators recognises the competitive nature of the UK market for international communications.

The volume of international calls continues to grow, partly because of significant price reductions. However, these price reductions and increased competition continue to have an adverse effect on revenues.

It is intended that much of our international call business will be transferred to our proposed global venture with AT&T later in 1999 once regulatory approvals are obtained.

**Mobile services in the UK**
Mobile communication services and products supplied by BT in the UK mainly comprise cellular telephony, together with radiopaging and voice messaging.

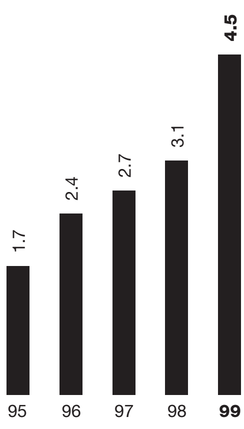
We have a 60% stake in BT Cellnet, one of the four cellular telephone network operators in the UK licensed by HM Government. BT Cellnet had 4.5 million customers at 31 March 1999, representing 30% of the UK market. During the course of the year, HM Government indicated that it would no longer object if BT decided to buy the 40% of BT Cellnet owned by Securicor.

In March 1999, BT Cellnet acquired an 80% stake in the mobile service provider Martin Dawes Telecommunications (MDT) for approximately £130 million. MDT, which will continue to be run as a separate business unit at least for the 2000 financial year, has 800,000 customers, mainly small and medium-sized businesses. Vodafone holds the remaining 20% of MDT and, until September 1999, has the right to sell it to BT Cellnet.

The market for mobile services is expanding faster than most other sectors of the UK telecommunications market but is extremely competitive with great pressure on prices. Throughout the year, BT Cellnet has responded with a number of marketing initiatives: discount offers specifically designed for particular types of customer (marketed as "BT Cellnet First"), products and services aimed at young people and, most notably, "pre-paid" phones. These can be bought over the counter at a range of outlets, including supermarkets and electrical stores, complete with a set amount of call time which can be topped up later, so avoiding the need for written contracts and monthly subscriptions. They have proved very popular and have been a major contributor to the large increase in BT's mobile communications customer base (up 47% over the 1999 financial year) and turnover (up 29% over the year, even after significant price reductions).

BT Cellnet has continued to invest in its digital cellular GSM network to improve its quality and capacity.

**BT Cellnet customers (millions)**
AT 31 MARCH




Vodafone, Orange and One 2 One are the other licensed mobile operators in the UK. They had 5.6 million, 2.5 million and 2.3 million connections, respectively, on 31 March 1999, up from 3.4 million, 1.3 million and 1.2 million at the same time last year.

As a result of an Inquiry by the Monopolies and Mergers Commission (MMC) (renamed the Competition Commission from 1 April 1999), the price of calls to BT Cellnet and Vodafone was reduced from 30 April 1999 on average by around 25%. These reductions have continued the downward trend in prices of calling from a BT line to a mobile phone, with prices at 31 March 1999 20% lower than two years earlier. This is covered in more detail in the mobile services section of *Regulation, competition and prices* below.

In the 2000 financial year, HM Government plans to auction licences for spectrum for the new third generation Universal Mobile Telecommunication Standard (UMTS). UMTS provides greater bandwidth than current technology, enabling high-speed data and multimedia applications.

**Private circuits**
We provide customers with private circuits, lines between fixed points reserved for the exclusive use of a customer, leased at a fixed rate irrespective of usage. Some 48% of these circuits are now digital. Private circuit revenues accounted for approximately 7% of the group's turnover in the 1999 financial year.

**Customer premises equipment supply**
We sell and rent a wide range of equipment for customer premises, from telephones for use in the home to advanced private exchange equipment for businesses. These activities accounted for approximately 5% of the group's turnover in the 1999 financial year.

**Interconnect**
Many other licensed operators in the UK use our network to help deliver their customers' calls. The emergence of many new operators in both the fixed and mobile markets led to a 30% increase in this turnover in the 1999 financial year, which accounted for approximately 4% of the group's turnover.

**Yellow Pages and other directories**
Yellow Pages is the UK's leading business information "bridge" linking buyers and sellers. The group manages a portfolio of products including *Yellow Pages, Business Pages* and *YELL*, its growing Internet and e-commerce service. Sales of Yellow Pages products accounted for approximately 3% of the group's turnover in the 1999 financial year. Revenue from volume growth of advertisements published by Yellow Pages increased by approximately 6% in the 1999 financial year compared with the previous year.

**Payphones**
BT operates more than 140,000 public payphones throughout the UK. More than 96% are in service at any one time.

During 1999 and 2000, BT Payphones is installing 1,000 Multi*phones*, the first of a new generation of BT multimedia payphones using touch screen technology and full interactive screen display. BT believes that Multi*phone* is an exciting breakthrough in public communications, combining fast and easy public access to e-mail and the Internet with a range of interactive features.

**Other UK sales and services**
Other UK sales and services, which accounted for approximately 10% of the group's total turnover in the 1999 financial year, include Syncordia Solutions, advanced services, audioconferencing, videoconferencing and multimedia.

Syncordia Solutions specialises in the end-to-end provision, maintenance and billing of value-added voice and data services. These services are brought to the international market by Concert. Syncordia Solutions also supplies communications outsourcing services to manage the complex international communications needs of organisations for voice and data, including the management of call centres.

We provide advanced voice services, primarily through our FeatureNet service, and advanced data services.

We provide freephone services, visual communications services, including the distribution of television material for broadcasting organisations, videoconferencing and closed circuit television.

**Multimedia and Internet**
The rapid growth in the use of multimedia and the Internet proved to be one of the most notable features of the year. The Internet, in particular, is increasingly becoming part of everyday life both for individuals and businesses. We have now over 600,000 Internet customers in the UK.

BT offers a range of consumer and business Internet and interactive multimedia services, including full-featured Internet access through BT Internet and BT Connect to Business; flexible Internet access through BT ClickFree, with e-mail included via *talk***21**; eBusiness services to enhance the security and flexibility of trading across the Internet, multimedia payphones and interactive TV.

In February 1999, we launched BT ClickFree, a free no-registration UK Internet service. Customers can access the Internet at the cost of a local call, or less if they belong to one of BT's call discount schemes such as Friends & Family or PremierLine.

Our new Highway service, launched during the year, is a mass-market digital communications service which, for the first time, enables UK customers to surf the Internet at high speeds and make calls or send faxes simultaneously over their existing telephone line.

In February 1999, we announced an agreement with Microsoft to develop a new range of Internet, intranet and corporate data services for mobile customers around the world. Services are expected to be available in several countries by early 2000.

In January 1999, BT acquired a 50% share in Excite UK, a subsidiary of the US-based global Internet media company, Excite, for £6 million. The agreement further develops our presence in Internet advertising and transactions – two important on-line revenue generators.

A joint venture formed in September 1998 between BT and Scitex Corporation, Vio Worldwide, provides graphic arts users worldwide with a secure network for rapid data transfers.

*Open,* the interactive TV service provided by British Interactive Broadcasting (BiB), a joint venture with BSkyB, HSBC and Matsushita, will enable high street businesses to offer interactive services, including home shopping, home banking, travel and holiday services.

Since April 1998, more than one in six schools have signed up to BT's Schools Internet Caller, which provides unlimited access via a standard phone or ISDN line for a set annual fee. BT Schools Internet Caller is a significant step towards the realisation of the Government's pledge of getting all of the UK's primary and secondary schools connected to the Internet National Grid for Learning by 2002.

**Customer satisfaction and quality of service**

BT's quality of service, and our customers' satisfaction with that service, is extremely important to us. To ensure our customers are satisfied with our service and to understand ways we can improve it, we talk to thousands of our customers every month, in the UK and throughout the world, asking for their opinion. We also run an extensive market research programme to focus on wider issues and to help us match our product and service offerings to customer requirements.

Every month, specialist market research agencies, acting on our behalf, talk to 23,500 residential and 14,000 business customers in the UK about all aspects of the service we provide.

For the period October 1998 to March 1999, overall satisfaction with BT among residential customers rose to 90% from 89% in the previous six months, while 86% of business customers continued to be satisfied overall.

At the start of this period, we changed our survey methodology for measuring business customers' satisfaction with our provision and repair services. We are now interviewing more customers whose orders or repairs did not require a visit from BT, reflecting the increase in this type of work. Taking this into account, satisfaction with both the business installation and repair services remained stable with around eight out of ten customers saying they are happy with the services they received. Among residential customers, satisfaction with our installation service continued to improve and 83% of customers were satisfied with our repair service.

When the UK telecommunications operator Ionica ceased to trade, we successfully connected more than 43,000 of its former customers to the BT network at very short notice, with the majority of the work being done in a six-week period.

We are continuing with our programme to make our network more resilient to the weather. This includes overnight testing of lines, so that we can identify problems before they become apparent to customers.

Some 86% of users are satisfied with our public payphone service, with a significant improvement in the number who are very satisfied.

We have continued to maintain high levels of performance in our 24-hour operator services, despite an increase in calls of 11% to operator assistance in the past year alone.

We regularly survey opinion formers throughout the world to find out their views on BT and on international telecommunications matters in general. Continuing the trend of previous surveys, in our November 1998 survey we found that BT and AT&T are two of the most recognised telecommunications brands throughout the world. The environment in which we operate is coming to be seen as increasingly diverse, with local operators (including our joint ventures) becoming recognised as significant players. There has been an increase in Europe in the number of BT's joint ventures being nominated by opinion formers as the best alternative to the incumbent supplier.

**Marketing, promotion and pricing offers**

Our marketing focus in the year has been on the launch of new services, including Highway for both residential and business customers, call stimulation, and major efforts to reinforce the reasons why customers should come back to BT.

We focused on promotions such as "Chatterday", and reducing calling rates at weekends to encourage people to make more calls.

We introduced a campaign "Thousands are coming back", which highlights the benefits that we can offer both our residential and business customers, such as the wide range of services and value for money. We also underpinned this campaign with attractive promotional prices in areas such as the connection of second lines.

The reconnection charge for residential customers was abolished in April 1999. Customers who wish to rejoin BT from a competitor can now do so free of charge, providing the former wiring is still in place.

At the same time, the cost of installing a new residential line was cut by 15% from £116.33 to £99.00 (including VAT).

In recognition of the growing importance of on-line marketing, the year saw us shift a significant emphasis onto our website, www.bt.com, as well as banner advertising on key websites of others. The Highway launch used on-line marketing to stimulate high levels of customer interest via the Internet.

A programme to redesign, refocus and relaunch our UK shops is underway. They will now concentrate on meeting the complete communications needs of individuals and small businesses. Some 22 of our 94 shops had been relaunched by 31 March 1999 and the target is to complete the programme during the next two to three years.

As well as these products and service campaigns, we have been running press advertisements highlighting the contribution that BT, in particular, and telecommunications in general, can make and are making to the social well-being of the UK. Areas covered include healthcare, disability, crime prevention and support for the elderly.

In April 1998, the cost of local calls made in the evening on weekdays came down from 1.7p to 1.5p a minute – a cut of more than 10%.

During the year, we also introduced a range of attractive discount plans which are targeted to meet the needs of a wide range of customers. In the business market, we launched the "Keys" plans, which can be customised to give discounts on Key Numbers, Key Cities, Key Regions and Key Countries. Another new plan is BT Dual Discount, which is designed to give extra savings to business customers based on their combined call spend for outgoing telephone and incoming **Lo-***call* and **Free***fone* calls.

BT Call & Save, introduced in January 1999, is available to residential customers whose quarterly call bill is more than £25. It gives a 10% discount on direct-dialled local, regional, national and international calls. When combined with other discount schemes these savings can be even greater. For example, used together with Friends & Family, savings of up to 20% on calls are possible.

Exchange line rental charges for business and residential customers rose during the year, but in both cases the increase was less than the rate of inflation.

Over the last five years, after taking account of inflation, the average residential bill has fallen by 21% and the bill for the average business customer by nearly 28%.

**Network development and capital expenditure**
The group's expenditure on transmission equipment, exchange and other network equipment accounted for 73% of total capital expenditure in the 1999 financial year.

We continued to invest heavily in ATM and SDH networks, the world standard for broadband, video, data and voice services. During the year, the number of ATM switches increased from 23 to 103 and the number of SDH nodes in the network more than doubled from 400 to 850, covering all major towns and cities across the UK, and the overall traffic capacity of the SDH network also doubled. Wavelength division multiplexing equipment has been introduced onto the optical fibre network to increase the traffic-carrying capacity of a single pair of fibres by at least sixteenfold.

During the year, BeTaNet, an advanced Internet protocol (IP) and multimedia optical fibre network, came into operation. BeTaNet, which interfaces with today's conventional telephone network, is a product of major investments in advanced switching and transmission equipment. It offers virtually unlimited bandwidth over a single link for simultaneous voice, data, video and Internet services. Supporting services such as eBusiness, interactive call centres and new intranet-based solutions for commercial and industrial customers, BeTaNet will be fully integrated, with more than 20,000 existing fibre nodes and over 300 more are being added every month. Over time, the need for multiple telephone lines and separate high-speed data networks will be reduced, and a wide range of multimedia services, such as Internet, eBusiness, voice over IP, interactive television and broadband data, will all be delivered in an integrated format.

BT has reached a framework agreement with a major manufacturer for the development and supply of the next generation of switches designed to meet the needs of the rapid data traffic growth in the UK. The agreement, potentially worth up to £270 million, will secure BT's network capacity into the next decade. The switches are expected to be deployed over the next four years, providing initial switching capabilities of up to 160 gigabits a second and future growth into terabits. (A gigabit is one billion bits, equivalent to about 120 novels. A terabit is a thousand gigabits). Gigabit switch trials began early in 1999, with the first switch scheduled to go live in August 1999.

BT is committed to investing in Information Services (IS) to provide and support the core information infrastructure on which BT operates. BT is determined to optimise its investment by looking at ways of exploiting this infrastructure for the benefit of shareholders and customers. Examples of this are programmes which involve sharing the risk of our IS investment with other large corporations and establishing the principle of managed services with our information technology suppliers.

### Research and development

We believe that, in a technologically-advanced industry such as telecommunications, well-directed and creative research and development activity is critical to gaining and retaining competitive advantage. We have world-class research and development centres at Martlesham (Suffolk), London, Cardiff, Belfast, Glasgow and in Reston and San Jose in the United States. In late 1998, in a MORI survey of directors of UK companies, BT was judged to be the fifth most innovative company in the world.

In the 1999 financial year, we spent £268 million on research and development, the majority of which was directed towards the development of new and improved networks and services for customers. Major areas of work include software systems for managing networks and the services they carry, speech and image processing, Internet and interactive services, mobile applications, information and system security, new ways of operating call centres, information management techniques, data services and the application of information and telecommunications technology in healthcare and education.

### Property

The group had a property portfolio of approximately 8,000 buildings at 31 March 1999, the majority of which are freehold, located principally throughout the UK. Specialised buildings account for the majority of properties, both in number and book value. They house mainly exchange equipment and are needed as part of the group's continuing operations. They do not readily adapt to other uses. General purpose properties consist chiefly of offices, depots, computer centres and shops. We are engaged in a programme of disposing of a small number of surplus properties.

The principal categories of BT's plant and equipment are exchanges and transmission equipment. Transmission equipment comprises: copper, fibre and radio access; underground ducts for copper and fibre access; equipment for the trunk network; and cellular and other transmission equipment.

### Organisation and employees

#### Organisation

BT is currently organised into two main operations: BT UK and BT Worldwide. Later this year, Syntegra and Syncordia Solutions will be combined to form a new solutions business. A number of support units in the group's headquarters provide specialised services.

The organisational structure of BT UK was realigned during the year to provide increased customer focus and competitiveness. Markets is responsible for developing customer relationships and managing sales channels across all markets and market sectors in the UK, and developing the value of the BT brand; Customer Service covers field engineering, operator services and call reception; Networks and Information Services is responsible for the network and information system's infrastructure; Mobility is responsible for BT Cellnet and BT's other mobility products; Products and Solutions offers products and end-to-end solutions to our customers; Enterprises comprises our stand-alone businesses which operate under their own brands. Other BT UK units provide support services.

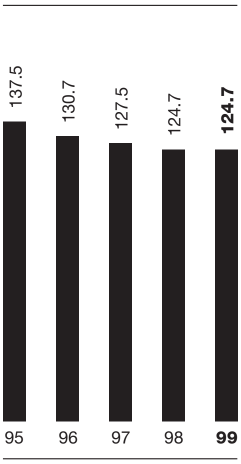
BT Worldwide includes BT Europe, which manages our growing family of ventures and alliances across the region, and Strategic Markets which addresses the growth opportunities across the Asia-Pacific region.

In the proposed global venture with AT&T, there will be three distribution channel organisations aimed at specific customer groups. There will also be a separate unit to develop established product lines and new IP services, and a Network and Systems organisation to build and operate the global network.

#### Employees

At 31 March 1999, BT employed around 125,000 people throughout the world with 119,000 in the UK, making us one of the UK's largest employers. The following chart shows the total number of BT employees at the end of each of the last five financial years.

**Employees (thousands)**
AT 31 MARCH




The number of BT's employees in the UK has been relatively stable over the past year, following substantial reductions in the early 1990s. BT expects to continue to use a wide range of other resources where this is appropriate in the context of our overall strategy and the maintenance of positive industrial relations.

BT has extended its global operations in the year through its increasing network of joint ventures and alliances. This has meant significant growth in people terms. At the beginning of the 1999 financial year, the BT Worldwide family of alliances consisted of approximately 17,000 people, mainly employed by our joint ventures and alliances. As at 31 March 1999, this number had doubled to over 33,500 people.

Our people are critical to our success and we believe that a reputation as a good employer helps us to win and retain customers.

To help our people balance work and home responsibilities, we have a range of flexible working arrangements, including annualised hours, teleworking, part-time working and job sharing.

BT encourages people to acquire shares in their company to enable them to share in its success. £64 million has been set aside this year for the allocation of shares to employees under the BT Employee Share Ownership Scheme. Employees also have the opportunity to buy shares at a discount under the popular BT Employee Sharesave Scheme, a savings-related share option scheme.

Most BT employees are members of the BT Pension Scheme, which is controlled by trustees who are company or union nominees.

An estimated 80% of the company's UK employees belong to one of two main trade unions recognised by the company. The pattern of industrial relations in the last few years has been stable and we continue to have constructive relationships with both unions.

BT is an equal opportunities employer and is committed to developing a working culture which enables all employees to make their own distinctive contribution. We actively encourage the employment and development of people with disabilities, including those who develop a disability during their career.

The application of our equal opportunities policies has seen BT win a number of awards, including the Opportunity 2000 "Framework for Success" award, which recognises best practice in encouraging women's participation in the workforce. As well as Opportunity 2000, we are members of, or are represented on, the key committees of Race for Opportunity, supporting the employment of ethnic minorities, and the Employer's Forum on Disability. We are also a founder member of the Employer's Forum on Age.

BT runs a number of employee attitude surveys, the most important of which is CARE – Communications and Attitude Research for Employees. Once feedback is received, managers work with their teams to explore any issues which may need attention.

BT prides itself on being a "learning organisation". We spend around £180 million a year on the training and development of our people. They have access to a comprehensive portfolio of development and training options, which include technical and commercial training, personal skills and management development.

In October 1998, BT achieved Investors in People accreditation, the largest organisation in the UK to have done so. Investors in People is a national quality standard for effective investment in the training and development of people to achieve business goals. The standard provides a framework for improving business performance and competitiveness, through a planned approach to setting and communicating business objectives and developing people to meet those objectives.

Two of our businesses, BT Northern Ireland and Yellow Pages received European Quality Awards prizes in September 1998. BT Payphones won the UK Quality Award for Business Excellence in October 1998.

### BT in the community

We were a founder member of the Per Cent Club in 1986. Through our Community Partnership Programme we commit a minimum of 0.5% of our UK pre-tax profits to activities in support of society. Other contributions in support of community activities and programmes are estimated to bring this up to about 1%. Our Community Partnership Programme, the largest of its kind in the UK, concentrates its efforts on education, health and welfare issues, as well as assisting the arts and disability, and has a growing focus on supporting the community activities of BT people. Our expenditure has grown from £10 million in 1987 to £15 million in the 1999 financial year, including donations to charity of £2.6 million. No donations were made to any political party.

Telecommunications has a large part to play in improving the quality of life of the elderly and disabled. BT spends £20 million a year to ensure that these customers can get the most from our products and services. Many of our products and services are designed specifically to help overcome disabilities or infirmity: induction loops in handsets, large button dialpads, amplifiers and loud bells etc. We also support Typetalk, a teletext service operated by the Royal National Institute for Deaf People, which enables people with hearing difficulties to use the phone.

### BT and the Millennium

BT is playing a large part in the activities taking place in the UK to mark the new Millennium. Through a wide-ranging programme of activities, we plan, under the FutureTalk banner, to offer everyone in the UK the chance to improve their skills at interpersonal communication and make greater use of the communication technology of the digital age. We have already distributed nearly two million copies of TalkWorks, a self-help guide to better everyday conversations, and will be staging special performances in thousands of schools throughout the UK. Futuretalk will have a spectacular presence within the Millennium Dome in London.

### Environment

BT takes its responsibility to the environment very seriously. We were one of the first major British companies to produce an environmental policy and an annual environmental report. We were also among the first to introduce comprehensive environmental management systems and to form a policy on sustainable development. We are confident that we are leading the way in this area and we have committed BT in the UK to achieve ISO14001 registration, the international environmental management system standard, progressively from March 1999.

BT has a long and widely recognised record of energy management. We reduced our energy consumption by more than 13% in the five years to April 1997 and are now aiming for a further 11% reduction by March 2002. We have an extensive programme for recycling and recovering materials, including metal from redundant exchange units, cables, toner cartridges, office paper and electronic waste.

BT's first social report, *An issue of responsibility,* which reviews the social impact of BT activities, will be published shortly.

### Education

BT is developing Internet-based services to support on-line training and education in workplaces and homes. Solstra, jointly developed by BT and Futuremedia, provides companies with an enterprise-wide solution to on-line delivered and managed knowledge, training and productivity tools. Solstra can deliver learning material on-line to anyone authorised to receive it, at any time (in any time zone) anywhere in the world. It is a system with the potential to deliver training on a global scale.

Education is about more than just technology. BT and its people offer support and help in many other ways. In particular, a number of programmes foster links between education and business, introducing pupils to the world of work and helping them to prepare for their working life. Our award schemes provide around £1 million a year to schools and further and higher education establishments, enabling a range of innovative projects and the use of new technology. We also host visits from teachers to raise their awareness of industry and skills needs. Away from work, more than 1,000 BT people are school governors.

### Regulation, competition and prices

The commercial environment in the UK and in the countries in which BT operates or wishes to operate is increasingly competitive and dynamic. However, we remain subject to extensive regulation, particularly in the UK, which can materially affect the way in which the company carries out its business.

#### Regulation in the UK

The regulatory structure for telecommunications in the UK is set out principally in the Telecommunications Act 1984, which gives regulatory authority to the Secretary of State for Trade and Industry and the Director General of Telecommunications who heads the Office of Telecommunications (Oftel). The Secretary of State and the Director General are required to ensure, as far as reasonably practicable, that demand for telecommunication services, including certain community services, is met and to secure the ability of licensed operators to finance the provision of those services. In addition, they are required to promote the interests of consumers, purchasers and other users in the prices, variety and quality of telecommunication services and equipment, and to promote and maintain efficiency and effective competition among the UK telecommunications operators.

With limited exceptions, a licence under the Telecommunications Act is required to run a telecommunication system and provide telecommunication services in the UK. The Secretary of State is responsible for issuing licences after consulting the Director General. Any modifications to a licence may be made by the Director General with the licensee's consent. Alternatively, changes to the licence may be referred to the Competition Commission (CC). In either case, the Telecommunications Act requires public consultation before a licence modification may be made. Licences may also be modified by legislation, including legislation implementing European Union directives in UK law. The Secretary of State has recently consulted on proposals to change the procedures for modifying licences in certain instances.

*The BT Licence*

BT operates in the UK under a number of licences granted under the Telecommunications Act, the most important of which is its public telecommunications operator licence to operate its fixed-linked public telecommunication network (the Licence). The Licence is for a period of 25 years from 5 August 1984 and can be revoked after ten years' notice (not to be given before 22 June 1999) and may also be revoked at any time on various grounds, including non-compliance with its terms.

The Licence contains terms and conditions designed principally to ensure the provision in the UK of widespread telecommunication services, to protect the interests of consumers and to encourage the development of effective competition in telecommunication services and equipment within the UK.

The company is required by the Licence to provide, throughout nearly all of the UK, telecommunication services, including rural and international services, which satisfy all reasonable demands to the extent that it is practicable to provide such services (the universal service obligation). The company must also make certain services and facilities available to the public.

The company is required to connect to its telecommunications system on non-discriminatory standard terms and conditions any other system run under a licence which authorises connection to the company's system.

The company must comply with a variety of fair trading obligations, such as a prohibition on showing undue preference or discrimination in the provision of certain services or unfairly favouring any part of its own business as against competitors; a prohibition on the unfair cross-subsidy of certain activities of the company; and a general prohibition on anti-competitive acts or omissions, in particular, agreements or concerted practices which may prevent, restrict or distort competition and any abuse of a dominant position.

The Licence contains price control formulae, the overall effect of which requires the company to reduce, or restricts the extent to which it can increase, the prices of many of its telephony services to the bulk of the residential market. In addition, the Licence contains certain specific restrictions on the terms on which BT can trade. In particular, the company is required to publish and adhere to standard prices and other terms for providing certain services and, in general, to apply uniformly a published scale of charges for installing residential exchange lines on premises to be served by a single line.

The Licence also contains provisions enabling the Director General to monitor the company's activities, including requirements for BT to supply him with information he requests and to maintain segregated accounting records for specified parts of its business. Where it appears to the Director General that an unfair cross-subsidy exists in relation to specified parts of its business, BT must take such steps as the Director General may direct to remedy the situation.

UK telecommunications licences, including the BT Licence, are currently being amended to meet the harmonisation requirements of the European Union Licensing Directive.

**Competition and regulation**

The UK telecommunications market is fully open to entry and is highly competitive. As a result, HM Government and Oftel have indicated their expectation that it will be appropriate to move away from specific licence-based regulation to greater reliance on the increased powers under the Competition Act 1998, which comes into effect in March 2000 (see *Future regulation* below).

However, as described above, Oftel currently regulates BT mainly through the provisions in the Licence. Although it is some years since the Telecommunications Act 1984 abolished the monopoly in telecommunications, obligations placed on BT are generally more onerous than for other licensees.

**Pricing regulation**

BT is subject to price controls on its fixed network services in the UK at two levels: retail and network. Competitors are generally not subject to price controls.

*Retail price controls*

BT is subject to two sets of UK retail price controls, one on certain public switched telephony call charges and exchange line rentals, and one on certain private circuits. Each price control is based on a formula calculated by reference to the UK Retail Prices Index (RPI). The weighted average decreases in prices charged for the services covered by the controls, in each twelve-month period beginning 1 August, cannot be less than a fixed percentage below the change in RPI (referred to as "RPI minus" the fixed percentage) for the twelve months to the preceding 30 June. The retail price control for public switched telephony, applying from August 1997 to July 2001, is RPI minus 4.5. Although it is measured on services used by the lowest 80% of BT's residential customers classified by bill size, controlled prices must be offered to all customers.

BT has also given an assurance that a normal residential bill will (for the same level of usage) not increase by more than RPI and that a "control" price package will be made available to business customers. The "control" package for business customers provides that call charges, which are no higher than the prices used for calculating adherence to the residential price control, and line rental increases will be no more than the increase in RPI.

The price control for private circuits, applying from August 1997 to July 2001, applies to analogue and lower speed digital private circuits, the prices of which cannot be increased by more than the change in the RPI in any year. Each discrete international private circuit price is subject to a safeguard cap of RPI.

*Network charge control*

The company operates under interconnection agreements with most other licensed operators.

A network charge control regime running to 30 September 2001 gives BT the freedom to set reasonable charges based on long-run incremental costs for its standard interconnection services. Depending on the degree of competition for these services, charges are basket controlled (i.e. at RPI minus 8), price cap controlled (i.e. no increases above RPI), or no longer subject to price controls. Those services considered unlikely to become competitive in the near future are subject to basket controls; those likely to become competitive are subject to price cap control; whereas fully competitive services are not subject to price controls.

The network charge controls are based around RPI minus 'X' rules. The value of 'X' in the 'RPI minus' formula has been set at 8% for the period of control. BT must publish a notification to the Director General and other licensed operators if it intends to amend existing charges or to offer new services.

BT is not allowed to discriminate unduly among operators or between BT's retail operations and other operators with respect to both price and quality of service. BT is also

The price control formula and the company's performance against the formula since 1 August 1994 have been as follows:

| | YEARS COMMENCING 1 AUGUST | | | | |
|---|---|---|---|---|---|
| **Price control formula** | 1994 | 1995 | 1996 | 1997 | **1998** |
| % RPI movement for the relevant period *(a)* | 2.62 | 3.52 | 2.14 | 2.94 | **3.75** |
| RPI formula in effect *(b)* | (7.50) | (7.50) | (7.50) | (4.50) | **(4.50)** |
| % required reduction in prices *(c)* | (4.86) | (1.38) | (4.92) | (1.56) | **(0.73)** |
| % reduction in prices overall | (7.35) | (1.82) | (4.92) | (1.56) | **(0.73)** |

*(a)* Annual increase in RPI to previous June.

*(b)* From 1 August 1997, the RPI formula covers the main switched telephone services provided to the lowest 80% by bill size of BT's residential customers. The previous formula covered such services supplied to all residential and business customers.

*(c)* After permitted carry forward of any unused allowance or shortfall from previous years.

required to publish and have audited financial statements for the regulatory “businesses” and “activities”, in order to support the linkage of costs with interconnect prices and with a view to providing demonstrable evidence that BT is neither behaving in a discriminatory fashion nor unfairly subsidising its activities. The regulatory “businesses” for which separated accounts are currently produced are: access; apparatus supply; network; retail systems; supplemental services; and residual services.

*Review of the price controls*
In May 1999, Oftel issued proposals to amend BT’s Licence to allow for a possible extension of the current retail price controls for eight months, and network charge controls for six months, from 31 July 2001 and 30 September 2001, respectively. This will allow Oftel to complete a more up-to-date assessment of the telecommunications markets and the need for any further price controls from 2001. The current controls would only be extended should Oftel and BT be unable to agree on future arrangements for price control, and the issue was referred to the CC.

**Non-UK regulation**
In developing its business internationally, BT must take account of the regulatory regimes in the countries in which it operates or wishes to operate.

*United States*
In the United States, the Federal Communications Commission (FCC) has extensive authority to regulate interstate and foreign services and services provided by common carriers, as well as the authority to implement policies that promote competition for all telecommunication services.

*European Union*
The European Commission has been pursuing a policy of progressive liberalisation and harmonisation in telecommunications. Since 1 January 1998, the provision of infrastructure and all telecommunication services has been liberalised in the European Union. Specific directives imposed new rules in relation to voice telephony, leased lines and interconnection, with particular emphasis on organisations with significant market power and with a common set of principles for licensing and enforcement. These have largely been implemented in national legislation. The Commission will be reviewing progress during 1999 and is expected to propose further measures.

*Japan*
Japan is taking a staged approach to deregulation. Full liberalisation (save a 20% ceiling on foreign ownership in Nippon Telegraph and Telephone Corporation) was implemented in 1998. A move to more effective regulation – especially in the areas of interconnection, carrier pre-selection and number portability – is anticipated in 2000.

*Rest of the world*
The World Trade Organisation’s Agreement on Basic Telecommunications, signed in February 1997, has created a framework for the progressive opening of telecommunication markets, in accordance with world trade standards. The agreement provides assurance that commitments made by the 69 participating nations can be legally enforced. However, the commitments themselves provide only limited opportunities in some markets. A further round of World Trade Organisation negotiations will start at the end of 1999.

**Future regulation**
In addition to regulation relating to the telecommunications industry, BT is subject to general competition law.

The Competition Act 1998, which comes into effect in March 2000 brings the UK into line with European Union law by prohibiting anti-competitive agreements and concerted practices and the abuse of a dominant market position. Enforcement will be by the Director General of Fair Trading and, in the case of telecommunications, the Director General of Telecommunications will have concurrent powers with the Director General of Fair Trading. They will have significant new powers of investigation. Breach of the prohibitions could lead to fines of up to 10% of group turnover and/or result in claims for damages in the civil courts. There are powers to order a company to cease an infringing activity. However, the Act will also introduce a new statutory independent appeals mechanism and the general fair trading condition in BT’s Licence will be removed.

**Other significant changes and issues**
*Domestic obligations in a global market*
As a result of BT’s growing global interests, a Licence condition prohibits BT from doing anything, by act or omission, that would detract materially from its ability to meet its Licence obligations to provide telecommunications services in the UK and to do so to any standards specified by the Director General of Telecommunications. BT’s directors are required to submit an annual compliance certificate to the Director General.

*HM Government’s review of utility regulation*
HM Government has initiated a review of utility regulation, with proposals for regulatory reform which include a tiered regime with little or no regulation for fully competitive industries, ranging to more close regulation for those industries where competition has not developed

sufficiently. BT believes the development of competition in the telecommunications market means that the need for a special telecommunications regulatory regime is diminishing.

*Universal service*
The Director General will review BT's obligations for the universal provision of telephony services during 1999, in particular whether to establish a universal service fund.

*Mobile services*
BT has a majority share in BT Cellnet and resells cellular services through its mobile communications business.

In March 1998, the Director General referred BT, BT Cellnet and Vodafone to the MMC for investigation into BT's retail charges for calls made from BT's fixed network to BT Cellnet and Vodafone's networks and BT Cellnet and Vodafone's charges to BT for terminating such calls.

The subsequent Licence modifications recommended by the MMC have led to an initial reduction of about 25% in the price of calls from a BT line to mobile phones from 30 April 1999. Specifically, the MMC require a reduction in BT's average retention (the amount BT keeps to cover costs and an element of profit after paying a termination charge to the mobile operator completing the call) from 5.8 pence per minute (ppm) to 3.4 ppm for the 2000 financial year; this retention will then come under a price control of RPI minus 7 for two years. The MMC also recommended that BT Cellnet and Vodafone make price reductions on their average termination charges, from 14.8 ppm to 11.7 ppm for the 2000 financial year; this price will then also come under a price control of RPI minus 9 for two years.

Oftel recently consulted on a proposal to require Vodafone and BT Cellnet to provide indirect access to competing service providers. BT believes this to be unnecessary given the high level of competition already existing for mobile services.

*Broadcasting policy*
HM Government policy has been to restrict BT from competing in the conveyance and provision of broadcast visual services to homes, but HM Government has announced the lifting of these restrictions on BT and other national telecommunications operators by 2001. This will allow BT to develop broadband access services to homes that could incorporate broadcast elements.

*Higher bandwidth services*
In December 1998, Oftel began a consultation to assess the market demand for and supply of higher bandwidth services, such as access to the Internet in the UK, with particular reference to the small and medium-sized enterprises and residential sectors. Oftel propose that this demand might be met by some form of local loop unbundling (i.e. giving competing operators separate access to the lines connecting BT's local exchanges to its customers), and are seeking views on several options. BT is assessing the possibly significant implications of these proposals.

*European Union Review*
From 1 January 2000, the European Union will require the availability of both carrier pre-selection, from operators with significant market power, and number portability at a fixed location between all fixed-network operators. Carrier pre-selection allows customers to opt for certain defined classes of call to be carried by an operator selected in advance without having to dial a routing prefix or follow any other different procedure to invoke such routing. For technical and operational reasons, the UK is seeking a derogation for the introduction of carrier pre-selection for a period until the end of 2000.

*Numbering*
Number portability on mobile networks, already available on fixed telephone lines, was introduced on 1 January 1999. This enables customers switching mobile networks to keep their number.

### Relationship with HM Government

HM Government collectively is BT's largest customer, but the provision of services to any one department or agency of HM Government does not comprise a material proportion of BT's revenues. Except as described below, the commercial relationship between BT as supplier and HM Government as customer has been on a normal customer and supplier basis.

BT can be required by law to do certain things and to provide certain services for HM Government. The Licence obliges BT to provide certain services for HM Government departments, such as priority repair of certain telephone lines. In addition, the Secretary of State has statutory powers to require BT to take certain actions in the interests of national security, international relations and the detection of crime.

### Legal proceedings

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group. See note 27 to the financial statements.

# *Five year financial summary*

YEARS ENDED 31 MARCH

| | 1995 £m | 1996 £m | 1997 £m | 1998 £m | **1999 £m** |
|---|---|---|---|---|---|
| **Profit and loss account** | | | | | |
| Total turnover – ongoing activities | 13,900 | 14,470 | 15,021 | 16,039 | **18,223** |
| – discontinued activities | 958 | 2,066 | 2,358 | 1,372 | **–** |
| Total turnover, including discontinued activities | 14,858 | 16,536 | 17,379 | 17,411 | **18,223** |
| Group's share of associates' and joint ventures' turnover | (965) | (2,090) | (2,444) | (1,771) | **(1,270)** |
| Group turnover – ongoing activities | 13,893 | 14,446 | 14,935 | 15,640 | **16,953** |
| Other operating income *(a)* | 129 | 103 | 106 | 372 | **168** |
| Operating costs *(b)(c)* | (11,359) | (11,449) | (11,796) | (12,355) | **(13,305)** |
| Group operating profit | 2,663 | 3,100 | 3,245 | 3,657 | **3,816** |
| Group's share of operating profit (loss) of associates and joint ventures | 107 | 101 | 184 | (196) | **(342)** |
| Total operating profit: | | | | | |
| Ongoing activities | 2,676 | 3,081 | 3,209 | 3,436 | **3,474** |
| Discontinued activities | 94 | 120 | 220 | 25 | **–** |
| | 2,770 | 3,201 | 3,429 | 3,461 | **3,474** |
| Profit on sale of fixed asset investments and group undertakings *(d)* | 241 | 7 | 8 | 63 | **1,107** |
| Net interest payable | (270) | (189) | (174) | (310) | **(286)** |
| Premium on repurchase of bonds | (75) | – | (60) | – | **–** |
| Profit on ordinary activities before taxation | 2,666 | 3,019 | 3,203 | 3,214 | **4,295** |
| Tax on profit on ordinary activities: | | | | | |
| Corporation and similar taxes | (926) | (1,027) | (1,102) | (977) | **(1,293)** |
| Windfall tax | – | – | – | (510) | **–** |
| Profit on ordinary activities after taxation | 1,740 | 1,992 | 2,101 | 1,727 | **3,002** |
| Minority interests | (9) | (6) | (24) | (25) | **(19)** |
| Profit for the financial year | 1,731 | 1,986 | 2,077 | 1,702 | **2,983** |
| Basic earnings per share | 27.8p | 31.6p | 32.8p | 26.6p | **46.3p** |
| Basic earnings per share before exceptional items | 27.8p | 31.6p | 32.8p | 31.7p | **34.7p** |
| Diluted earnings per share | 27.2p | 31.0p | 32.2p | 26.2p | **45.3p** |
| Diluted earnings per share before exceptional items | 27.2p | 31.0p | 32.2p | 31.2p | **34.0p** |
| Dividends per share (including 1997 special dividend of 35p) | 17.7p | 18.7p | 54.85p | 19.0p | **20.4p** |
| *(a)* Including MCI merger break-up fee net of expenses in 1998 | – | – | – | 238 | **–** |
| *(b)* Including redundancy charges | 820 | 421 | 367 | 106 | **124** |
| *(c)* Including exceptional costs relating to the disengagement from MCI | – | – | – | – | **69** |
| *(d)* Including gain on MCI shares sold in 1999 | – | – | – | – | **1,133** |

Figures for the years ended 31 March 1995 to 31 March 1998 have been restated for the changes in accounting policy and presentation summarised on page 66.

## Cash flow statement

YEARS ENDED 31 MARCH

| | 1995 £m | 1996 £m | 1997 £m | 1998 £m | **1999 £m** |
|---|---|---|---|---|---|
| Cash flow from operating activities | 5,114 | 5,829 | 6,185 | 6,071 | **6,035** |
| Dividends from associates and joint ventures | 5 | 5 | 7 | 5 | **2** |
| Returns on investments and servicing of finance | (348) | (150) | (220) | (160) | **(328)** |
| Taxation | (1,175) | (784) | (1,045) | (1,886) | **(630)** |
| Capital expenditure and financial investment | (2,535) | (2,500) | (2,820) | (3,108) | **1,046** |
| Acquisitions and disposals | (2,260) | (132) | (252) | (1,501) | **(1,967)** |
| Equity dividends paid | (1,065) | (1,138) | (1,217) | (3,473) | **(1,186)** |
| Cash inflow (outflow) before management of liquid resources and financing | (2,264) | 1,130 | 638 | (4,052) | **2,972** |
| Management of liquid resources | 2,557 | (1,317) | (504) | 2,247 | **(2,447)** |
| Financing | (207) | 215 | (224) | 1,794 | **(458)** |
| Increase (decrease) in cash for the year | 86 | 28 | (90) | (11) | **67** |
| Decrease (increase) in net debt for the year | (2,146) | 1,319 | 849 | (3,860) | **3,146** |

Figures for the years ended 31 March 1995 to 31 March 1998 have been restated for the changes in accounting policy and presentation summarised on page 66.

## Balance sheet

AT 31 MARCH

| | 1995 £m | 1996 £m | 1997 £m | 1998 £m | **1999 £m** |
|---|---|---|---|---|---|
| Intangible fixed assets | – | – | – | – | **742** |
| Tangible fixed assets | 16,012 | 16,496 | 16,802 | 17,252 | **17,854** |
| Fixed asset investments | 1,082 | 1,057 | 1,273 | 1,708 | **1,832** |
| Net current liabilities | (725) | (106) | (2,667) | (2,637) | **(495)** |
| Total assets less current liabilities | 16,369 | 17,447 | 15,408 | 16,323 | **19,933** |
| Loans and other borrowings falling due after one year | (3,361) | (3,322) | (2,693) | (3,889) | **(3,386)** |
| Provisions for liabilities and charges | (879) | (1,267) | (1,391) | (1,426) | **(1,391)** |
| Minority interests | (132) | (180) | (208) | (223) | **(216)** |
| Total assets less liabilities | 11,997 | 12,678 | 11,116 | 10,785 | **14,940** |
| Total equity shareholders' funds | 11,997 | 12,678 | 11,116 | 10,785 | **14,940** |
| Total assets | 21,459 | 23,536 | 25,062 | 23,285 | **27,962** |

## US GAAP

YEARS ENDED 31 MARCH

| | 1995 £m | 1996 £m | 1997 £m | 1998 £m | **1999 £m** |
|---|---|---|---|---|---|
| Income before taxes | 2,580 | 2,774 | 3,326 | 2,791 | **3,745** |
| Net income | 1,744 | 1,806 | 2,149 | 1,447 | **2,589** |
| Basic earnings per ordinary share | 28.0p | 28.8p | 33.9p | 22.7p | **40.2p** |
| Diluted earnings per ordinary share | 27.6p | 28.4p | 33.6p | 22.3p | **39.3p** |
| Basic earnings per ADS | £2.80 | £2.88 | £3.39 | £2.27 | **£4.02** |
| Diluted earnings per ADS | £2.76 | £2.84 | £3.36 | £2.23 | **£3.93** |

AT 31 MARCH

| | 1995 £m | 1996 £m | 1997 £m | 1998 £m | **1999 £m** |
|---|---|---|---|---|---|
| Total assets | 23,879 | 26,183 | 27,239 | 27,951 | **29,323** |
| Ordinary shareholders' equity | 12,185 | 13,010 | 11,588 | 12,615 | **13,674** |

# Financial review

## Introduction

BT's earnings of 46.3 pence per share for the year ended 31 March 1999 (the 1999 financial year) compare with 26.6 pence for the 1998 financial year and 32.8 pence for the 1997 financial year. Of the earnings in the 1999 financial year, 11.6 pence per share represented net exceptional income mainly relating to the sale of the group's investment in MCI Communications Corporation in September 1998. Earnings for the 1998 financial year were affected by net exceptional charges of 5.1 pence per share, relating to the windfall tax, partially offset by a fee received relating to the termination of the BT/MCI merger. Earnings before exceptional items of 34.7 pence per share for the 1999 financial year compare with an equivalent 31.7 pence and 32.8 pence for the 1998 and 1997 financial years, respectively.

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| **Total turnover – ongoing** | **18,223** | 16,039 | 15,021 |
| Group's share of ventures' turnover – ongoing | **(1,270)** | (399) | (86) |
| **Group turnover – ongoing** | **16,953** | 15,640 | 14,935 |
| Other operating income | **168** | 372 | 106 |
| Operating costs | **(13,305)** | (12,355) | (11,796) |
| Group operating profit | **3,816** | 3,657 | 3,245 |
| Group's share of ventures' profits (losses) | **(342)** | (196) | 184 |
| Total operating profit | **3,474** | 3,461 | 3,429 |
| Profit on sale of fixed asset investments and group undertakings | **1,107** | 63 | 8 |
| Net interest and premium payable | **(286)** | (310) | (234) |
| **Profit before taxation** | **4,295** | 3,214 | 3,203 |
| Taxation – ordinary | **(1,293)** | (977) | (1,102) |
| – windfall | **–** | (510) | – |
| **Profit after taxation** | **3,002** | 1,727 | 2,101 |
| Minority interests | **(19)** | (25) | (24) |
| **Profit for the financial year** | **2,983** | 1,702 | 2,077 |
| **Basic earnings per share** | **46.3p** | 26.6p | 32.8p |
| **Basic earnings per share before exceptional items** | **34.7p** | 31.7p | 32.8p |

The results for the 1999 and 1998 financial years benefited from the strong growth in demand for the group's products and services. In the 1999 financial year, Internet and mobile phone usage expanded rapidly and this led to increased turnover and profit. In the 1998 financial year, the buoyant UK economy had a beneficial effect on the results. Our new ventures in Continental Europe and Asia Pacific which we have established, or in which we have acquired interests, in the past two to three years, are contributing significantly to our turnover growth. However, the initial losses being incurred in their development stages are, as anticipated, adversely affecting the group's results. We continue to be affected by the tight regulatory regime in the UK and intense competition. Price reductions, including those imposed by the price control formulae, totalled approximately £500 million following reductions of over £750 million in the 1998 financial year and £800 million in the 1997 financial year. The 1999 and 1998 financial years' results included lower redundancy costs in comparison with the 1997 financial year.

The group's interest in MCI was sold in September 1998 on the completion of the MCI/WorldCom merger. We recognised a pre-tax profit of £1,133 million on the sale in the 1999 financial year; this followed the £273 million fee we received in November 1997 on announcement of their agreed merger, as compensation for the break-off of the merger we had planned with MCI. We ceased equity accounting for MCI as an associate on 31 October 1997. At the same time as we disposed of our interest in MCI in September 1998, we acquired the minority interest owned by MCI in Concert Communications Services (Concert). Concert is to be transferred to our proposed global venture with AT&T later in 1999, once we have obtained regulatory clearances.

## Accounting and presentation changes

A number of changes have been made to the presentation of the group's results, largely due to our implementing several new UK financial reporting standards (FRSs) in the 1999 financial year. The group's proportional share of its associates' and joint ventures' (ventures) turnover is now shown in the group profit and loss account. We are also required to show our share of our ventures' results at the operating level in that statement with our share of their interest charge or income being aggregated with the group's. Additionally, BT's share of its joint ventures' assets and liabilities is shown on the face of the group balance sheet. Goodwill arising on acquisitions completed after 1 April 1998 is being capitalised and amortised over their economic lives.

Other additional disclosures and minor changes in the financial statements have been made as a result of implementing FRSs 9 to 14 in the year and additional disclosures on segmental reporting and pensions have been included in accordance with two new US accounting standards, SFASs Nos. 131 and 132. We have also taken the opportunity to expand the turnover analysis to reflect the changing nature of the group. Prior year figures have been restated where necessary and practical, but there have been no significant changes to previously reported profits or earnings per share. Further details are set out in note 1 to the financial statements.

**Regulation and prices**

BT has been operating under a new retail price control from 1 August 1997 under which a cap of RPI minus 4.5 applies to the services used by the lowest 80% of BT's residential customers by bill size. This retail price control is estimated to have covered services representing about 16% of the group's turnover for the year to 31 March 1999. In the current price control year to 31 July 1999, BT has reduced its prices by the required reduction of 0.73%. The equivalent reduction in the previous control year was 1.56%.

The determination of most of BT's interconnect charges with other UK operators was changed, from 1 October 1997, from one based on fully allocated historical costs to a long-run incremental cost basis. Annual determinations have been replaced with a system based on RPI minus price caps. There was an initial reduction in charges of 10% in the 1998 financial year and this is being followed by annual reductions over a four-year period based on a RPI minus 8 price cap.

The period to 31 July 1997, affecting the 1997 and 1998 financial years, was the last in which the majority of BT's main UK services were subject to price regulation. Under the price controls which were in force up to that date, BT had to reduce its overall prices for its main UK services, principally inland and outgoing international call services and exchange line rentals, under the RPI minus 7.5 formula. In the final price control year under this formula, BT reduced its prices by about 5% in the year to 31 July 1997.

In March 1998, Oftel referred BT, BT Cellnet and Vodafone, BT Cellnet's direct competitor, to the MMC for investigation into the charges for calls made from BT's fixed network to BT Cellnet and Vodafone's networks. In its report, the MMC required BT to reduce its charges to its customers by around 25% in the 2000 financial year and an effective annual RPI minus 8.5 cut for a further two years. The initial 25% reduction took effect on 30 April 1999. The company believes that the impact of these price reductions is not likely to be significant to the group's financial position in light of the experience of significant price cuts in the last two financial years and in view of the continuing volume growth in services provided.

The regulatory environment in the UK has had, and will continue to have, a significant adverse impact on the group's turnover and operating profit. As the group extends its operations to other countries, BT has to consider the regulatory regimes in those countries. Generally, most countries have regulatory regimes that are currently less liberal than those in the UK and the United States.

**Competition and the UK economy**

BT has a significant market share in its main UK markets for telephone calls and provision of exchange lines. Competition has eroded BT's market share significantly in key market sectors, in particular areas of the UK and for certain products and services. We estimate that BT had 70% of the market for national calls for the 1999 financial year, compared with 75% and 79% in the 1998 and 1997 financial years, respectively, and supplied 86% of the exchange lines in the UK at 31 March 1999, compared with 89% and 90% at 31 March 1998 and 1997, respectively. Additionally, we estimate that BT had 81% of the market for local calls for the 1999 financial year, compared with 85% and 90% in the 1998 and 1997 financial years, respectively. We believe that we no longer have a dominant market position for outgoing international calls from the UK.

The growth in cable operators' networks in the UK is having an adverse effect on BT's share of the residential market. In each of the last four financial years, BT has experienced a small net reduction in residential exchange line connections as a result of increasing competition from these cable operators in certain geographic areas. This small rate of reduction is expected to continue as they complete building out their networks.

In an environment of strong competition, BT Cellnet had 30% of the market based on the number of customer connections at 31 March 1999, compared with 34% at 31 March 1998 and 38% at 31 March 1997. There has also been a downward pressure on prices.

The group has seen some diversion of demand from its fixed network as a result of the growth of other licensed operators' activities. This diversion might intensify once BT's fixed-line customers are able to pre-select their carrier for national and international calls, as required under an EU directive, expected to be implemented by BT in 2000.

For its operations as a whole, BT expects the competitive pressure to persist and it will continue to defend its market share vigorously and fairly.

The strength of the UK economy is an important determinant of BT's business volumes and the gross domestic product grew by 0.6% in the year ended 31 March 1999, compared with 2.9% and 3.0% in the previous two years.

### Turnover

**Total turnover (£m)**
YEARS ENDED 31 MARCH


Total turnover in the 1999 financial year of £18,223 million includes BT's proportionate share of its ongoing ventures' turnover of £1,270 million. This total turnover grew by 13.6% in the 1999 financial year after growing by 6.8% in the 1998 financial year compared with the 1997 financial year. For ease of comparison, both the 1998 and 1997 financial years exclude BT's share of MCI's turnover while it was BT's associate of £1,372 million and £2,358 million, respectively. BT's new ventures in Europe and Asia Pacific accounted for around a third of these increases in turnover in both years.

Group turnover, excluding the ventures, grew by 8.4% to £16,953 million in the 1999 financial year after growing by 4.7% in the 1998 financial year compared with the 1997 financial year. The strong growth in demand for the group's products and services of approximately 12% in the 1999 financial year and approximately 10% in the 1998 financial year was partially offset by the effect of price reductions which averaged approximately 3% across the business in the 1999 financial year, compared with approximately 5% in the 1998 financial year. Both mobile and fixed-network calls in the UK made strong contributions to the group's activities in the 1999 financial year, as a result of the significant growth in BT Cellnet's mobile customer base and increased Internet usage.

The group's ongoing turnover is analysed as follows:

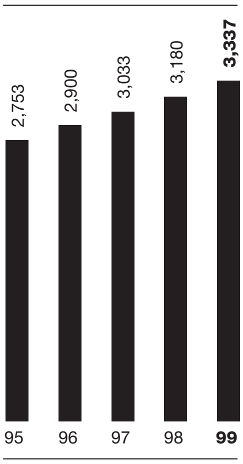
| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Inland calls | **5,178** | 4,924 | 4,874 |
| Exchange lines | **3,337** | 3,180 | 3,033 |
| International calls | **1,501** | 1,553 | 1,809 |
| Mobile communications | **1,400** | 1,089 | 949 |
| Private circuits | **1,165** | 1,149 | 1,124 |
| Customer premises equipment supply | **870** | 896 | 914 |
| Receipts from UK operators | **645** | 496 | 319 |
| Yellow Pages and other directories | **491** | 466 | 438 |
| Other UK sales and services | **1,770** | 1,332 | 994 |
| Non-UK operations | **596** | 555 | 481 |
| Group turnover | **16,953** | 15,640 | 14,935 |
| Share of ventures' turnover | **1,270** | 399 | 86 |
| Total turnover | **18,223** | 16,039 | 15,021 |

In the 1999 financial year, a significant increase in calls to mobile phones and the increased use of the Internet were the main factors behind an increase in inland calls over BT's fixed network, particularly in the second half of the year. The strong inland call volume growth of 9% was partially offset by the price reduction effect, resulting in total call turnover increasing by 5.2% in the year to £5,178 million. In the 1998 financial year, inland call volume growth of 7% was largely offset by the price reduction effect, resulting in total call turnover increasing by 1% in the year. Fixed network to mobile calls and inbound services, including 0800 numbers, were the main areas of the strong volume growth in the 1998 financial year.

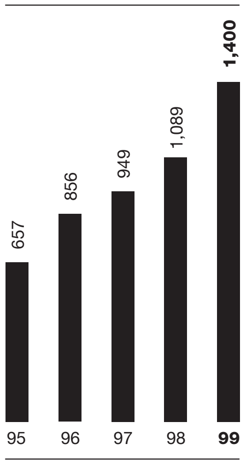
Price reductions had an impact on turnover from inland calls made over the fixed network for the fifth year in succession. Reductions in **Free***fone* and **Lo-***call* prices charged to service providers and lower national and fixed network to mobile call prices were the main reductions affecting the 1999 financial year. The combined effect of the price changes totalled over £160 million in the 1999 financial year, which was equivalent to a 3% reduction in call prices following falls of 6% and 7% in the previous two years.

Turnover from the fixed-network lines grew by 4.9% in the 1999 financial year to £3,337 million after increasing by 4.8% in the 1998 financial year. The increased turnover was the combined result of the growth in business lines and rental price increases. The number of business lines grew by 6.1% in the 1999 financial year and by 5.0% in the 1998 financial year, with ISDN services being the main driver behind this growth. The numbers of residential lines declined slightly

**Exchange lines turnover (£m)**
YEARS ENDED 31 MARCH




**Mobile communications turnover (£m)**
YEARS ENDED 31 MARCH




in both years due to the competition from cable operators offset in part by the large number of BT customers installing second lines. Overall, BT's total fixed-network lines grew by 1.4% in the 1999 financial year to 28.1 million and were maintained at 27.6 million in the 1998 financial year.

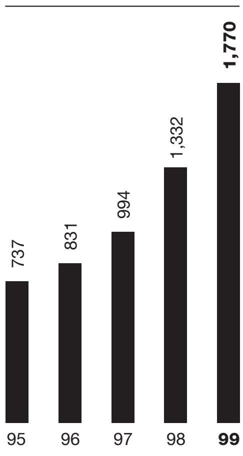
International call turnover declined by 3.3% in the 1999 financial year to £1,501 million after declining by 14.2% in the 1998 financial year. This was primarily the result of price reductions averaging 12% and 20% in the two years, respectively, and the impact of the strengthening of sterling in the 1998 financial year, partially offset by strong volume growth of 11% and 9%, respectively. Transit call volumes increased significantly in the 1999 financial year.

Mobile communications turnover increased by 29% in the 1999 financial year to £1,400 million, following growth of 14.8% in the previous financial year. This reflected the 47% and 14% growth in BT Cellnet's customer-base in the two years, respectively, offset by the effect of reductions in mobile call prices. Over 1.4 million new customers were connected to BT Cellnet's network in the 1999 financial year, partially due to the success of the new "pre-paid" mobile phone introduced in the second half of the year. BT Cellnet had 4.5 million customer connections at 31 March 1999, over 90% of which were connected to its digital GSM network.

Private circuit turnover grew by 1.4% in the 1999 financial year to £1,165 million after increasing by 2.2% in the 1998 financial year. Although demand for digital KiloStream and MegaStream services continued at a high level in both years, supported by a significant migration from analogue circuits, price reductions in the 1999 financial year prevented any significant turnover growth.

Turnover from UK operators for interconnect charges increased from £319 million in the 1997 financial year to £496 million in the 1998 financial year and to £645 million in the 1999 financial year. These increases reflect the growing market share of BT's UK competitors and the increasing level of traffic flowing into BT from their networks. There was a large corresponding increase in the payments made by BT to these operators for traffic passing to their networks.

**Other UK sales and services turnover (£m)**
YEARS ENDED 31 MARCH




BT's other UK sales and services mainly comprise outsourcing, data and multimedia services. These include Syncordia Solutions, FeatureNet, Syntegra, videoconferencing, and broadcast and other multimedia services. Each of these services contributed strongly to the 33% increase in turnover for this category, which totalled £1,770 million in the 1999 financial year, and the 34% growth in turnover in the previous financial year.

BT's turnover from its overseas operations grew by 7.4% in the 1999 financial year after growing by 15.4% in the previous year. Concert services to multinational customers provided much of the growth in the 1998 financial year and these, combined with Syntegra's services to non-UK customers, led to the growth in the 1999 financial year.

BT's share of its ventures' turnover, excluding MCI, rose from £86 million in the 1997 financial year to £399 million in the 1998 financial year and to £1,270 million in the 1999 financial year. This growth was due to our establishment and acquisition of interests in ventures in Europe and Asia Pacific over the past three years. In the 1999 financial year, £1,149 million of the total arose from ventures located outside the UK. The principal contributors were Cegetel (£578 million), Airtel (£157 million), Viag Interkom (£82 million) and LG Telecom (£81 million from October 1998).

### Other operating income

In the 1998 financial year, BT received US$465 million as the break-up fee and partial reimbursement of expenses incurred on the BT/MCI merger agreement. This receipt, net of relevant expenses incurred in that financial year, was included as an exceptional profit of £238 million in other operating income for that year.

### Operating costs

Total operating costs increased by 7.7% in the 1999 financial year to £13,305 million after increasing by 4.7% in the 1998 financial year. As a percentage of group turnover, operating costs decreased from 79.0% in the 1997 and 1998 financial years to 78.5% in the 1999 financial year. In the 1999 financial year, exceptional costs of £69 million were incurred which primarily related to Concert expenses. These exceptional costs are considered separately in the table below and the discussion which follows.

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Staff costs | **3,871** | 3,917 | 3,778 |
| Own work capitalised | **(428)** | (424) | (399) |
| Depreciation | **2,568** | 2,395 | 2,265 |
| Payments to telecommunication operators | **2,106** | 1,600 | 1,476 |
| Other operating costs | **5,119** | 4,867 | 4,676 |
| Total operating costs before exceptional costs | **13,236** | 12,355 | 11,796 |
| Exceptional costs | **69** | – | – |
| Total operating costs | **13,305** | 12,355 | 11,796 |

Staff costs for the 1998 financial year included a non-recurring charge of £120 million for compensation for the special dividend paid that year. The compensation was for those employees holding unexercised rights, mainly under group-wide sharesave schemes. Staff costs increased by 1.9% in the 1999 financial year, after rising by 0.5% in the 1998 financial year, if this non-recurring charge is excluded. In the 1999 financial year, the impact of pay awards was partially offset by reduced overtime worked and the reduction in average employee numbers. In the 1998 financial year, the pay awards impact was substantially offset by reduced pension costs, as explained in more detail below.

The allocation for the employee share ownership scheme, included within staff costs, was £64 million in the 1999 financial year, representing 2% of pre-tax profit for the year before the gain on the sale of MCI shares. The allocation in each of the 1998 and 1997 financial years was also £64 million.

The depreciation charge increased by 7.2% in the 1999 financial year to £2,568 million after increasing by 5.7% in the 1998 financial year, reflecting BT's continuing high level of investment in its networks.

Payments to other telecommunication operators grew by 31.6% in the 1999 financial year to £2,106 million after increasing by 8.4% in the 1998 financial year. The growth in these payments was primarily as a result of the growing number of calls terminating on UK competitors' fixed and mobile networks and, in particular, from the increase in mobile phone usage and Internet calls. The increase in the 1998 financial year was mitigated by lower payments to non-UK operators for outgoing calls from the UK as a consequence of lower prices and the strengthening of sterling more than offsetting call volume growth.

Other operating costs, which rose by 5.2% in the 1999 financial year to £5,119 million and by 4.1% in the 1998 financial year, include the maintenance and support of the networks, accommodation and marketing costs, the cost of sales of customer premises equipment and redundancy costs. The costs incurred in supporting the recent expansion of BT Cellnet was the main factor behind the increase in costs in the 1999 financial year. Also, in the 1999 financial year, a currency gain of £87 million from investing the proceeds of the MCI shares was offset against these costs. In the 1998 financial year, the cost increases were due to the expansion of BT Cellnet and Concert, and more was spent on BT's marketing programmes, including extensive TV advertising, than in the 1997 financial year.

Redundancy costs of £124 million were incurred in the 1999 financial year, compared with £106 million in the 1998 financial year and £367 million in the 1997 financial year. The lower costs in the 1998 and 1999 financial years compared with the 1997 financial year are a consequence of a surplus arising in BT's main pension scheme at its last full actuarial valuation at 31 December 1996. In view of this surplus, and in accordance with BT's accounting policies, redundancy charges for the 1999 and 1998 financial years do not include the costs of the incremental pension benefits provided to early retirees, which totalled £279 million and £224 million, respectively. In the 1997 financial year, redundancy costs included £258 million relating to incremental pension benefits.

Now that Concert is wholly owned by BT, work is being undertaken to ensure that the group's business becomes fully independent of MCI. The costs involved in this work are estimated at £150 million over the 1999 and 2000 financial years, of which £69 million had been incurred to 31 March 1999. These costs are shown as exceptional items in the group profit and loss account.

### Group operating profit

Group operating profit for the 1999 financial year of £3,816 million was £159 million higher than in the previous year, which was £412 million higher than in the 1997 financial year. Before the exceptional income in the 1998 financial year and the exceptional costs in the 1999 financial year, described above, group operating profit in the 1999 financial year was 13.6% higher than in the 1998 financial year. This, in turn, was 5.4% higher than that in the 1997 financial year.

### Associates and joint ventures

The group's share of its ventures' operating losses totalled £342 million in the 1999 financial year. The comparable losses, excluding MCI's results, amounted to £221 million in the 1998 financial year and £36 million in the 1997 financial year. The principal loss in all three years arose in Viag Interkom in developing its networks to compete in the German market; BT's share of these losses was £193 million, £151 million and £23 million in the 1999, 1998 and 1997 financial years, respectively. In the 1999 financial year, other losses were incurred by Telfort in the Netherlands, Albacom in Italy, British Interactive Broadcasting in the UK and LG Telecom in the Republic of Korea, which has been a BT joint venture since October 1998. In the 1998 financial year, the other losses were principally those incurred by Telfort and Cegetel in France, which has been a BT associate since September 1997.

As a consequence of the termination of the BT/MCI merger agreement and the then-prospective MCI/WorldCom merger, BT ceased treating MCI as an associate on 31 October 1997. The group's pre-tax profit for the 1998 financial year incorporated a loss of £27 million, representing BT's share of MCI's results up to that date, which included a special charge of £63 million. BT's share of MCI's pre-tax profit for the 1997 financial year amounted to £175 million, under BT's accounting policies.

### Total operating profit

Total operating profit for the 1999 financial year at £3,474 million, including BT's share of the operating results of its ventures, increased by £13 million compared with the 1998 financial year after increasing by £32 million over the 1997 financial year. Before exceptional items, total operating profit for the 1999 financial year was 9.9% higher than that in the previous financial year, which was 6.0% lower than the result for the 1997 financial year, due principally to the losses in the group's new ventures.

### Profit on sale of MCI shares

Following the completion of the MCI/WorldCom merger on 15 September 1998, BT sold its holding in MCI to WorldCom under the agreement made in November 1997. The proceeds totalled £4,159 million on which an exceptional profit of £1,133 million was realised in the 1999 financial year, after taking into account the goodwill written off on BT's interest in MCI, originally acquired in September 1994.

### Interest charge and bond repurchase premium

In the 1999 financial year, the group's net interest charge at £286m was £24 million lower than in the preceding year. The group benefited since September 1998 from the interest derived from the short-term investments funded with the MCI share sale proceeds. In the 1998 financial year, the group's net interest charge of £310 million was £136 million higher than the interest charge in the previous year, due mainly to the increase in the group's net debt following the special dividend payment in September 1997. Interest cover for the 1999 financial year represented 12 times total operating profit.

During August 1996, the company took the opportunity to repurchase two of the three then-remaining series of Government held bonds for £422 million, at an effective premium of £60 million which was charged against profit in the 1997 financial year in accordance with UK accounting standards. The last-remaining series of these bonds was repaid on its maturity in March 1997.

### Profit and taxation

The group's profit before taxation for the 1999 financial year was £4,295 million, compared with £3,214 million in the 1998 financial year and £3,203 million in the 1997 financial year. The higher profit in the 1999 financial year was due substantially to the gain on the MCI shares sold. Before this and other exceptional items, profit before taxation in the 1999 financial year was 9.4% higher than the comparable profit in the 1998 financial year. This was 7.1% below that in the 1997 financial year due to the initial impact of our ventures' losses in the 1998 financial year and higher interest charges following the special dividend payment.

The tax charge of £1,293 million for the 1999 financial year as a percentage of profit before taxation was 30.1%, compared with an ordinary tax charge of 30.4% for the 1998 financial year and 34.4% for the 1997 financial year. The group's tax charge for the 1999 financial year is an effective 31.0% of pre-tax profit, excluding the MCI share sale gain, which is effectively subject to a lower tax charge under UK capital gains tax legislation. The group's ordinary tax charge for the 1998 financial year was an effective 31.5% of pre-tax profit, excluding the MCI merger break-up fee which again was similarly subject to a lower tax charge. These effective tax charges reflect the lower 31% rate of corporation tax set for the 1999 and 1998 financial years, compared with 33% for the 1997 financial year. The higher effective rate in the 1997 financial year was due to the premium on the bond repurchase being only partially deductible for tax purposes. HM Government has set the corporation tax rate for the 2000 financial year at 30%.

The tax charge for the 1998 financial year included BT's £510 million share of HM Government's windfall tax on certain privatised companies, imposed in July 1997. The tax was paid in two equal £255 million instalments in December 1997 and December 1998.

### Earnings and dividends

Basic earnings per share, based on a profit for the 1999 financial year of £2,983 million, were 46.3 pence. Earnings per share for the 1998 and 1997 financial years were 26.6 pence and 32.8 pence, respectively. Earnings before exceptional items were 34.7 pence per share for the 1999 financial year, in comparison with 31.7 pence for the 1998 financial year and 32.8 pence for the 1997 financial year. Diluted earnings per share are not materially different.

Dividends paid and recommended for the 1999 financial year of 20.4 pence per share represent a 7.4% increase on the previous year and are covered 1.7 times by earnings before exceptional items. These dividends comprise the interim dividend of 8.1 pence per share, paid in February 1999, and the proposed final dividend of 12.3 pence per share which, if approved at the annual general meeting, will be paid on 20 September 1999 to shareholders on the register on 20 August 1999. These dividends will absorb £1,322 million.

In the 1998 financial year, BT paid or recommended ordinary dividends of 19.0 pence per share. The company also paid a special dividend of 35.0 pence per share in respect of the 1997 financial year. This dividend, which was paid in September 1997, absorbed £2,244 million. For the 1997 financial year, ordinary dividends of 19.85 pence per share were paid or recommended. The Board adjusted the level of subsequent dividends to take into account the effect of the special dividend.

### Financing

Net cash inflow from operating activities of £6,035 million in the 1999 financial year compared with £6,071 million in the 1998 financial year and £6,185 million in the 1997 financial year. The £200 million special contribution to the main pension fund, described below, reduced the cash inflow in the 1999 financial year. The higher net cash inflow in the 1997 financial year than in either of the two later years reflected a reduction in working capital in that year.

Tax paid in the 1999 financial year, which totalled £630 million, included the second and final windfall tax instalment of £255 million. We paid less UK corporation tax than in either of the two previous years because of the advance corporation tax (ACT) paid on the 1997 special dividend. In contrast, the tax paid in the 1998 financial year, which totalled £1,886 million, was particularly high because of £561 million ACT paid in respect of the special dividend and £255 million paid as the first windfall tax instalment. The tax paid in the 1997 financial year, which amounted to £1,045 million, principally related to the prior year's profit.

The UK Government has changed the pattern of corporation tax payments from April 1999 by requiring companies to pay tax in quarterly instalments starting at the half year stage in each financial year. The changes are being phased in over the 2000 to 2002 financial years, and replace the former main single corporation tax payment made nine months after the financial year end and ACT payments associated with dividends. The effect

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Net cash inflow from operating activities | **6,035** | 6,071 | 6,185 |
| Dividends from ventures | **2** | 5 | 7 |
| Net cash outflow for returns on investments and servicing of finance | **(328)** | (160) | (220) |
| Tax paid | **(630)** | (1,886) | (1,045) |
| Net cash inflow (outflow) for capital expenditure and financial investment | **1,046** | (3,108) | (2,820) |
| Net cash outflow for acquisitions and disposals | **(1,967)** | (1,501) | (252) |
| Equity dividends paid | **(1,186)** | (3,473) | (1,217) |
| Cash inflow (outflow) before management of liquid resources and financing | **2,972** | (4,052) | 638 |
| Management of liquid resources | **(2,447)** | 2,247 | (504) |
| Net cash inflow (outflow) from financing | **(458)** | 1,794 | (224) |
| Increase (decrease) in cash in the year | **67** | (11) | (90) |
| Decrease (increase) in net debt in the year | **3,146** | (3,860) | 849 |

of these accelerated payment arrangements will be to increase the tax payments to be made by the group in the 2000 to 2002 financial years, notwithstanding the reduction in the standard rate of corporation tax to 30% for these years.

Net cash inflow of £1,046 million from capital expenditure and financial investment in the 1999 financial year mainly comprises the £4,159 million proceeds of the MCI shares sold in September 1998 offset by expenditure on plant, equipment and property totalling £3,220 million. This net cash inflow compares with outflows of £3,108 million in the 1998 financial year and £2,820 million in the 1997 financial year, which were principally for capital expenditure.

The net cash outflow on acquisitions totalled £1,967 million in the 1999 financial year, the principal part of which was the acquisition of MCI's minority interest in Concert, the investment in LG Telecom and Binariang as well as additional funding of the European ventures discussed below. The group's investment in Cegetel in September 1997 represented the main part of the net cash outflow of £1,501 million for the 1998 financial year.

Equity dividends paid in the 1999 financial year totalled £1,186 million. Those paid in the 1998 financial year amounted to £3,473 million and included the special dividend of £2,244 million in September 1997. In the 1997 financial year, dividends of £1,217 million were paid.

The resulting cash inflow, before liquid resources and financing, of £2,972 million in the 1999 financial year was mainly applied by investing in short-term investments. In the 1998 financial year, there was a resulting cash outflow of £4,052 million. This was financed by the issue of new loans, principally two Eurobonds totalling US$2,500 million, and by using the group's existing short-term investments. In the 1997 financial year, the group had a positive net cash inflow before financing of £638 million.

The cash inflow for the 1999 financial year, generated mainly by the MCI share sale proceeds, resulted in net debt falling to £953 million at 31 March 1999. This was after the high cash outflow in the 1998 financial year caused by the special dividend payment and the investment in Cegetel which had resulted in net debt rising to £3,977 million at 31 March 1998. Consequently, balance sheet gearing or the ratio of net debt (borrowings net of cash and short-term investments) to shareholders' equity and minority interests stood at 6.3% at 31 March 1999, compared with 36% a year earlier.

In the 1999 financial year, the group repaid long-term debt totalling £457 million; no significant new long-term debt needed to be raised. In the 1998 financial year, the group borrowed £1,637 million in long-term loans and repaid £338 million in long-term debt. BT issued a US$1.5 billion five year 6¾% Eurobond in April 1997 and a US$1.0 billion ten year 7% Eurobond in May 1997 in preparation for the group's cash requirements later in 1997.

On 18 May 1999, BT issued a £600 million 5.75% Eurobond repayable in 2028. In the 2000 financial year, £575 million of long-term debt falls due. We expect to fund this by liquidating short-term investments or refinancing it with further debt, as appropriate.

**Treasury policy**

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

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

We have set out further details on this topic and on our capital resources and foreign currency exposure in note 33 to the financial statements in compliance with FRS13.

**Capital resources**

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

At 31 March 1999, the group had cash and short-term investments of £3,380 million. At that date, £372 million of short-term debt was outstanding. In addition, the group had unused committed short-term bank facilities, amounting to approximately £150 million at 31 March 1999, in support of a commercial paper programme or other borrowings. The group also has substantial uncommitted short-term bank facilities.

The group had £953 million net debt at 31 March 1999, a decrease of £3,024 million in the year. Net debt reduced substantially during the course of the 1999 financial year, primarily as a result of the MCI share sale.

The majority of the group's long-term borrowings has been, and is, subject to fixed interest rates. The group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and period for which interest rates are fixed. At 31 March 1999, the group had outstanding interest rate swap agreements with notional principal amounts totalling £1,371 million.

**Foreign currency and interest rate exposure**

Most of the group's current turnover is invoiced in pounds sterling, and most of its operations and costs arise within the UK. The group's foreign currency borrowings, which totalled £1,880 million at 31 March 1999, are used to finance its operations. Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investment, interest expense, purchase and sale commitments. The commitments hedged are principally US dollars and the euro. As a result of these policies, the group's exposure to foreign currency arises mainly on the residual currency exposure on non-UK investments and on any imbalances between the value of outgoing, transit and incoming international calls with non-UK telecommunication operators. To date, these imbalances have not been material. As a result, the group's profit has not been materially affected by movements in exchange rates, with the exception of the second half of the 1999 financial year when we had a large US dollar position with the short-term investments resulting from the MCI proceeds. We progressively closed out this exposure in the period to 31 March 1999 as the US dollar strengthened against sterling and, as noted above, we recorded a gain of £87 million, which has been included in the profit for the year.

The group is not significantly exposed to changes in interest rates. Based upon the composition of net debt at 31 March 1999, a one percentage point increase in interest rates would decrease the group's net interest expense by less than £35 million. The group is also not significantly exposed to changes in currency rates. A 10% strengthening in sterling against major currencies would cause the group's net assets at 31 March 1999 to fall by less than £250 million, with insignificant effect on the group's profit. Because the foreign exchange contracts are entered into as a hedge of sales and purchases, a change in the fair value of the hedge is offset by a corresponding change in the value of the underlying sale or purchase.

**Capital expenditure**

Capital expenditure on plant, equipment and property totalled £3,269 million in the 1999 financial year, compared with £3,030 million in the 1998 financial year and £2,719 million in the 1997 financial year. Work continues on enhancing the intelligence of the network to enable customers to benefit from advanced services and improving the network's capacity to carry high-speed data. BT Cellnet has continued improving the quality and capacity of its digital GSM network.

The group expects capital expenditure in the 2000 financial year to be at a level similar to, or slightly higher than, that of the 1999 financial year. BT expects that future capital expenditure will be provided from net cash inflows from operating activities supplemented, if appropriate, by external financing.

**Acquisitions, associates and joint ventures**

Following completion of the MCI/WorldCom merger in September 1998 and on the same day as the sale of the MCI shares, BT acquired from MCI its 24.9% interest in Concert for £607 million. Goodwill of £568 million arose on this transaction. This goodwill is not being amortised and Concert is to be transferred at a profit to the proposed global venture with AT&T once we obtain regulatory clearances.

In March 1999, the group, through its 60%-owned subsidiary BT Cellnet, completed the acquisition of Martin Dawes Telecommunications Holdings Limited (MDT), then the largest independent mobile telecommunication services provider in the UK. The consideration totalled approximately £130 million of which £90 million is deferred. Vodafone, a major supplier to the MDT group, continues to own 20% of MDT's main operating subsidiary, although it has, until September 1999, the right to sell its holding to BT Cellnet. Goodwill of £160 million arose on this acquisition and will be amortised over 10 years.

The group has invested £1,326 million in the 1999 financial year on acquiring interests in associates and joint ventures and providing their further funding. The most significant investments were made in October 1998 in the Asia-Pacific region. A 33.3% stake in Binariang of Malaysia was acquired for £279 million and a 23.5% interest in LG Telecom in the Republic of Korea was acquired for £234 million. The goodwill element of these acquisitions is being amortised over 20 years under the group's new accounting policy for goodwill adopted from the beginning of this financial year. BT continued to share in funding the development of its ventures, principally Viag Interkom of Germany (£482 million) and Telfort of the Netherlands (£103 million), in the financial year.

In the 1998 financial year, the group invested over £1,650 million in acquisitions and further funding. In September 1997, the group completed its acquisition of a 26% interest in Cegetel of France for a total of £1,029 million. Over £400 million was invested in other European telecommunications companies in the year, primarily in Germany, Spain and the Netherlands. The goodwill arising on all of these acquisitions amounted to £869 million out of a total of £937 million, which was written off to reserves under the UK accounting policy in operation for that and preceding years.

In the 1997 financial year, the group acquired the Rijnhaave group, a Netherlands-based systems integration business, in April 1996 and, in March 1997, completed the formation of Telfort, a joint venture with the Dutch railways company, to offer telecommunication services in that country. In February 1997, BT agreed to acquire the 50% interest in its Spanish joint venture, BT Telecomunicaciones, it did not already own, thereby obtaining full control; this transaction was completed in July 1997. The goodwill arising on these acquisitions amounted to £166 million. The remaining goodwill taken to reserves in the 1997 financial year of £33 million mainly related to BT's share of goodwill arising on MCI's acquisitions.

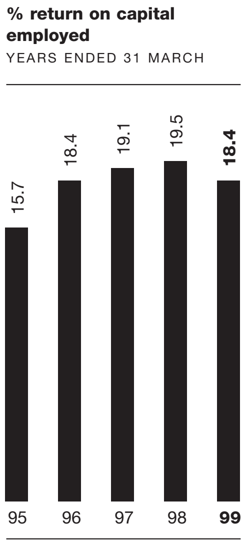
In April 1999, we completed the acquisition of a 20% interest in ImpSat, a leading telecommunications company in Latin America for approximately £90 million. Also, in May 1999, we acquired a 20% interest in SmarTone of Hong Kong, a leading provider of digital mobile communications services, for approximately £240 million.

On 25 April 1999, BT, together with AT&T, announced that they would acquire a 30% interest in Japan Telecom. The consideration will be about £1.2 billion. BT will have an economic interest of 20% with both companies jointly managing the investment. BT Communication Services will be integrated into Japan Telecom. Subject to regulatory clearances, the transaction is expected to close by autumn 1999.

**Global venture with AT&T**

The proposed global venture with AT&T for our trans-border telecommunications activities will be jointly owned. We will be transferring to it the majority of our cross-border international networks, our international traffic, our business with selected multinational customers and our international products for business customers, as well as Concert. The formation of this venture is subject to regulatory clearances which we expect to obtain later in 1999. Following the formation of the global venture, total turnover, including our share of the ventures' turnover will increase, although group turnover, excluding this share, will reduce as a consequence of these activities being transferred.

### Return on capital employed




The group made a return of 18.4% on the average capital employed in its business, on a historical cost basis, in the year ended 31 March 1999, compared with returns of 19.5% and 19.1% in the previous two financial years, respectively.

### Pensions

The most recent actuarial valuation of BT's main pension fund was carried out as at 31 December 1996. This valuation revealed the fund to be in surplus to an amount of approximately £66 million. Assets of the fund at £19,879 million at that date covered just over 100% of the fund's liabilities, in contrast to an asset coverage of 97% at the previous valuation date, 31 December 1993. The actuarial valuation took into account the effect of HM Government's measures in July 1997 to end pension funds' ability to reclaim the tax credit associated with UK companies' dividends.

The group's annual pension charges for the 1999 and 1998 financial years of £176 million and £177 million, respectively, have been based on the December 1996 valuation. These charges compare with the charge of £291 million in the 1997 financial year which was based on the previous valuation. These lower charges take into account the amount of the pension provision which had been established over recent years in the group's accounts and which stood at £953 million at 31 March 1999. Additionally, under UK accounting standards, the cost of providing incremental pension benefits for early leavers in the 1998 and 1999 financial years has not been charged against the profit in the period in which people agree to leave, since the latest actuarial valuation of the pension fund indicated a surplus.

The actuarial valuation confirmed that the group's ordinary contribution into the fund should continue at 9.5% of employees' pensionable pay. The company paid a special contribution of £200 million into the fund in March 1999. This was made in part because the investment return on the fund's assets in 1998 fell slightly below the market average.

The number of retired members and other current beneficiaries in the pension fund has been increasing in recent years and, at 31 December 1998, was approximately 50% higher than the number of active members. Consequently, BT's future pension costs and contributions will depend to a large extent on the investment returns of the pension fund and could fluctuate in the medium term.

The next full actuarial valuation of the pension fund will be carried out as at 31 December 1999.

### Impact of inflation

In accordance with a requirement of BT's main licence, the group's annual accounts for the 1998 financial year prepared on a current cost basis were published in September 1998. These accounts showed that the group's current cost profit before tax was £2,210 million, compared with £3,219 million under the historical cost convention. The group's current cost total assets at 31 March 1998 were £28,017 million, compared with £23,285 million in its historical cost accounts. The current cost accounts for the 1999 financial year are to be published by 30 September 1999.

### Environment

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

### Segmented information

BT essentially operates as a unitary business, providing an integrated range of telecommunications products and services. Accordingly, BT does not publish separately the operating profit for the various sources of turnover described above. In the 1999 and 1998 financial years, approximately 96% of the group's turnover was generated by operations in the UK, compared with 97% in the 1997 financial year.

BT is required under its main licence to publish disaggregated financial information for various activities of the group, which have been used as the basis of charges paid by other telecommunication operators in the UK for the use of BT's network. The activities presented separately in the regulatory financial statements do not necessarily correspond with any businesses separately managed, funded or operated within the group. The results set out in these statements for the 1998, 1997 and 1996 financial years showed that the group's operating profit is derived predominantly from local, national and international calls, after taking account of an operating deficit arising on the provision of exchange lines.

For the 1999 financial year, BT has provided disaggregated financial information in accordance with the requirements of the US SFAS No. 131 which requires such information to be analysed in a similar manner to that used by management in managing the business. This information is set out in note 35 to the financial statements. It should be appreciated that this information is used internally as part of the group's system of management and budgetary control over income and costs and the absolute results for any one particular element are not necessarily meaningful in isolation. In particular, capital resource allocation is planned and managed using capital project systems which are centralised in nature.

**Tangible fixed assets**

For the 2000 financial year, BT will be adopting FRS15 on tangible fixed assets. We do not foresee that the introduction of this new financial reporting standard will have any significant impact on our results.

**Year 2000**

The Year 2000 problem arises from the inability of many computer-based systems to handle correctly the century date change and other significant dates such as 29 February 2000. BT has recognised this issue for some time and, in December 1995, established a programme to tackle the problem. Working to guidelines defined by the British Standards Institution, we set out to deploy conformant systems, including those which support billing and finance, into our computer and telecommunications networks by 31 December 1998. We believe that we have substantially achieved this aim and, subject to the risks identified below, we plan to offer customers normal levels of service during the transition into the year 2000 and beyond.

The programme is now in its final phase where the focus is on the continuity of our business, including the completion of all outstanding technical work, maintaining conformance and regular, periodic reviews of our contingency plans to manage the risks of the Year 2000 transition.

BT is working closely with other UK operators, Oftel, the utilities and HM Government (including Action 2000, the Government-appointed body dealing with Year 2000) to ensure that not only is BT ready but also that its risks and dependencies are fully understood.

BT has about 650 corporate systems and about 97% were declared conformant by our target date of 31 December 1998. Our Year 2000 work incorporates supporting the conformance programmes of our joint ventures. However, progress on global services is complicated by the group's dependency on non-UK operators at the national and local level. BT is part of the International Telecommunications Union Taskforce to stimulate action through information sharing, workshops in high-risk regions, testing between operators and other initiatives with the UN, the EU and IMF. We believe much progress has been made around the world but concern exists for a minority of international operators where information is sparse.

The total cost of the Year 2000 programme is expected to be around £300 million, which is being funded by displacement of other activities. The cost includes BT's own people. We believe that costs will be held within this forecast as much of the spending had been completed by 31 March 1999. Costs to be incurred in the 2000 financial year are estimated at around £70 million. Depending on circumstances, there is likely to be increased demand for our network services and, hence, costs may vary.

All Year 2000 related investigation, remedial work and testing costs have been written off as incurred as these relate to making existing computer software Year 2000 conformant.

As the technical work is almost complete, the risk of an internal failure arising from a date-related problem has been reduced. We believe the greatest risks are external to the group and they include:

- the failure of parts of the services or systems of an international operator could result in loss of revenue if BT is unable to terminate a call or reconcile billing;
- potential congestion on the network. BT expects demand for telecommunications services to exceed its normal peak at the beginning of 2000 due to additional celebrations and resulting emergencies. Other

organisations may be testing their networks at the same time, placing additional demands on BT;
- many small failures, inside or outside BT, could occur simultaneously and multiply;
- failure in the supply chain causing stock shortages and disruption in the transport network;
- extreme bad weather at the turn of the year could add a further burden.

Contingency plans are in place to mitigate these risks. Contingency plans are built upon existing incident management and emergency plans but have been enhanced to include a transition operating plan to deal with the special needs of this particular new year. BT has invested in additional equipment to manage congestion and protect the 999 emergency service. Where there remains a risk, additional contingency plans are in place and a special remuneration package has been arranged for employees to ensure that key areas of the business are properly resourced over the New Year period. Contingency plans fall into three categories:

- prevention: plans in this category deal with changes from third party suppliers;
- mitigation: while we are unable to prevent unusual demand for our services, we are undertaking risk assessment on the likely demand and will then add network capacity where it is justified;
- transition: we believe the most probable risks will result from the combination of demand for services and event-related disruption rather than technical failure.

The activities of BT's Year 2000 programme focus on achieving a significant reduction of the Year 2000 risk. However, due to various unknowns, mainly relating to insufficient information regarding the readiness of non-UK carriers and other third parties, the effect of this issue on BT will not be known until January 2000. There can be no assurance or guarantee that the Year 2000 problem will not have a material adverse effect on our business, financial condition or results of BT's operations. A Year 2000 failure could result in BT being unable to continue to provide its services to its customers, loss of network capability, inaccurate billing, loss of revenue and reputation, legal and regulatory exposure and failure of management controls. BT believes, however, that its Year 2000 programme is reducing the level of uncertainty and, together with its continuity planning, will reduce the risks it faces.

The above disclosure is the Year 2000 readiness disclosure within the meaning of the US Year 2000 Information and Readiness Disclosure Act of 1998 to the extent that the disclosure relates to Year 2000 processing by BT or products or services offered by BT.

**Economic and Monetary Union (EMU)**

On 1 January 1999, a new currency, the euro, was introduced into the European Union as part of EMU and 11 participating member states established fixed conversion rates between their existing currencies and the euro. The currencies of these participating member states now exist only as subdivisions of the euro.

Most of the group's business in Europe is conducted in the UK, which remains outside EMU. Government policy on UK membership of the single currency was set out by the Chancellor of the Exchequer in a statement to the House of Commons in October 1997. The determining factor underpinning any Government decision on membership of the single currency is whether the economic case for the UK joining is clear and unambiguous. Because of the magnitude of the decision, HM Government believes that, whenever the decision to enter is taken, it should be put to a referendum of the British people. In the National Changeover Plan published in February 1999 by HM Government, it was stated that, barring some fundamental and unforeseen change in economic circumstances, making a decision during this Parliament to join was not realistic but preparations should be made so that, should five economic tests set out by the Government be met, a decision to join a successful single currency can be made early in the next Parliament.

BT set up a steering group early in 1998 with representatives from across the group to review the impact of the introduction of EMU. A project team acts as a co-ordination point to ensure consistency of approach across the group and that plans are in place to meet agreed business strategy on EMU. BT is prepared to allow customers to settle certain sterling-based bills in euros under certain circumstances.

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

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

**US GAAP**

The group's net income and earnings per share for the three financial years ended 31 March 1999 and shareholders' equity at 31 March 1999 and 1998 under

US Generally Accepted Accounting Principles (US GAAP) are shown on page 98. Differences between UK GAAP and US GAAP include results of the differing accounting treatment of pension costs, redundancy costs, intangible assets, goodwill, deferred taxation, capitalisation of interest and dividends. Cash flow information under the US GAAP presentation is also shown on page 99.

In its US GAAP reconciliation statement for the 2002 financial year, BT expects to adopt SFAS No. 133 on accounting for derivative instruments and hedging activities. Under this standard, derivative instruments are required to be included in the balance sheet at fair value and certain changes in these fair values need to be recognised in the income statement. We are in the process of assessing the impact of this statement on our US GAAP reconciliations.

# *Board of directors*

## CHAIRMAN

**Sir Iain Vallance** *(d) (f)*

Sir Iain Vallance was appointed a director in 1984. He served as Chief Executive from 1986 to the end of 1995 and has been Chairman since 1987. Sir Iain became part-time Chairman on 1 August 1998. He chairs the *Nominating* and *Community Support* committees. Sir Iain is also a vice-chairman of The Royal Bank of Scotland, a non-executive director of Mobil Corporation and Scottish Enterprise, vice-chairman of the European advisory committee of The New York Stock Exchange and a vice president of the Princess Royal Trust for Carers. Aged 56.

## EXECUTIVE DIRECTORS

**Sir Peter Bonfield CBE** *Chief Executive (a)*

Sir Peter Bonfield was appointed to the Board on 1 January 1996 as Chief Executive. He chairs the *Group Executive Committee*. Sir Peter is a fellow of the Royal Academy of Engineering and the Institution of Electrical Engineers. From 1981 to 1995, he worked for ICL, latterly as chairman and chief executive. He is currently non-executive deputy chairman of ICL, a non-executive director of AstraZeneca, and vice president of the British Quality Foundation. Aged 54.

**Robert P Brace FCA** *Group Finance Director (a) (e)*

Robert Brace joined the company in 1989 and was appointed to the Board in 1993 as Group Finance Director. A career-long finance professional, he started with Peat Marwick Mitchell (KPMG) in 1971 and subsequently held senior finance roles with Unipart and Black & Decker. Aged 49.

**Bill Cockburn CBE, TD** *Group Managing Director, BT UK (a)*

Bill Cockburn joined the company on 1 October 1997 as Group Managing Director of BT's UK business and was appointed to the Board with effect from 1 April 1998. After a career in the Post Office, he became chief executive in 1992. In November 1995, Bill Cockburn joined WH Smith as a director, becoming chief executive in 1996. He is a non-executive director of Centrica and Lex Service, a member of the Business in the Community board and a trustee of the Princess Royal Trust for Carers. Aged 56.

## NON-EXECUTIVE DIRECTORS

**Lord Marshall of Knightsbridge**

*Deputy Chairman (b) (c) (d)*

Lord Marshall was appointed to the Board in 1995 and became Deputy Chairman in January 1996. He chairs the *Audit* and *Remuneration* committees. Lord Marshall is chairman of British Airways, Inchcape and Invensys, a non-executive director of HSBC Holdings, RAC Holdings and The New York Stock Exchange, and deputy president of the Confederation of British Industry. Aged 65.

**Helen Alexander** *(b) (d)*

Helen Alexander joined the Board on 1 June 1998. She has been chief executive of The Economist Group since January 1997. Helen Alexander joined The Economist in 1984 and was managing director of The Economist Intelligence Unit from 1993 to the end of 1996. She is also a non-executive director of Northern Foods, and a member of the ethics committee of the University College London Hospitals. Aged 42.

**Dr Iain Anderson** *(b) (c) (d) (e)*

Dr Anderson was appointed to the Board in 1995. He is a member of the BT Scotland Board and chairs the *Pensions Committee.* Dr Anderson joined the Board of Unilever in 1988 and was the strategy and technology director of Unilever until he retired in May 1998. He is a non-executive director of Scottish & Newcastle, Special Adviser to the Prime Minister on Millennium Compliance (Y2K), a director of Scottish Science Trust and the Leverhulme Trust. Aged 60.

**Neville Isdell** Ireland *(c)*

Neville Isdell joined the Board on 1 July 1998. Formerly President of The Coca-Cola Co. Greater Europe Group, he is currently chairman and chief executive of Coca-Cola Beverages, a new European bottling company. Neville Isdell joined Coca-Cola in 1968 and has held a number of posts managing Coca-Cola's businesses in various parts of the world. He has served on the boards of the publicly-quoted Coca-Cola Enterprises US and Coca-Cola Amatil Australia. Aged 55.

**Keith Oates** *(b) (c) (d)*

Keith Oates was appointed to the Board in 1994. Formerly deputy chairman and managing director of Marks and Spencer, he is a non-executive director of Diageo. Keith Oates' international experience includes working for IBM and Black & Decker. He is a member of the Financial Services Authority and the English Sports Council and a former governor of the BBC. Aged 56.

**Sir John Weston** *(b) (e) (f)*

Sir John Weston joined the Board on 1 October 1998. He retired as Britain's Ambassador to the United Nations in New York in July 1998. Sir John was formerly British Ambassador to NATO. He is also a non-executive director of Rolls Royce and honorary president of the Association of Community Trusts and Foundations. Aged 61.

## COMPANY SECRETARY

**Colin R Green** *(a)*

Colin Green, a solicitor, was appointed Secretary and Chief Legal Adviser in 1994. On 1 April 1999, he became Group Commercial Director and Secretary. Aged 50.

***Key to membership of principal Board committees:***

*(a) Group Executive*
*(b) Audit*
*(c) Remuneration*
*(d) Nominating*
*(e) Pensions*
*(f) Community Support*

*All of the non-executive directors are considered independent of the management of the company*

# Report of the directors

The directors submit their report and the audited financial statements of the company, British Telecommunications plc, and the group, which includes its subsidiary undertakings, for the year ended 31 March 1999.

### Introduction

The business review on pages 8 to 23, the financial review on pages 26 to 39, the discussion on corporate governance on pages 44 to 46 and the report on directors' remuneration on pages 47 to 55 form part of this report. The audited financial statements are presented on pages 59 to 103.

### Principal activity

The group's principal activity is the supply of communication services and equipment. In the year, 96% of group turnover arose from operations in the UK.

### Directors

The names and biographical details of the directors of the company are given on pages 40 and 41. All served throughout the financial year, with the exception of Helen Alexander, Neville Isdell and Sir John Weston who joined the Board on 1 June 1998, 1 July 1998 and 1 October 1998, respectively.

In addition, Malcolm Argent and Sir Ewen Fergusson served on the Board until their retirement as directors on 31 December 1998 and 31 March 1999, respectively.

In accordance with the articles of association, Sir John Weston, having been appointed to the Board since the last annual general meeting, retires at the forthcoming annual general meeting and will be proposed for election. Dr Iain Anderson, Sir Peter Bonfield, Robert Brace and Sir Iain Vallance retire by rotation and will be proposed for re-election. Details of these directors' service contracts or contracts of appointment are included in the report on directors' remuneration on page 49 and the discussion on corporate governance on page 44, respectively.

### Substantial shareholdings

At 25 May 1999, the company had received no notification under Part VI of the Companies Act 1985 in respect of holdings of 3% or more of the company's issued ordinary share capital.

### Interest of management in certain transactions

During and at the end of the 1999 financial year, none of the company's directors was materially interested in any material transaction in relation to the group's business and none is materially interested in any presently proposed material transactions.

### Policy on the payment of suppliers

BT's policy is to use its purchasing power fairly and to pay promptly and as agreed.

BT has a variety of payment terms with its suppliers. The terms for payments for purchases under major contracts are settled when agreeing the other terms negotiated with the individual suppliers. It is BT's policy to make payments for other purchases within 30 working days of the invoice date, provided that the relevant invoice is presented to the company in a timely fashion and is complete. BT's payment terms are printed on the company's standard purchase order forms or, where appropriate, specified in individual contracts agreed with the supplier. The ratio, expressed in days, between the amounts invoiced to the company by its suppliers in the year ended 31 March 1999 and the amounts owed to its trade creditors at the end of the year was 28 days.

**Auditors**

Following the merger of Price Waterhouse and Coopers & Lybrand on 1 July 1998, Coopers & Lybrand resigned as auditors and the directors appointed PricewaterhouseCoopers to fill the vacancy created by the resignation. A resolution to reappoint PricewaterhouseCoopers as auditors of the company will be proposed at the annual general meeting.

**Authority to purchase shares**

The authority for the company to purchase 641 million of its shares, representing 10% of the issued share capital, in the market expires on 14 October 1999. This authority was not used during the year and shareholders will be asked to give a similar authority at the annual general meeting.

**Annual general meeting resolutions**

The resolutions to be proposed at the annual general meeting to be held on 14 July 1999, together with explanatory notes, appear in the separate Notice of Annual General Meeting sent to all shareholders.

By order of the Board

**C R Green**
*Secretary*
25 MAY 1999
Registered office: 81 Newgate Street, London EC1A 7AJ
Registered in England: No 1800000

# Corporate governance

It is BT's policy in all our activities around the world to achieve best practice in our standards of business integrity. This includes a commitment to follow the highest standards of corporate governance throughout the BT group. This section of the annual report describes how BT has applied the principles set out by the London Stock Exchange, for all UK listed companies, in Section 1 of the Combined Code (the Code).

The directors consider that, throughout the year, BT has fully complied with the provisions set out in Section 1 of the Code.

**The Board**

The Board continues to meet every month, except in August. Its principal focus is the overall strategic direction, development and control of the group. Key matters, such as approval of the group's strategic plans and annual operating plan and budget, and monitoring the company's operating and financial performance, are reserved for the Board. These reserved matters are set out in a formal statement of the Board's role. It is sent to all directors, key senior executives and managers involved in the management of the company's principal operations, together with information on the authorities delegated by the Board and the terms of reference and membership of the principal Board and management committees.

BT's aim is for the Board to comprise approximately two-thirds non-executive directors. Six of the ten current directors are non-executive, all of whom are independent of the management of BT. Between them, the non-executive directors bring experience and independent judgement at a senior level of international business operations and strategy, marketing, doing business in the key markets in which the group now operates and international affairs.

The non-executive directors provide a strong independent element on the Board with Lord Marshall, Deputy Chairman, as the senior independent member. However, the Board operates as a single team.

Non-executive directors are appointed initially for three years. Towards the end of that period, the Board will consider whether to continue the appointment, which will then become terminable on twelve months' notice from either BT or the director. Appointments will be reviewed again by the Board before the end of the sixth year. Normally, appointments will be for a maximum of ten years. The Deputy Chairman's contract was renewed for a second three-year term from 1 April 1998. It may be terminated on twelve months' notice.

All directors are required by the company's articles of association to be elected by shareholders at the first annual general meeting after their appointment. One third of the other directors must seek re-election by the shareholders each year. This can mean that directors are not necessarily re-elected every three years. Shareholders will be asked at this year's annual general meeting (AGM) to approve a change to the articles of association to clarify the position. To comply this year with the Code, four directors will retire by rotation and seek re-election rather than three as required by the articles of association.

The Chairman and executive directors have service agreements, which are reviewed by the *Remuneration Committee*. Information about the periods of these contracts is in the *Report on directors' remuneration*.

The Board has agreed and established a procedure for directors, in furtherance of their duties, to take independent professional advice if necessary, at the company's expense. In addition, all directors have access to the advice and services of the Secretary, the removal of whom is a matter for the whole Board. He advises the Board on appropriate procedures for the management of its meetings and duties, as well as the implementation of corporate governance and compliance in the group.

On appointment, directors participate in an induction programme when they receive information about BT, the formal statement of the Board's role, the powers which have been delegated to the company's senior managers and management committees and latest financial information about the group. This is supplemented by visits to key BT locations and meetings with members of the *Group Executive Committee* and other key senior executives. Throughout their period in office this information is up-dated as BT's business, management structure and the competitive and regulatory environments in which it operates change. This can include further meetings with senior BT executives. Directors are also advised on appointment of their legal and other obligations as a director of a listed company, both in writing and in face-to-face meetings with the Secretary. They are reminded of these obligations each year and are encouraged to attend training courses at the company's expense.

Guidelines are in place concerning the content, presentation and delivery of papers to directors for each Board meeting, so that the directors have enough information to be properly briefed.

**Principal Board committees**

The Chief Executive, Sir Peter Bonfield, chairs the *Group Executive Committee*. The other members are the Group Finance Director, the Group Managing Director BT UK, the President and Chief Executive BT Worldwide, the Group Commercial Director and Secretary, the Group Personnel Director, the Group Director Strategy and Development, the Director of Corporate Communications, the Group Engineering and Technology Director, and the Managing Director, BT Cellnet and UK Mobility. The Committee develops the group's strategy, for Board approval, and oversees its implementation. It also finalises, before Board approval, annual operating and capital expenditure plans and budgets, reviews operational activities and agrees and monitors group-wide policies, where these are not reserved to the Board.

The *Nominating Committee*, consisting of the Chairman, Deputy Chairman and three other non-executive directors, ensures the Board has an appropriate balance of expertise and ability. For this purpose it has agreed, and regularly reviews, a profile of the required skills and attributes. This profile is used to assess the suitability as non-executive directors of candidates put forward by the directors and outside consultants. Candidates short-listed for appointment are met by the Committee before it recommends an appointment to the Board.

The *Nominating Committee* also assesses candidates for executive directorships before it recommends an appointment.

The *Audit Committee,* comprising solely non-executive directors, is chaired by Lord Marshall. Its terms of reference, which are in writing, include reviewing BT's internal controls and published financial reports for statutory compliance and against standards of best practice, and recommending appropriate disclosure in these reports to the Board. It also reviews annually the performance of the company's auditors to ensure that an objective, professional and cost-effective relationship is maintained. It recommends to the Board the auditors' fees for their audit services. The Group Finance Director and the Group Commercial Director and Secretary attend these meetings. Each year, the Committee sets aside time to seek the views of the company's auditors in the absence of executives.

The *Remuneration Committee* comprises solely non-executive directors and is chaired by Lord Marshall. Further details about the Committee are included in the *Report on directors' remuneration*.

Committee membership is identified in the table of directors on pages 40 and 41.

**Internal financial control**

The Board is responsible for the group's systems of internal financial control.

Any system can provide only reasonable and not absolute assurance against material financial misstatement or loss. Key elements are:

- Formal policies and procedures are in place, including the documentation of key systems and rules relating to the delegation of authorities, which allow the monitoring of controls and restrict the unauthorised use of the group's assets.
- Experienced and suitably qualified staff take responsibility for important business functions. There are rigorous recruitment policies and annual appraisal procedures which assess performance against agreed objectives and identify necessary training to maintain and enhance standards of performance.
- Forecasts and budgets are prepared which allow management to monitor the key business and financial activities and risks and the progress towards financial objectives set for the year and the medium term; monthly management accounts are prepared promptly providing relevant, reliable and up-to-date financial and other information; significant variances from budget are investigated as appropriate.
- All investment projects are subject to formal authorisation procedures. The Board considers major investment projects, with other projects being approved by the *Group Investment Committee* (a sub-committee of the *Group Executive Committee*) or senior management within delegated authorities approved and reviewed by the Board.
- The *Audit Committee* reviews reports from management, from the internal auditors and from the external auditors, to provide reasonable assurance that control procedures are in place and are being followed.
- Formal procedures have been established for instituting appropriate action to correct weaknesses identified from the above reports.

The *Audit Committee* has conducted its annual review of the effectiveness of the systems of internal financial control in existence in the group for the year ended 31 March 1999 and for the period up to the date of approval of the financial statements.

The Board recognises the importance of non-financial controls. However, specific guidance on the scope, extent, nature and review of internal non-financial controls is not expected to be finalised until summer 1999. When the guidelines are finalised, the Board intends to use them to report on the whole system of internal control.

### Relations with shareholders

Senior executives, led by the Chief Executive and Group Finance Director, hold meetings with the company's principal institutional shareholders to discuss the company's strategy, financial performance and specific major investment activities. As explained in the *Report on directors' remuneration*, the company also maintains contact, when appropriate, through the Chairman of the *Remuneration Committee* and appropriate senior executives to discuss overall remuneration policies and plans. Contact with institutional shareholders (and financial analysts, brokers and the press) is controlled by written guidelines to ensure the protection of share price sensitive information which has not already been made available generally to the company's shareholders.

The company's policy has always been to allow shareholders to vote at the AGM on the annual report and it is continuing that policy this year. The Board has also decided that shareholders should this year be asked to vote on the company's directors' and senior executives' remuneration policy, as set out on pages 47 to 49 in the *Report on directors' remuneration*.

It is also part of the company's policy to involve its shareholders fully in the affairs of the company and to give them the opportunity at the AGM to ask questions about the company's activities and prospects and to vote on every substantially different issue by proposing a separate resolution for each issue. The Board's opinion is that the re-election and fees of the auditors are inter-related issues and should therefore be dealt with by one resolution.

Shareholders are being asked this year to approve updated articles of association. These also include some changes to the current provisions. An explanation is given in the notes accompanying the Notice of the AGM. These are being dealt with in a single resolution as the Board considers changes to the company's constitution to be a single issue. The proxy votes for and against each resolution, as well as abstentions, will be counted before the 1999 AGM and the results will be made available at the meeting after shareholders have voted on a show of hands.

It is our policy for all directors to attend the AGM if at all possible. Whilst, because of ill health or other pressing reasons, this may not always be achievable, in normal circumstances this means the chairman of the *Audit* and *Remuneration* committees is at the AGM and is available to answer questions.

BT's practice is to post the annual report and Notice of AGM, given the large number of shareholders, in the most cost-effective manner. We aim to give as much notice as possible and at least 21 days, as required by our articles of association. In practice, the Report and the Notice of AGM are being sent to shareholders more than 20 working days before the AGM.

Established procedures ensure the timely release of share price sensitive information and the publication of financial results and regulatory financial statements.

### Statement of Business Practice

BT's policy is to achieve best practice in our standards of business integrity for all of our activities around the world. To reinforce our determination to live up to these standards BT has, over the year, reviewed its existing Statement of Business Practice, which sets out the principles the group will observe. This review included consultation with individuals and groups, inside and outside the company. The Statement now better reflects BT's growing worldwide operations and the increasing expectations in the areas of corporate governance and business practice standards. It also recognises the importance of our joint venture partnerships and outlines how we work with our partners in the creation of added value whilst working within high standards of business practice. This new Statement is being sent to every employee and it is on the company intranet site. These high level principles are then linked into everyday policies and principles by the operating units. A confidential help line is available to employees who have questions regarding the application of these principles. We also continue to require our agents and contractors to apply these principles when representing BT.

### Pension fund

BT's main pension fund – the BT Pension Scheme – is not controlled by the Board, but by trustees who are company and union nominees, with an independent chairman. The trustees look after the assets of the pension fund, which are held separately from those of the company. The pension scheme funds can only be used in accordance with its rules and for no other purpose.

### Reporting

A statement by the directors of their responsibilities for preparing the financial statements is included on page 57.

# Report on directors' remuneration

The *Remuneration Committee* is made up wholly of independent non-executive directors. Throughout the year, the company has applied the principles in Section 1 of the London Stock Exchange Combined Code (the Code) and complied with the Code's provisions.

The Committee's role is to set the remuneration policy for the Chairman, the executive directors and the members of the company's *Group Executive Committee*. Specifically, it agrees the service contracts, salaries, other benefits, including bonuses and participation in the company's executive share plans, and other terms and conditions of employment. Lord Marshall has chaired the Committee since 1 January 1996. Its other members during the year were:

Dr Iain Anderson
Sir Ewen Fergusson (retired 31 March 1999)
Neville Isdell (appointed 1 July 1998)
Keith Oates

The Committee met five times during the 1999 financial year. The Chairman and Chief Executive are invited to attend meetings to discuss senior executive remuneration recommendations. They are not present when their own remuneration arrangements are being considered.

Although the full Board considers itself ultimately responsible for both the framework and the cost of executive remuneration, the Board has delegated prime responsibility for these issues, together with control of executive remuneration packages, to the *Remuneration Committee*. Non-executive directors who are not members of the Committee are entitled to receive papers and minutes of the Committee.

The Committee has access to professional advisers both within the company and externally. The Committee Chairman and senior executives maintain contact when appropriate with BT's principal shareholders and the main representative groups of the institutional shareholders to discuss the company's overall remuneration policy and its development.

## Remuneration policy

BT's executive remuneration policy is in line with the company's overall practice on pay and benefits. This is to reward employees competitively taking into account performance, market comparisons and competitive pressures in the communications and IT sectors worldwide. Whilst not seeking to maintain a strict market position, it takes account of comparable roles in similar organisations. These may be similar in size, market sector, business complexity or international scope. As BT extends its business globally, it takes account of markets outside the UK where the scope of a particular role warrants this approach. The strategy for executive pay, in general terms, is for basic salaries to reflect the relevant market median with total direct compensation (that is, basic salary, annual bonus payments and the value of long-term incentives) at the upper quartile for exceptional performance.

The Committee considers that it is crucial to link a significant proportion of the total executive remuneration package to individual and corporate performance.
Over several years, it has been the Committee's policy to increase the proportion of the total remuneration package linked to performance to align executive performance and reward with the interests of shareholders. Remuneration policy and arrangements are kept under constant review to achieve this objective and to ensure the company can attract and retain executives of the necessary quality in a highly and increasingly competitive marketplace.

### Packages

The remuneration package for the Chairman and executive directors comprises some or all of the following elements:

- **Basic salary**
  Salaries are reviewed (although not necessarily increased) annually. Salaries are increased only where the Committee believes that adjustments are appropriate to reflect performance, increased responsibilities and/or market pressures.

- **Performance-related remuneration**
  **Annual bonus**
  The annual bonus plan focuses on annual objectives and is designed to reward appropriately the achievement of results against these objectives. Targets are set at the start of the financial year based on key corporate objectives, such as revenue growth, profitability, quality of service, customer satisfaction and people management. Specific weights are attached to each objective on the basis of the BT Corporate Scorecard. The Committee retains the flexibility to enhance bonus awards in exceptional circumstances.

  **BT Executive Share Plan/**
  **BT Performance Share Plan**
  The BT Executive Share Plan (ESP), formerly the BT Long Term Remuneration Plan, was approved by shareholders in 1995. Awards of BT shares normally vest at the end of five years only if BT's total shareholder return (TSR) meets a pre-determined target relative to the FT-SE 100 companies and if the executive is still employed by the group. Awards are based on the executive's bonus and are therefore dependent upon his

or her individual performance. The initial value of the awards is between 33% and 100% of salary. The first potential vesting of awards under the ESP will be in the 2000 financial year. Around 120 senior executives participate in the ESP.

The BT Performance Share Plan (PSP) was also approved by shareholders in 1995. Like the ESP, the vesting of awards of BT shares under the PSP is subject to the company meeting a pre-determined TSR target measured against the FT-SE 100 companies. Normally, if the performance target is met and the participant is still employed by the group, the awards will vest within two years of the end of a three-year cycle (which may be extended up to five years).

The value of awards granted under the PSP has generally been around 10% to 20% of salary each year. For the awards to be granted in the 2000 financial year it is intended that the minimum value of the awards will remain at 10% of salary but the maximum value of the awards will be increased to 25% of salary to ensure that the awards are competitive. Around 1,200 senior managers, who do not participate in the ESP, will receive awards under the PSP. The first vesting under the PSP was in 1998 when 90% of the shares vested, based on BT's TSR measured against the FT-SE 100 companies, ranking in 34th position.

In the event of the company purchasing its own shares, the *Remuneration Committee* will review performance targets under the ESP and the PSP and adjust them if it considers such an adjustment would be appropriate.

**BT Deferred Bonus Plan**

The BT Deferred Bonus Plan (DBP) was introduced in 1998.

The first awards, in the form of BT shares, were granted to around 200 senior executives during the 1999 financial year in respect of the 1998 financial year. The awards were equivalent in value to one-half of the executive's gross annual bonus (excluding any special bonuses) and the shares are held in trust. The shares will normally be transferred to the executive if he or she has continued to be employed by the group throughout a three-year deferred period. It is intended that the value of deferred bonuses granted in respect of the 1999 financial year will, except in a very limited number of exceptional circumstances where higher levels of award are justified, be equivalent to 50% of annual bonus. It is anticipated that around 300 senior executives will receive deferred bonuses in respect of the 1999 financial year.

**BT Share Option Scheme**

The BT Share Option Scheme for senior executives was not replaced after its expiry in January 1995. The last options were granted in December 1994.

Details of options exercised during the 1999 financial year and unexercised options are shown on page 53.

- **Pensions**

  For the executive directors and other senior executives, the policy is to provide pension benefits of one thirtieth of final salary for each year of service with a two-thirds pension for the surviving spouse. The executive directors and certain other senior executives have undertakings of pension benefits of two-thirds of final salary at normal retirement age with a pension of two-thirds of the director's pension for the surviving spouse. On death in service a lump sum equal to four times annual salary is payable together with a pension of two-thirds of the director's prospective pension for the surviving spouse. Pensions are based on salary alone – bonuses, other benefits and long-term incentives are excluded.

  The primary means of providing pensions is through the BT Pension Scheme (BTPS).

- **Other benefits**

  Other benefits include car and driver, personal telecommunications facilities, medical and dental cover for the director and immediate family and financial counselling. During the year, the company introduced a permanent health insurance policy to provide cover for full-time executive directors and members of the *Group Executive Committee.*

- **Other incentive plans**

  During the year, an incentive plan was established for senior executives in BT Cellnet, the mobile phone operator owned 60% by BT. This plan specifically links an element of these executives' long-term remuneration to the performance of BT Cellnet over a three and a half year period, rather than to the performance of the BT group. All the awards are cash awards. It replaces participation in the DBP for the executives concerned for so long as it operates.

  The *Remuneration Committee* has reviewed this plan and will review any further plans of this type, to ensure they are consistent with BT's overall remuneration policy for its senior executives.

### Service agreements

It is the company's policy that the Chairman and the executive directors have service agreements providing for one year's notice, except where it is necessary to offer longer periods to new directors from outside BT or circumstances make it appropriate to offer a longer fixed term. All the service agreements contain provisions dealing with the removal of a director through poor performance. They also deal with payments to which the director would be entitled in the event of early termination of the contract by BT.

### Outside appointments

The Committee believes there are significant benefits to both the company and the individual from executive directors accepting non-executive directorships of companies outside BT. The Committee will consider approving up to two external appointments for which the director may retain the fees.

### Non-executive directors' contracts of appointment

It is the company's policy that every non-executive director has a contract of appointment. This covers, amongst other things, the initial term for which they are appointed, a general statement of their role and duties, the fees they will receive as a director and supplementary fees for additional work such as being a member of a Board Committee.

Non-executive directors are normally appointed for an initial period of three years and are then subject to 12 months' notice. Further details of their appointment arrangements are set out on page 44 in the section of this report dealing with corporate governance issues.

### Non-executive directors' remuneration

About two-thirds of the BT Board are non-executive directors who, in accordance with BT's articles of association and as recommended by the Code, cannot individually vote on their own remuneration. Therefore, the Board does not consider it appropriate for the whole Board to determine non-executive remuneration. This is set by the Chairman and the Chief Executive after considering external advice on appropriate levels of remuneration.

The basic fee for non-executive directors, which includes membership of one committee, was increased from 1 January 1999 to £30,000 per year (previously £25,000). Additional fees for membership of Board committees range from £3,000 to £5,000 per year. Committee chairmen receive an additional fee of £2,000 a year for each committee they chair. The Deputy Chairman is paid an inclusive annual fee of £75,000 (1998: £65,000).

To align further the interests of the non-executive directors with those of shareholders, in January 1999 the company introduced a policy to encourage these directors to purchase £5,000 of BT shares each year. The directors are expected to hold those shares until they retire from the Board. All the non-executive directors have confirmed that they support this policy and will buy shares.

## Remuneration review

### Directors' remuneration

As reported elsewhere in the annual report, Sir Iain Vallance became part-time Chairman from 1 August 1998. From that date, his annual salary has been £275,000 (from £500,000 as full-time Chairman). From 1 April 1998, fifteen months after their previous increase, Sir Peter Bonfield's salary was increased from £570,000 to £617,500 and Robert Brace's salary increased from £300,000 to £330,000. Bill Cockburn was appointed to the Board on 1 April 1998. His salary from 1 July 1998 has been £465,000 (from £450,000).

From 1 March 1998, Bill Cockburn's salary was, at his request, reduced by £10,000 a month. From that date, the company made contributions of £10,000 each month to an unapproved retirement benefits scheme transferred from Bill Cockburn's previous employer. This voluntary salary reduction ceased on 30 September 1998. Bill Cockburn's bonus and other relevant benefits were determined on his full salary during the period of his voluntary salary reduction.

From 1 April 1999, Sir Peter Bonfield's salary was increased to £725,000 a year and Robert Brace's to £355,000. Bill Cockburn's salary will be increased to £495,000 from 1 June 1999.

For Sir Peter Bonfield, annual bonus awards are based wholly on the achievement of group-wide objectives and results measured against the overall BT Corporate Scorecard. His "on target" bonus for the 1999 financial year was 65% of salary, subject to a maximum of 100% of salary. In addition, Sir Peter was paid a bonus in January 1999 of £150,000 in recognition of his contribution to the sale of BT's stake in MCI to WorldCom for US$7 billion and to the agreement with AT&T for the formation of the global venture.

For Robert Brace, Bill Cockburn and other members of the *Group Executive Committee,* annual bonus awards are based on the achievement of a mix of group, divisional and personal objectives. Robert Brace's bonus this year also took account of his contribution to the sale of BT's MCI stake and the formation of the global venture.

Robert Brace's "on target" bonus for the 1999 financial year was between 35% and 40% of salary, subject to a maximum of 60%.

Bill Cockburn's bonus arrangements provide for an "on target" bonus of 50% of salary, subject to a maximum of 75%.

Annual bonus awards for executive directors for the year under review ranged from 50% to 88% of salary.

The Remuneration Committee noted the particular contribution of Sir Peter Bonfield to the significant success of the company in the 1999 financial year, likewise in respect of Bill Cockburn for the performance of the UK business. It also wished to improve the retention incentives.

For the 1999 financial year, the Committee has increased the deferred bonuses which are held in the DBP and paid in shares in three years time if they are still employed by the company to twice the annual bonus for Sir Peter and to the amount of his annual bonus for Bill Cockburn.

In recognition of his contribution to the success of the company throughout the 1999 financial year, Sir Iain Vallance received a bonus of £300,000.

The remuneration (excluding pension arrangements and deferred bonuses) of the directors was as follows:

| | Salary and fees | | Annual and special bonuses | | Benefits excluding pension *(a)* | | Total *(c)* | |
|---|---|---|---|---|---|---|---|---|
| | **1999 £000** | 1998 £000 | **1999 £000** | 1998 £000 | **1999 £000** | 1998 £000 | **1999 £000** | 1998 £000 |
| Sir Iain Vallance | **349** | 500 | **300** | 325 | **45** | 37 | **694** | 862 |
| Sir Peter Bonfield | **617** | 570 | **725** | 325 | **37** | 43 | **1,379** | 938 |
| R P Brace | **329** | 300 | **210** | 162 | **26** | 23 | **565** | 485 |
| B Cockburn | **400** | – | **280** | – | **15** | – | **695** | – |
| Lord Marshall | **75** | 65 | **–** | – | **–** | – | **75** | 65 |
| H Alexander | **24** | – | **–** | – | **–** | – | **24** | – |
| J I W Anderson | **46***(b)* | 38*(b)* | **–** | – | **–** | – | **46** | 38 |
| Sir Ewen Fergusson | **33** | 38 | **–** | – | **–** | – | **33** | 38 |
| N Isdell | **22** | – | **–** | – | **–** | – | **22** | – |
| J K Oates | **36** | 35 | **–** | – | **–** | – | **36** | 35 |
| Sir John Weston | **16** | – | **–** | – | **–** | – | **16** | – |
| M Argent | **30** | 52 | **–** | – | **1** | 1 | **31** | 53 |
| A W Rudge | **–** | 208 | **–** | 70 | **–** | 11 | **–** | 289 |
| Non-executive directors who retired in previous year | **–** | 30 | **–** | – | **–** | – | **–** | 30 |
| | **1,977** | 1,836 | **1,515** | 882 | **124** | 115 | **3,616** | 2,833 |

*(a)* Includes other benefits as described above. In addition to his company car, Sir Iain Vallance has use of a car in Scotland.

*(b)* Payments to non-executive directors include fees paid to their principal employer of £9,500 (1998 – £38,000).

*(c)* In addition, deferred bonuses payable in shares in three years time, provided they are still employed by the company, were awarded to Sir Peter Bonfield – £1,150,000 (1998 – £163,000), Robert Brace – £82,500 (1998 – £59,000) and Bill Cockburn – £280,000.

When added to the amounts paid or currently payable for the 1999 financial year, in the table above, the total remuneration of Sir Peter Bonfield was £2,529,000 (1998 – £1,101,000), Robert Brace £647,500 (1998 – £544,000) and Bill Cockburn £975,000.

The directors' long-term remuneration benefits, through the exercise of share options, were as follows:

| | **1999 £000** | 1998 £000 |
|---|---|---|
| Sir Iain Vallance | **–** | 415 |
| R P Brace | **891** | – |
| A W Rudge | **41** | 442 |

The figures in the above table are based on the amount by which the market value of the shares on the date of exercise exceeded the option price. The figures include the employee compensation for the special dividend (see note 4 to the financial statements).

Bill Cockburn was appointed a director on 1 April 1998, Helen Alexander on 1 June 1998, Neville Isdell on 1 July 1998 and Sir John Weston on 1 October 1998. Malcolm Argent retired on 31 December 1998 and Sir Ewen Fergusson on 31 March 1999. In the previous year, Yve Newbold retired on 30 June 1997, Dr Alan Rudge on 31 October 1997, Gerald Taylor on 9 November 1997, Bert Roberts on 17 March 1998 and Birgit Breuel on 31 March 1998. Yve Newbold remains on the Community Support Committee for which she received fees of £5,000 in the year ended 31 March 1999 (1998 – £3,750) after her retirement as a director.

### BT Performance Share Plan

The first three-year performance cycle of the PSP ended on 31 July 1998 and, on the basis of the company's TSR compared with the FT-SE 100 companies, 90% of the shares vested on 19 August 1998 in 745 participants and 5 million shares were transferred to those participants. Further awards of shares were granted in 1998 under the second three-year performance cycle of the PSP.

### Pensions

The Chairman and all the executive directors, except Sir Peter Bonfield, are members of the BTPS. In addition to the company's contribution, individuals contributed 6% of salary in the year ended 31 March 1999. Sir Peter's pension arrangements are non-approved (by the Inland Revenue) and unfunded.

When an individual will not achieve the target level of pension benefit at normal retirement age because of the Government earnings cap for calculation of pension benefits, the company may make up the shortfall by purchasing additional service in the BTPS and/or through non-approved, unfunded arrangements.

From 1 August 1998, Sir Iain Vallance has been entitled to receive an annual pension of £333,333 from the company in accordance with his supplementary pension arrangements. This pension will be increased in line with future inflation. The pension paid in the year ended 31 March 1999 amounted to £222,222.

Whilst Sir Iain is part-time Chairman he is a deferred member of the BTPS and his pension is being paid entirely by the company. Sir Iain's pension arrangements entitle his surviving widow to his full pension until July 2003 and to two-thirds of his pension after that date.

Sir Peter Bonfield's pension arrangements provide for a pension of two-thirds of his final salary at 60, inclusive of any retained benefits from his previous employment, and a surviving spouse's pension of two-thirds of his pension. He is entitled to a pension of 52% of salary if he were to retire at 55. If retirement occurs between 55 and 60, the percentage of salary used to calculate the pension will increase on a uniform basis.

Bill Cockburn is a member of the BTPS and has an unfunded and non-approved arrangement to meet the shortfall resulting from the pensions cap. In addition he has a funded non-approved retirement benefits scheme transferred from his previous employer to which the company made monthly contributions of £10,000 from 1 March 1998 to 30 September 1998. Bill Cockburn's salary was reduced, at his request, by £10,000 a month during this period.

The table below shows the increase in the accrued benefits to which each director has become entitled during the year and the transfer value of the increase in accrued benefit.

| | Increase in accrued pension during year or to date of retirement in year *(a)* | | Total accrued pension at year end or at date of retirement, if earlier *(b)* | | Transfer value of increase in accrued benefit *(c)* | |
|---|---|---|---|---|---|---|
| | **1999 £000** | 1998 £000 | **1999 £000** | 1998 £000 | **1999 £000** | 1998 £000 |
| Sir Iain Vallance *(d)* | **1** | 9 | **333** | 332 | **5** | 159 |
| Sir Peter Bonfield | **30** | 18 | **72** | 41 | **500** | 276 |
| R P Brace | **17** | 14 | **118** | 98 | **205** | 173 |
| B Cockburn | **15** | – | **23** | – | **258** | – |

*(a)* The increase in accrued pension during the year excludes any increase for inflation.

*(b)* The pension entitlement is that which would be paid annually on retirement at normal retirement age based on service to the end of the year or date of retirement if earlier.

*(c)* The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes directors' contributions. The transfer value represents a liability of the company rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.

*(d)* Based on service to 31 July 1998, after which no further pension entitlements accrue.

**Directors' interests**

The interests of directors and their families in the company's shares at 31 March 1999 and 1 April 1998, or date of appointment if later, are shown below:

| Beneficial holdings | **1999** | 1998 |
|---|---|---|
| Sir Iain Vallance | **208,452** | 208,366 |
| Sir Peter Bonfield | **9,465***(a)* | 9,228*(a)* |
| R P Brace | **144,283***(a)* | 30,103*(a)* |
| B Cockburn | **4,181** | 4,181 |
| Lord Marshall | **2,000** | 2,000 |
| H Alexander | **–** | –*(b)* |
| J I W Anderson | **4,155** | 4,155 |
| Sir Ewen Fergusson | **–** | – |
| N Isdell | **2,000** | –*(b)* |
| J K Oates | **3,878** | 3,810 |
| Sir John Weston | **1,008** | 1,000*(b)* |
| **Total** | **379,422** | 262,843 |

*(a)* Includes 9,245 shares (1998 – 9,094 shares) purchased and held by Sir Peter Bonfield and 22,200 shares (1998 – 21,841 shares) by Robert Brace in the ESP (see note 31 to the financial statements).

*(b)* At date of appointment.

Details of share options held at 1 April 1998, granted and exercised under the share option schemes during the year, and the balance held at 31 March 1999 are as follows:

| | Number of shares under option | | | | Option exercise price per share | Market price at date of exercise | Usual date from which exercisable | Usual expiry date |
|---|---|---|---|---|---|---|---|---|
| | 1 April 1998 | Granted | Exercised | **31 March 1999** | | | | |
| Sir Iain Vallance | 57,957 | – | – | **57,957** | **333p** | | 09/03/95 | 09/03/02 |
| | 20,770 | – | – | **20,770** | **430p** | | 04/03/96 | 04/03/03 |
| | 3,760 | – | – | **3,760** | **375p** | | 08/12/97 | 08/12/04 |
| | 82,487 | – | – | **82,487** | | | | |
| Sir Peter Bonfield | 6,460 | – | – | **6,460** | **267p** | | 14/08/01 | 14/02/02 |
| R P Brace | 136,890 | – | 136,890*(b)* | **–** | 263p | 734p | 06/09/92 | 06/09/99 |
| | 18,680 | – | 18,680*(b)* | **–** | 289p | 734p | 07/12/93 | 07/12/00 |
| | 18,020 | – | 18,020*(b)* | **–** | 333p | 734p | 09/03/95 | 09/03/02 |
| | 24,890 | – | – | **24,890** | **430p** | | 04/03/96 | 04/03/03 |
| | 30,180 | – | – | **30,180** | **460p** | | 15/11/96 | 15/11/03 |
| | 23,470 | – | – | **23,470** | **375p** | | 08/12/97 | 08/12/04 |
| | 2,265 | – | 2,265*(c)* | **–** | 320p | 817.5p | 14/06/98 | 14/12/98 |
| | 3,876 | – | – | **3,876** | **267p** | | 14/08/01 | 14/02/02 |
| | – | 1,332*(d)* | – | **1,332** | **518p** | | 14/08/03 | 14/02/04 |
| | 258,271 | 1,332 | 175,855 | **83,748** | | | | |
| B Cockburn | – | 3,330*(d)* | – | **3,330** | **518p** | | 14/08/03 | 14/02/04 |
| A W Rudge*(e)* | 10,940 | – | 10,940*(f)* | **–** | 430p | 648p | 04/03/96 | 04/03/03 |
| | 2,460 | – | 2,460*(f)* | **–** | 375p | 648p | 08/12/97 | 08/12/04 |
| | 2,254 | – | 1,193*(g)* | **–** | 306p | 670.5p | 14/06/00 | 14/12/00 |
| | 15,654 | – | 14,593 | **–** | | | | |
| **Total** | 362,872 | 4,662 | 190,448 | **176,025** | | | | |

*(a)* All of the above options were granted for nil consideration.

*(b)* Options exercised under the BT Share Option Scheme on 12 October 1998.

*(c)* Options exercised under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 15 July 1998.

*(d)* Options granted under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 25 June 1998.

*(e)* Dr Rudge retired as a director of the company on 31 October 1997.

*(f)* Options exercised under the BT Share Option Scheme on 22 April 1998.

*(g)* Options exercised under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 3 April 1998. Dr Rudge exercised a proportion of the shares under option in accordance with the rules of the Scheme, following which the remaining 1,061 shares under option lapsed.

Unrealised gains on the above share options at 31 March 1999, based on the market price of the shares at that date, excluding the employee compensation for the special dividend which is discretionary in respect of directors' share options, were as follows:

| | Options exercisable | | | Options not exercisable | | |
|---|---|---|---|---|---|---|
| | | Unrealised gains | | | Unrealised gains | |
| | Number of shares | **1999 £000** | 1998*(a)* £000 | Number of shares | **1999 £000** | 1998*(a)* £000 |
| Sir Iain Vallance | **82,487** | **538** | 240 | **–** | **–** | – |
| Sir Peter Bonfield | **–** | **–** | – | **6,460** | **48** | 25 |
| R P Brace | **78,540** | **460** | 831 | **5,208** | **35** | 22 |
| B Cockburn | **–** | **–** | – | **3,330** | **16** | – |

*(a)* Based on options outstanding at 31 March 1998 and the market price of the shares at that date.

The market price of the shares at 31 March 1999 was 1,011p (1998 – 650p) and the range during the year ended 31 March 1999 was 630p to 1,118.5p.

Details of the company's ordinary shares provisionally awarded to directors, as participants under the ESP and PSP (note 31 to the financial statements), are as follows:

| | Total number of award shares *(a) (b)* | | | | Range of value of award *(c) (d)* | |
|---|---|---|---|---|---|---|
| | 1 April 1998 | Awarded | Dividends reinvested | **31 March 1999** | Minimum £000 | Maximum £000 |
| Sir Peter Bonfield | 240,420 | 71,909 | 6,511 | **318,840** | 499 | 3,223 |
| R P Brace | 256,909 | 36,508 | 6,106 | **299,523** | 478 | 3,028 |
| B Cockburn | 32,520 | 49,782 | 1,714 | **84,016** | 302 | 816 |
| A W Rudge | 124,028 | – | 2,582 | **126,610** | 256 | 1,280 |
| **Total** | 653,877 | 158,199 | 16,913 | **828,989** | 1,535 | 8,347 |

*(a)* Excluding shares purchased by each director and held under the ESP (see page 52).

*(b)* During the 1998 financial year, Bill Cockburn was awarded 32,520 shares under the PSP. The three-year performance cycle for that award ended on 31 July 1998 and, on the basis of the position of BT's TSR at the end of the initial three-year cycle, 90% of the shares under award, including reinvested dividends, will vest. The vesting will take place within the two years following the end of the performance cycle in accordance with the rules of the plan.

*(c)* For the ESP, based on the market value of the company's shares at 31 March 1999. The minimum figure represents those shares held at 31 March 1999 which will transfer to each director at the end of year five of the plan (1999 to 2003). The maximum figure represents all shares held at 31 March 1999 which will transfer to each director at the end of year five of the plan (1999 to 2003) provided the corporate performance measure has been fully met. Normally, shares will transfer only if the individual is still employed by the group. However, the plan gives discretion to preserve awards of shares after retirement. Under this discretion, Dr Rudge's awards have been preserved until the end of year five of the plan.

*(d)* For the PSP, shows the market value at 31 March 1999 of the company's shares which will vest in Bill Cockburn.

At 31 March 1999, deferred bonuses of 18,352 shares, 6,605 shares and 6,605 shares had been awarded to Sir Peter Bonfield, Robert Brace and Bill Cockburn, respectively, under the DBP for the 1998 financial year. These shares will normally be transferred to participants at the end of the three-year deferred period if those participants are still employed by BT.

At 31 March 1999, Sir Iain Vallance, Sir Peter Bonfield, Robert Brace and Bill Cockburn each had a non-beneficial interest in 53,912 shares (1998 – 21,919) purchased by BT Employee Shares Trustees Limited for allocation to employees under the BT Employee Share Ownership Scheme, and 6,947,296 shares (1998 – 10,467,987) held in trust by Ilford Trustees (Jersey) Limited for allocation to participating employees under the ESP, the DBP and the PSP.

No director had any interest in the debentures of the company or in the share capital or debentures of its subsidiaries.

Subsequent to 31 March 1999, Robert Brace has notified the company of the acquisition of beneficial holdings of a total of 26 shares under personal equity plans and Helen Alexander notified the company of the acquisition of 930 shares. There have been no other changes in the directors' interests in the share capital, including options to subscribe for shares, or in the debentures of the company and its subsidiaries between 31 March 1999 and 25 May 1999.

**Directors' service agreements and contracts of appointment**

The dates on which the Chairman's and each current executive directors' initial service agreement commenced and the current expiry dates are as follows:

| Chairman and executive directors | Commencement date of initial service agreement | Expiry date of current service agreement |
|---|---|---|
| Sir Iain Vallance | 6 August 1984 | 31 July 2000*(a)* |
| Sir Peter Bonfield | 1 January 1996 | 31 December 1999*(b)* |
| R P Brace | 1 October 1993 | *(c)* |
| B Cockburn | 1 April 1998 | 30 September 1999*(d)* |

*(a)* Sir Iain Vallance entered into a new agreement when he became part-time Chairman on 1 August 1998. To ensure Sir Iain's contribution to BT for a reasonable period after he took up his part-time role, this agreement is for an initial fixed two-year term.

*(b)* The initial term of Sir Peter Bonfield's agreement was extended in the year ended 31 March 1998. After 31 December 1999 the agreement can be terminated by either the company or Sir Peter on 12 months' notice.

*(c)* Terminable on 12 months' notice by either the company or Robert Brace.

*(d)* Terminable after 30 September 1999 on 12 months' notice by either the company or Bill Cockburn.

The dates on which current non-executive directors' contracts of appointment commenced and the current expiry dates are as follows:

| Non-executive director | Commencement date of initial contract | Expiry date of current contract |
|---|---|---|
| Lord Marshall | 1 April 1995 | 31 March 2001 |
| H Alexander | 1 June 1998 | 31 May 2001 |
| J I W Anderson | 1 November 1995 | *(a)* |
| N Isdell | 1 July 1998 | 30 June 2001 |
| J K Oates | 1 June 1994 | *(a)* |
| Sir John Weston | 1 October 1998 | 30 September 2001 |

*(a)* Terminable on 12 months' notice by either the company or the director or on one month's notice effective on the sixth anniversary of initial appointment.

There are no other service agreements or material contracts, existing or proposed, between the company and the directors. There are no arrangements or understandings between any director or executive officer and any other person pursuant to which any director or executive officer was selected to serve. There are no family relationships between the directors.

By order of the Board

**Lord Marshall of Knightsbridge**

*Deputy Chairman and Chairman of Remuneration Committee*

25 MAY 1999

# *Statement of directors' responsibility*

FOR PREPARING THE FINANCIAL STATEMENTS

The directors are required by law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the profit or loss and cash flows of the group for that period.

The directors consider that, in preparing the financial statements for the year ended 31 March 1999 on pages 59 to 103, the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. The directors also consider that all applicable accounting standards have been followed and confirm that the financial statements have been prepared on the going concern basis.

The directors are responsible for ensuring that the company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The directors are also responsible for taking such steps that are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The auditors' responsibilities are stated in their report to the shareholders.

# *Report of the auditors*

TO THE SHAREHOLDERS OF BRITISH TELECOMMUNICATIONS plc

We have audited the financial statements on page 59 to 103. We have also examined the amounts disclosed relating to the directors' remuneration, share options, long term incentives and pension entitlements on pages 47 to 55.

**Respective responsibilities of directors and auditors**

The directors are responsible for preparing the annual report including, as described on page 57, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the report of the directors is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on page 44 reflects the company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the group's corporate governance procedures or its internal controls.

**Basis of audit opinion**

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, which are substantially the same as auditing standards generally accepted in the United States. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion**

In our opinion the financial statements:

- give a true and fair view of the state of affairs of the company and the group at 31 March 1999 and of the profit and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

- present fairly, in all material respects, the consolidated financial position of the group as at 31 March 1999 and 31 March 1998 and the results of its operations and its cash flows for the years ended 31 March 1999, 31 March 1998 and 31 March 1997 in conformity with accounting principles generally accepted in the United Kingdom. The principles differ in certain respects from accounting principles generally accepted in the United States. The effect of the differences in the determination of net income, shareholders' equity and cash flows is shown on pages 97 to 99.

**PricewaterhouseCoopers**
*Chartered Accountants and Registered Auditors*
London
25 MAY 1999

# Accounting policies

**I Basis of preparation of the financial statements**
The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards and the provisions of the Companies Act 1985. The group financial statements consolidate those of the company and all of its subsidiary undertakings. Where the financial statements of subsidiary undertakings, associates and joint ventures do not conform with the group's accounting policies, appropriate adjustments are made on consolidation in order to present the group financial statements on a consistent basis. The principal subsidiary undertakings' financial years are all coterminous with those of the company.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reporting period. Actual results could differ from those estimates. Estimates are used principally when accounting for income, provision for doubtful debts, payments to telecommunication operators, depreciation, employee pension schemes and taxes. Certain comparative figures have been restated to conform with revised presentation and reclassification of figures in the year ended 31 March 1999, required by Financial Reporting Standards Nos 9 to 14.

**II Turnover**
Group turnover, which excludes value added tax and other sales taxes, comprises the value of services provided and equipment sales by group undertakings, excluding those between them.

Total turnover is group turnover together with the group's share of its associates' and joint ventures' turnover.

**III Research and development**
Expenditure on research and development is written off as incurred.

**IV Interest**
Interest payable, including that related to financing the construction of tangible fixed assets, is written off as incurred. Discounts or premiums and expenses on the issue of debt securities are amortised over the term of the related security and included within interest payable. Premiums payable on early redemptions of debt securities, in lieu of future interest costs, are written off when paid.

**V Foreign currencies**
On consolidation, assets and liabilities of foreign undertakings are translated into sterling at year-end exchange rates. The results of foreign undertakings are translated into sterling at average rates of exchange for the year.

Exchange differences arising from the retranslation at year-end exchange rates of the net investment in foreign undertakings, less exchange differences on borrowings which finance or provide a hedge against those undertakings, are taken to reserves and are reported in the statement of total recognised gains and losses.

All other exchange gains or losses are dealt with through the profit and loss account.

**VI Goodwill**
Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired.

For acquisitions completed on or after 1 April 1998, the goodwill arising is capitalised as an intangible asset or, if arising in respect of an associate or joint venture, recorded as part of the related investment. In most cases, the goodwill is amortised on a straight line basis from the time of acquisition over its useful economic life. Where special circumstances exist such that amortising goodwill over a finite period would not give a true and fair view, that goodwill is not amortised. The economic life is normally presumed to be a maximum of 20 years.

For acquisitions on or before 31 March 1998, the goodwill is written off on acquisition against group reserves.

If an undertaking is subsequently divested, the appropriate unamortised goodwill is dealt with through the profit and loss account in the period of disposal as part of the gain or loss on divestment.

**VII Tangible fixed assets**
Tangible fixed assets are stated at historical cost less depreciation.

**(a) Cost**
Cost in the case of network services comprises expenditure up to and including the last distribution point and includes contractors' charges and payments on account, materials, direct labour and related overheads.

**(b) Depreciation**
Depreciation is provided on tangible fixed assets on a straight line basis from the time they are available for use, so as to write off their costs over their estimated useful lives taking into account any expected residual values. No depreciation is provided on freehold land.

**(b) Depreciation** (continued)
The lives assigned to other significant tangible fixed assets are:

| | |
|---|---|
| Freehold buildings – | 40 years |
| Leasehold land and buildings – | Unexpired portion of lease or 40 years, whichever is the shorter |
| Transmission equipment: | |
| duct – | 25 years |
| cable – | 3 to 25 years |
| radio and repeater equipment – | 2 to 25 years |
| Exchange equipment – | 2 to 13 years |
| Computers and office equipment – | 2 to 6 years |
| Payphones, other network equipment, motor vehicles and cableships – | 2 to 20 years |

### VIII Fixed asset investments
Investments in subsidiary undertakings, associates and joint ventures are stated in the balance sheet of the company at cost less amounts written off. Amounts denominated in foreign currency are translated into sterling at year-end exchange rates.

Investments in associates and joint ventures are stated in the group balance sheet at the group's share of their net assets, together with any attributable unamortised goodwill on acquisitions arising on or after 1 April 1998.

The group's share of profits less losses of associates and joint ventures is included in the group profit and loss account.

Investments in other participating interests and other investments are stated at cost less amounts written off.

### IX Stocks
Stocks mainly comprise items of equipment, held for sale or rental, consumable items and work in progress on long-term contracts.

Equipment held and consumable items are stated at the lower of cost and estimated net realisable value, after provisions for obsolescence.

Work in progress on long-term contracts is stated at cost, after deducting payments on account, less provisions for any foreseeable losses.

### X Redundancy costs
Redundancy costs arising from periodic reviews of staff levels are charged against profit in the year in which employees agree to leave the group.

If the most recent actuarial valuation of the group's pension scheme shows a deficit, the estimated cost of providing incremental pension benefits in respect of employees leaving the group is charged against profit in the year in which the employees agree to leave the group, within redundancy charges.

### XI Pension scheme
The group operates a defined benefit pension scheme, which is independent of the group's finances, for the substantial majority of its employees. Actuarial valuations of the scheme are carried out as determined by the trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The cost of providing pensions is charged against profits over employees' working lives with the group using the projected unit method. Variations from this regular cost are allocated over the average remaining service lives of current employees to the extent that these variations do not relate to the estimated cost of providing incremental pension benefits in the circumstances described in X above.

Interest is accounted for on the provision in the balance sheet which results from differences between amounts recognised as pension costs and amounts funded.
The regular pension cost, variations from the regular pension cost, described above, and interest are all charged within staff costs.

### XII Taxation
The charge for taxation is based on the profit for the year and takes into account deferred taxation. Provision is made for deferred taxation only to the extent that timing differences are expected to reverse in the foreseeable future, with the exception of timing differences arising on pension costs where full provision is made irrespective of whether they are expected to reverse in the foreseeable future.

### XIII Financial instruments
#### (a) Debt instruments
Debt instruments are stated at the amount of net proceeds adjusted to amortise any discount evenly over the term of the debt.

#### (b) Derivative financial instruments
The group uses derivative financial instruments to reduce exposure to foreign exchange risks and interest rate movements. The group does not hold or issue derivative financial instruments for financial trading purposes.

**(b) Derivative financial instruments** (continued)

*Criteria to qualify for hedge accounting*

The group considers its derivative financial instruments to be hedges when certain criteria are met. For foreign currency derivatives, the instrument must be related to actual foreign currency assets or liabilities or a probable commitment and whose characteristics have been identified. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the group's operations. For interest rate derivatives, the instrument must be related to assets or liabilities or a probable commitment and must also change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa.

*Accounting for derivative financial instruments*

Principal amounts underlying currency swaps are revalued at exchange rates ruling at the date of the group balance sheet and are included in debtors or creditors.

Interest differentials, under interest rate swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of interest payable.

The forward exchange contracts used to change the currency mix of net debt are revalued to balance sheet rates with net unrealised gains and losses being shown as part of debtors or creditors. The difference between spot and forward rate for these contracts is recognised as part of net interest payable over the term of the contract.

The forward exchange contracts hedging transaction exposures are revalued at the prevailing forward rate on the balance sheet date with net unrealised gains and losses being shown as debtors and creditors.

# Group profit and loss account

FOR THE YEAR ENDED 31 MARCH 1999

| | Notes | Before exceptional items 1999 £m | Exceptional items 1999 £m | After exceptional items 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|---|---|---|
| **Total turnover – ongoing activities** | *2* | **18,223** | **–** | **18,223** | 16,039 | 15,021 |
| – discontinued activities | *2* | **–** | **–** | **–** | 1,372 | 2,358 |
| Total turnover, including discontinued activities | *2* | **18,223** | **–** | **18,223** | 17,411 | 17,379 |
| Group's share of joint ventures' turnover | *2* | **(561)** | **–** | **(561)** | (147) | (80) |
| Group's share of associates' turnover | *2* | **(709)** | **–** | **(709)** | (1,624) | (2,364) |
| **Group turnover – ongoing activities** | *2* | **16,953** | **–** | **16,953** | 15,640 | 14,935 |
| Other operating income *(a)* | *3* | **168** | **–** | **168** | 372 | 106 |
| Operating costs | *4* | **(13,236)** | **(69)** | **(13,305)** | (12,355) | (11,796) |
| Group operating profit – ongoing activities | | **3,885** | **(69)** | **3,816** | 3,657 | 3,245 |
| Group's share of operating loss of joint ventures | *5* | **(342)** | **–** | **(342)** | (199) | (36) |
| Group's share of operating profit (loss) of associates | *5* | **–** | **–** | **–** | 3 | 220 |
| Total operating profit: | | | | | | |
| Ongoing activities | | **3,543** | **(69)** | **3,474** | 3,436 | 3,209 |
| Discontinued activities | | **–** | **–** | **–** | 25 | 220 |
| | | **3,543** | **(69)** | **3,474** | 3,461 | 3,429 |
| Profit on sale of fixed asset investments | *6* | **–** | **1,107** | **1,107** | – | – |
| Profit on sale of group undertakings | *6* | **–** | **–** | **–** | 63 | 8 |
| Interest receivable | *7* | **165** | **–** | **165** | 162 | 209 |
| Interest payable | *8* | **(451)** | **–** | **(451)** | (472) | (383) |
| Premium on repurchase of bonds | *9* | **–** | **–** | **–** | – | (60) |
| **Profit on ordinary activities before taxation** | | **3,257** | **1,038** | **4,295** | 3,214 | 3,203 |
| Tax on profit on ordinary activities: | | | | | | |
| Corporation and similar taxes | *10* | **(1,002)** | **(291)** | **(1,293)** | (977) | (1,102) |
| Windfall tax | *10* | **–** | **–** | **–** | (510) | – |
| | | **(1,002)** | **(291)** | **(1,293)** | (1,487) | (1,102) |
| **Profit on ordinary activities after taxation** | | **2,255** | **747** | **3,002** | 1,727 | 2,101 |
| Minority interests | *11* | **(19)** | **–** | **(19)** | (25) | (24) |
| Profit for the financial year | | **2,236** | **747** | **2,983** | 1,702 | 2,077 |
| Dividends: | | | | | | |
| Ordinary | *12* | | | **(1,322)** | (1,216) | (1,266) |
| Special | *12* | | | **–** | – | (2,244) |
| | | | | **(1,322)** | (1,216) | (3,510) |
| **Retained profit (transfer from reserves) for the financial year** | *26* | | | **1,661** | 486 | (1,433) |
| **Basic earnings per share** | *13* | | | **46.3p** | 26.6p | 32.8p |
| **Basic earnings per share before exceptional items** | *13* | | | **34.7p** | 31.7p | 32.8p |
| **Diluted earnings per share** | *13* | | | **45.3p** | 26.2p | 32.2p |
| **Diluted earnings per share before exceptional items** | *13* | | | **34.0p** | 31.2p | 32.2p |
| *(a)* Including MCI break up fee net of expenses | | | | **–** | 238 | – |

# *Group statement of total recognised gains and losses*

FOR THE YEAR ENDED 31 MARCH 1999

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Profit (loss) for the financial year: | | | |
| Group | **3,362** | 1,951 | 1,987 |
| Joint ventures | **(362)** | (202) | (38) |
| Associates | **(17)** | (47) | 128 |
| Total profit for the financial year | **2,983** | 1,702 | 2,077 |
| Currency movements arising on consolidation of foreign subsidiaries, joint ventures and associates | **45** | (74) | (76) |
| **Total recognised gains and losses for the financial year** | **3,028** | 1,628 | 2,001 |

# *Group cash flow statement*

FOR THE YEAR ENDED 31 MARCH 1999

| | Notes | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|---|
| **Net cash inflow from operating activities** | *14* | **6,035** | 6,071 | 6,185 |
| **Dividends from joint ventures and associates** | | **2** | 5 | 7 |
| **Returns on investments and servicing of finance** | | | | |
| Interest received | | **111** | 168 | 196 |
| Interest paid, including finance costs | | **(439)** | (328) | (342) |
| Premium paid on repurchase of bonds | | **–** | – | (60) |
| Dividends paid to minorities | | **–** | – | (14) |
| **Net cash outflow for returns on investments and servicing of finance** | | **(328)** | (160) | (220) |
| **Taxation** | | | | |
| UK corporation tax paid | | **(359)** | (1,625) | (1,032) |
| Windfall tax paid | | **(255)** | (255) | – |
| Overseas tax paid | | **(16)** | (6) | (13) |
| **Tax paid** | | **(630)** | (1,886) | (1,045) |
| **Capital expenditure and financial investment** | | | | |
| Purchase of tangible fixed assets | | **(3,220)** | (3,020) | (2,823) |
| Sale of tangible fixed assets | | **143** | 127 | 124 |
| Purchase of fixed asset investments | | **(103)** | (265) | (172) |
| Disposal of fixed asset investments | | **4,226** | 50 | 51 |
| **Net cash inflow (outflow) for capital expenditure and financial investment** | | **1,046** | (3,108) | (2,820) |
| **Acquisitions and disposals** | | | | |
| Purchase of subsidiary undertakings, net of £5m overdraft (1998 – £6m, 1997 – £2m cash acquired) | | **(672)** | (121) | (126) |
| Investments in joint ventures | | **(1,038)** | (323) | (131) |
| Investments in associates | | **(288)** | (1,057) | (17) |
| Sale of subsidiary undertakings | | **14** | – | 11 |
| Sale of investments in joint ventures and associates | | **17** | – | 11 |
| **Net cash outflow for acquisitions and disposals** | | **(1,967)** | (1,501) | (252) |
| **Equity dividends paid** | | **(1,186)** | (3,473) | (1,217) |
| Cash inflow (outflow) before management of liquid resources and financing | | **2,972** | (4,052) | 638 |
| **Management of liquid resources** | *15* | **(2,447)** | 2,247 | (504) |
| **Financing** | | | | |
| Issue of ordinary share capital | | **161** | 144 | 160 |
| Minority shares issued | | **13** | 48 | 51 |
| New loans | | **10** | 1,637 | 35 |
| Loan repayments | | **(457)** | (338) | (670) |
| Net increase (decrease) in short-term borrowings | | **(185)** | 303 | 200 |
| **Net cash inflow (outflow) from financing** | | **(458)** | 1,794 | (224) |
| **Increase (decrease) in cash in the year** | | **67** | (11) | (90) |
| **Decrease (increase) in net debt in the year** | *16* | **3,146** | (3,860) | 849 |

# Balance sheets

AT 31 MARCH 1999

| | Notes | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|---|
| **Fixed assets** | | | | | |
| Intangible assets | *17* | **742** | – | **–** | – |
| Tangible assets | *18* | **17,854** | 17,252 | **15,022** | 14,899 |
| Investments in joint ventures: | *19* | | | | |
| Share of gross assets and goodwill | | **1,857** | 524 | | |
| Share of gross liabilities | | **(775)** | (274) | | |
| | | **1,082** | 250 | | |
| Investments in associates | *19* | **418** | 143 | | |
| Other investments | *19* | **332** | 1,315 | | |
| Total investments | *19* | **1,832** | 1,708 | **12,371** | 7,808 |
| **Total fixed assets** | | **20,428** | 18,960 | **27,393** | 22,707 |
| **Current assets** | | | | | |
| Stocks | | **159** | 145 | **134** | 124 |
| Debtors | *20* | **3,995** | 3,387 | **5,976** | 4,918 |
| Investments | *21* | **3,278** | 731 | **1,897** | 15 |
| Cash at bank and in hand | | **102** | 62 | **7** | 1 |
| **Total current assets** | | **7,534** | 4,325 | **8,014** | 5,058 |
| **Creditors: amounts falling due within one year** | | | | | |
| Loans and other borrowings | *22* | **947** | 881 | **7,250** | 3,282 |
| Other creditors | *23* | **7,082** | 6,081 | **7,008** | 6,043 |
| **Total creditors: amounts falling due within one year** | | **8,029** | 6,962 | **14,258** | 9,325 |
| **Net current liabilities** | | **(495)** | (2,637) | **(6,244)** | (4,267) |
| **Total assets less current liabilities** | | **19,933** | 16,323 | **21,149** | 18,440 |
| **Creditors: amounts falling due after more than one year** | | | | | |
| Loans and other borrowings | *22* | **3,386** | 3,889 | **4,289** | 4,126 |
| **Provisions for liabilities and charges** | *24* | **1,391** | 1,426 | **1,116** | 1,269 |
| **Minority interests** | | **216** | 223 | **–** | – |
| **Capital and reserves** | | | | | |
| Called up share capital | *25* | **1,617** | 1,603 | **1,617** | 1,603 |
| Share premium account | *26* | **1,206** | 892 | **1,206** | 892 |
| Other reserves | *26* | **774** | 776 | **747** | 749 |
| Profit and loss account | *26* | **11,343** | 7,514 | **12,174** | 9,801 |
| **Total equity shareholders' funds** | *26* | **14,940** | 10,785 | **15,744** | 13,045 |
| | | **19,933** | 16,323 | **21,149** | 18,440 |

Debtors include amounts receivable after more than one year: group £nil (1998 – £97m) and company £nil (1998 – £213m).

The financial statements on pages 59 to 103 were approved by the board of directors on 25 May 1999 and were signed on its behalf by

**Sir Iain Vallance** *Chairman*

**Sir Peter Bonfield CBE** *Chief Executive*

**R P Brace** *Group Finance Director*

# Notes to the financial statements

**1. Changes in accounting policies and presentation**

During the year ended 31 March 1999, the company has made a number of changes in its accounting policies and in the presentation of its financial statements, mainly impacted by the requirement to implement new UK Financial Reporting Standards (FRSs). These changes are summarised as follows:

*(a) FRS9 – Associates and joint ventures*
The group's share of its associates' and joint ventures' turnover is included in the profit and loss account in memorandum form. The group's share of their operating results is shown separately in the profit and loss account and the group's share of their interest charges and income is included with the respective group figures; formerly these shares were presented as one net figure.

In the cash flow statement, dividends from associates and joint ventures are shown on a separate line, whereas formerly these dividends were included within net cash inflow from operating activities.

In the group balance sheet, the group's investments are analysed between associates, joint ventures and other investments and the group's shares of its joint ventures' gross assets and liabilities are also disclosed; formerly the investments were presented as one figure.

Prior years' figures have been restated for FRS9.

*(b) FRS10 – Goodwill and intangible assets*
Goodwill arising on acquisitions completed on or after 1 April 1998 is being capitalised and, in most cases, amortised over its useful economic life. Where special circumstances exist such that amortising goodwill over a finite period would not give a true and fair view, that goodwill is not amortised. Goodwill arising on acquisitions completed on or before 31 March 1998 are continuing to be accounted for under the group's previous accounting policy which was to write the goodwill off to reserves on acquisition. Prior years' figures have not had to be restated for FRS10.

*(c) FRS11 – Impairment of fixed assets and goodwill*
Where indications of impairment have become apparent, the group has reviewed the carrying value of the relevant assets but no significant impairment losses have been incurred. Previously losses on fixed assets would have been recognised only when a permanent diminution in value had become apparent.

*(d) FRS12 – Provisions, contingent liabilities and contingent assets*
Provisions for liabilities, with some exceptions – in particular those for pension costs and deferred taxes – may now only be made when the group has a legal or constructive obligation at the balance sheet date. Previously, provisions were made when the directors considered them to be required. A review has been made of the group's relevant provisions and no significant adjustment was found to be necessary.

Liabilities covered by insurance recoveries are now presented in the balance sheet on a gross basis; previously they were presented net of the insurance recovery. The balance sheet at 31 March 1998 has not been restated for FRS12 as the amounts involved are not significant.

*(e) FRS13 – Derivatives and other financial instruments – disclosures*
The main disclosures required by FRS13 are contained in note 33. Some of the information in this note may be found to overlap with information in other notes impacted by other accounting disclosure requirements.

*(f) FRS14 – Earnings per share*
Earnings per share on both a basic and diluted basis are calculated in accordance with FRS14 and presented in the financial statements. There has been an insignificant effect on the group's previously reported undiluted earnings per share. The FRS amended UITF Abstract 13 which has resulted in an insignificant change in policy for recognising dividends on the company's shares held in employee trusts. Under the revised policy, these dividends are neither accrued nor recognised as interest and other similar income, whereas they were previously. These dividends are now shown as an addition to investments when reinvested in more of the company's shares.

*(g) Computer software capitalisation*
From 1 April 1998, the group has capitalised the cost of computer software for its non-network systems thereby bringing the policy into line with that for its network systems. It has not been practical to restate prior year figures.

*(h) Turnover*
The previous analysis of turnover has been modified in light of the group's emerging fast growing activities. The comparative figures in note 2 have been restated and include the group's share of continuing associates and joint ventures.

*(i) Segmented results*
The group is not required to present segmented results under SSAP25 as it is a unitary business. However, under US accounting standard SFAS No. 131, the company is required to present segmented results based on information presented to the group's senior management. This information, which is set out in note 35, is presented for the first time.

| 2. Turnover | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Inland calls | **5,178** | 4,924 | 4,874 |
| Exchange lines | **3,337** | 3,180 | 3,033 |
| International calls | **1,501** | 1,553 | 1,809 |
| Mobile communications | **1,400** | 1,089 | 949 |
| Private circuits | **1,165** | 1,149 | 1,124 |
| Customer premises equipment supply | **870** | 896 | 914 |
| Receipts from UK operators | **645** | 496 | 319 |
| Yellow Pages and other directories | **491** | 466 | 438 |
| Other UK sales and services | **1,770** | 1,332 | 994 |
| Non-UK operations | **596** | 555 | 481 |
| Group turnover – ongoing activities | **16,953** | 15,640 | 14,935 |
| Group's share of associates' and joint ventures' turnover | **1,270** | 1,771 | 2,444 |
| Total turnover, including discontinued activities | **18,223** | 17,411 | 17,379 |
| Less: discontinued activities *(a)* | **–** | (1,372) | (2,358) |
| Total turnover – ongoing activities | **18,223** | 16,039 | 15,021 |

| | | | |
|---|---|---|---|
| Group's share of associates' and joint ventures' turnover comprised: | | | |
| Joint ventures – continuing activities | **561** | 147 | 80 |
| Associates: | | | |
| Continuing activities | **709** | 252 | 6 |
| Discontinued activities *(a)* | **–** | 1,372 | 2,358 |
| | **709** | 1,624 | 2,364 |
| Group's share of associates' and joint ventures' turnover | **1,270** | 1,771 | 2,444 |

*(a)* Discontinued activities relate to the group's former interest in MCI *(note 19(c))*.

The group provides telecommunication services, principally in the United Kingdom, essentially operating as a unitary business. Its main services and products are local and national telephone calls in the United Kingdom, the provision of telephone exchange lines to homes and businesses, international telephone calls made to and from the United Kingdom, the supply of mobile communication services and equipment to businesses and individuals, the provision of private circuits to businesses and the supply of telecommunication equipment for customers' premises.

Approximately 4% (1998 – 4%, 1997 – 3%) of group turnover arose from operations outside the United Kingdom.

Unaudited information concerning the group's classified directory business in the UK is shown on page 107 of this annual report.

| 3. Other operating income | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Merger agreement break up fee *(a)* | **–** | 273 | – |
| Merger expenses written off | **–** | (35) | – |
| Other | **168** | 134 | 106 |
| Total other operating income | **168** | 372 | 106 |

*(a)* The company received US$465 million on 12 November 1997 from WorldCom, Inc as a break up fee and partial reimbursement of expenses (the MCI merger break up fee) following the termination of the BT/MCI merger agreement on 9 November 1997 *(note 19 (c))*. This income and the associated merger expenses were exceptional items in the year ended 31 March 1998.

| 4. Operating costs | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Staff costs: | | | |
| Wages and salaries | **3,366** | 3,290 | 3,161 |
| Social security costs | **275** | 266 | 262 |
| Pension costs *(note 28)* | **176** | 177 | 291 |
| Employee share ownership scheme *(a)* | **64** | 64 | 64 |
| Employee share option scheme compensation for special dividend *(b)* | **–** | 120 | – |
| Total staff costs | **3,881** | 3,917 | 3,778 |
| Own work capitalised | **(428)** | (424) | (399) |
| Depreciation *(note 18)* | **2,581** | 2,395 | 2,265 |
| Payments to telecommunication operators | **2,120** | 1,600 | 1,476 |
| Other operating costs *(c)* | **5,151** | 4,867 | 4,676 |
| Total operating costs | **13,305** | 12,355 | 11,796 |
| Operating costs included the following: | | | |
| Research and development | **268** | 307 | 291 |
| Rental costs relating to operating leases, including plant and equipment hire £9m (1998 – £19m, 1997 – £10m) | **185** | 192 | 215 |
| Foreign currency (gains) losses | **(88)** | (9) | (7) |
| Year 2000 computer issue costs | **138** | 76 | 1 |
| Exceptional costs relating to the disengagement from MCI: | | | |
| Staff costs | **10** | – | – |
| Depreciation | **13** | – | – |
| Payments to telecommunication operators | **14** | – | – |
| Other operating costs | **32** | – | – |
| | **69** | – | – |

*(a)* Amount set aside for the year for allocation of ordinary shares in the company to eligible employees.

*(b)* Compensation for employees holding share options on 15 August 1997 in respect of the September 1997 special dividend.

*(c)* Includes redundancy charges of £124m (1998 – £106m, 1997 – £367m). Redundancy charges for the year ended 31 March 1997 included £258m being the cost of providing incremental pension benefits for employees taking early retirement. No charge for these pension benefits was made in the years ended 31 March 1999 and 31 March 1998 in view of the surplus in the BT Pension Scheme disclosed by the most recent actuarial valuation as at 31 December 1996; the previous valuation had shown a deficit.

The directors believe that the nature of the group's business is such that the analysis of operating costs required by the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adapted the prescribed format so that operating costs are disclosed in a manner appropriate to the group's principal activity.

| 5. Group's share of operating profit (loss) of associates and joint ventures | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| The group's share of operating profit (loss) of associates and joint ventures comprised: | | | |
| Joint ventures – continuing activities | **(342)** | (199) | (36) |
| Associates: | | | |
| Continuing activities | **–** | (22) | – |
| Discontinued activities | **–** | 25 | 220 |
| | **–** | 3 | 220 |
| Group's share of operating profit (loss) of associates and joint ventures | **(342)** | (196) | 184 |

The group's amortisation of goodwill for the year ended 31 March 1999 arising in its joint ventures and associates was £12m and £5m, respectively. The group's share of results of associates from discontinued activities for the year ended 31 March 1998 included the group's share of a charge, made by MCI Communications Corporation, amounting to £63m mainly for the exiting from and restructuring of customer contracts.

**6. Profit on sale of fixed asset investments and group undertakings**

In September 1998, the group completed the sale of its interest in MCI for £4,159m at a pre-tax profit of £1,133m, after taking into account goodwill of £2,214m originally written off on the acquisition of the group's interest in MCI in September 1994. A provision for impairment of £26m against another fixed asset investment has been offset against this profit giving a net gain of £1,107m. These two items have been classified as exceptional in the year ended 31 March 1999.

In the years ended 31 March 1999, 1998 and 1997 the subsidiary undertakings disposed of had a negligible effect on the group's operating profit and cash flows and their net assets were immaterial to the group's financial position.

| 7. Interest receivable | 1999 £m | 1998*(a)* £m | 1997*(a)* £m |
|---|---|---|---|
| Income from listed investments | **9** | 11 | 12 |
| Other interest receivable | **150** | 149 | 194 |
| Group | **159** | 160 | 206 |
| Joint ventures | **2** | – | – |
| Associates | **4** | 2 | 3 |
| Total interest receivable | **165** | 162 | 209 |

*(a)* Figures have been restated to include the group's share of its associates' and joint ventures' interest receivable. Income from listed investments for the year ended 31 March 1998 has been restated to exclude £5m dividends from the company's shares held in trust *(note 31).*

| 8. Interest payable | 1999 £m | 1998*(a)* £m | 1997*(a)* £m |
|---|---|---|---|
| Interest payable and similar charges in respect of: | | | |
| Bank loans and overdrafts | **77** | 80 | 76 |
| Other borrowings *(b)* | **343** | 334 | 259 |
| Group | **420** | 414 | 335 |
| Joint ventures | **19** | 2 | – |
| Associates | **12** | 56 | 48 |
| Total interest payable | **451** | 472 | 383 |

*(a)* Figures have been restated to include the group's share of its associates' and joint ventures' interest payable.

*(b)* Includes £7m premium charged in the year ended 31 March 1999 on the early redemption of US$200m 9⅝% Guaranteed Debentures 2019 on 16 February 1999.

**9. Premium on repurchase of bonds**

In August 1996, the company repurchased two of the three series of HM Government held bonds then outstanding for £422m at an effective premium of £60m. The final bond series with a face value of £140m was repaid on maturity on 31 March 1997.

| 10. Tax on profit on ordinary activities | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| United Kingdom: | | | |
| Corporation tax at 31% (1998 – 31%, 1997 – 33%) | **1,200** | 984 | 1,135 |
| Deferred taxation charge (credit) at 30% (1998 – 30%, 1997 – 33%) | **71** | 17 | (100) |
| Taxation on the group's share of results of associates | **1** | 1 | – |
| Deferred taxation provision released due to reduction in corporation tax rate | – | (25) | – |
| Prior year adjustments | **–** | (2) | 1 |
| Total UK taxation, excluding windfall tax | **1,272** | 975 | 1,036 |
| Overseas taxation: | | | |
| Current | **14** | 6 | 17 |
| Taxation charge on the group's share of results of joint ventures | **3** | 1 | 2 |
| Taxation charge (credit) on the group's share of results of associates | **4** | (5) | 47 |
| Total corporation and similar taxes | **1,293** | 977 | 1,102 |
| Windfall tax | **–** | 510 | – |
| Total tax on profit on ordinary activities | **1,293** | 1,487 | 1,102 |

The company's charge to the UK windfall tax, imposed on certain privatised companies in July 1997, was paid in two equal instalments in December 1997 and 1998. The charge was based on the group's profit for the financial years ended 31 March 1986 to 31 March 1989.

Total tax on profit on ordinary activities, excluding the windfall tax, varied from the amount computed by applying the corporation tax rate to profit on ordinary activities before taxation. The differences were attributable to the following factors:

| | 1999 % | 1998 % | 1997 % |
|---|---|---|---|
| UK corporation tax rate | **31.0** | 31.0 | 33.0 |
| Non-deductible depreciation | **0.6** | 0.6 | 0.8 |
| Non-deductible overseas losses | **1.5** | 1.1 | 1.0 |
| Unprovided deferred taxes on excess capital allowances | **(0.7)** | (0.9) | (0.9) |
| Effect of reduction in UK corporation tax rate on deferred tax provision | **(0.1)** | (0.8) | – |
| Lower effective tax on gain in MCI shares (1998 – MCI merger break up fee) | **(2.4)** | (0.7) | – |
| Non-deductible premium on bonds repurchased | **–** | – | 0.4 |
| Other | **0.2** | 0.1 | 0.1 |
| Effective corporation tax rate | **30.1** | 30.4 | 34.4 |

Deferred taxation of £30m (1998 – £30m, 1997 – £28m) arising on excess capital allowances and £nil (1998 – £nil, 1997 – £19m) on profits of associates and joint ventures was not provided in the year ended 31 March 1999.

The deferred taxation charge (credit) was mainly the result of the tax effect of timing differences as follows:

| | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Excess capital allowances | **1** | 24 | 62 |
| Pension provisions | **81** | 20 | (103) |
| Other timing differences | **(11)** | (27) | (59) |
| | **71** | 17 | (100) |
| Release due to reduction in corporation tax rate | **–** | (25) | – |
| Prior year adjustments *(a)* | **5** | (14) | 21 |
| Total deferred taxation charge (credit) | **76** | (22) | (79) |

*(a)* Reclassification between deferred and current taxation on the profit on ordinary activities for prior years.

| 11. Minority Interests | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Group | **15** | 25 | 24 |
| Associates | **4** | – | – |
| Total minority interests | **19** | 25 | 24 |

| 12. Dividends | 1999 pence per share | 1998 pence per share | 1997 pence per share | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|---|---|---|
| Interim dividend paid | **8.10** | 7.55 | 7.90 | **523** | 480 | 502 |
| Proposed final dividend | **12.30** | 11.45 | 11.95 | **799** | 736 | 764 |
| Total ordinary dividends | **20.40** | 19.00 | 19.85 | **1,322** | 1,216 | 1,266 |
| Special dividend | **–** | – | 35.00 | **–** | – | 2,244 |
| Total dividends | **20.40** | 19.00 | 54.85 | **1,322** | 1,216 | 3,510 |

**13. Earnings per share**

The basic earnings per share are calculated by dividing the profit for the financial year attributable to shareholders by the weighted average number of shares in issue after deducting the company's shares held by employee share ownership trusts.

In calculating the diluted earnings per share, share options outstanding and other potential ordinary shares have been taken into account.

The weighted average number of shares in the years were:

| | 1999 millions of shares | 1998 millions of shares | 1997 millions of shares |
|---|---|---|---|
| Basic | **6,442** | 6,387 | 6,332 |
| Dilutive ordinary shares from share options outstanding and shares held in trust | **150** | 97 | 114 |
| Total diluted | **6,592** | 6,484 | 6,446 |

The items in the calculation of earnings per share before exceptional items in the years were:

| | 1999 pence per share | 1998 pence per share | 1997 pence per share | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|---|---|---|
| MCI merger break up fee received less expenses | **–** | 3.7 | – | **–** | 238 | – |
| Profit on sale of MCI shares | **17.6** | – | – | **1,133** | – | – |
| Provision against another fixed asset investment | **(0.4)** | – | – | **(26)** | – | – |
| Costs relating to the disengagement from MCI | **(1.1)** | – | – | **(69)** | – | – |
| | **16.1** | 3.7 | – | **1,038** | 238 | – |
| Less tax charge attributable | **(4.5)** | (0.8) | – | **(291)** | (50) | – |
| Windfall tax charge | **–** | (8.0) | – | **–** | (510) | – |
| Net credit (charge) | **11.6** | (5.1) | – | **747** | (322) | – |
| Earnings per share/profit for the financial year after exceptional items | **46.3** | 26.6 | 32.8 | **2,983** | 1,702 | 2,077 |
| Exceptional charge (credit) | **(11.6)** | 5.1 | – | **(747)** | 322 | – |
| Earnings per share/profit for the financial year before exceptional items | **34.7** | 31.7 | 32.8 | **2,236** | 2,024 | 2,077 |

Earnings per share before exceptional items are provided to help readers evaluate the performance of the group.

| 14. Reconciliation of operating profit to operating cash flows | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Group operating profit | **3,816** | 3,657 | 3,245 |
| Depreciation | **2,581** | 2,395 | 2,265 |
| Decrease (increase) in stocks | **(8)** | 36 | 31 |
| Increase in debtors | **(410)** | (29) | (168) |
| Increase in creditors | **388** | 44 | 478 |
| Increase (decrease) in provisions | **(259)** | (47) | 321 |
| Other | **(73)** | 15 | 13 |
| Net cash inflow from operating activities | **6,035** | 6,071 | 6,185 |

| 15. Management of liquid resources | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Purchase of short-term investments and payments into short-term deposits over 3 months | **(2,973)** | (1,103) | (2,242) |
| Sale of short-term investments and withdrawals from short-term deposits over 3 months | **1,735** | 1,334 | 2,790 |
| Net movement of short-term investments and short-term deposits under 3 months not repayable on demand | **(1,209)** | 2,016 | (1,052) |
| Net cash inflow (outflow) from management of liquid resources | **(2,447)** | 2,247 | (504) |

Movements in all short-term investments and deposits not repayable on demand are reported under the heading of management of liquid resources.

| 16. Net debt | At 1 April 1998 £m | Cash flow £m | Other non-cash changes £m | Currency movement £m | At 31 March 1999 £m |
|---|---|---|---|---|---|
| **Analysis of net debt** | | | | | |
| Cash in hand and at bank | 62 | 40 | – | – | **102** |
| Overnight deposits | 14 | 12 | – | – | **26** |
| Bank overdrafts | (42) | 15 | – | 1 | **(26)** |
| | 34 | 67 | – | 1 | **102** |
| Other current asset investments | 717 | 2,447 | (1) | 89 | **3,252** |
| **Short-term investments and cash, less bank overdrafts** | **751** | **2,514** | **(1)** | **90** | **3,354** |
| Debt due within one year, excluding bank overdrafts | (839) | 519 | (574) | (27) | **(921)** |
| Debt due after one year | (3,889) | 113 | 455 | (65) | **(3,386)** |
| **Total debt, excluding bank overdrafts** | **(4,728)** | **632** | **(119)** | **(92)** | **(4,307)** |
| **Net debt** | **(3,977)** | **3,146** | **(120)** | **(2)** | **(953)** |

| Reconciliation of net cash flow to movement in net debt | 1999 £m | 1998 £m | 1997 £m |
|---|---|---|---|
| Increase (decrease) in cash in the year | **67** | (11) | (90) |
| Cash (inflow) outflow from (increase) decrease in debt | **632** | (1,602) | 435 |
| Cash (inflow) outflow from (decrease) increase in liquid resources | **2.447** | (2,247) | 504 |
| Decrease (increase) in net debt resulting from cash flows | **3,146** | (3,860) | 849 |
| Currency and translation movements | **(2)** | 79 | (47) |
| Other non-cash movements | **(120)** | (20) | (30) |
| Decrease (increase) in net debt in the year | **3,024** | (3,801) | 772 |
| Net debt at 1 April | **(3,977)** | (176) | (948) |
| Net debt at 31 March | **(953)** | (3,977) | (176) |

| 17. Intangible assets | Gross book value £m | Amortisation £m | Net book value £m |
|---|---|---|---|
| At 1 April 1998 | – | – | – |
| Additions | 742 | – | 742 |
| Charge for the year | – | – | – |
| **At 31 March 1999** | **742** | **–** | **742** |

In September 1998, the group acquired MCI's 24.9% interest in Concert Communications Company (Concert) for £607m. Goodwill of £568m arose on this transaction. This goodwill has not been amortised and Concert is to be transferred into the proposed global venture with AT&T Corp in the year ending 31 March 2000 at a value higher than its current book value including this goodwill. Amortisation for the period would not be material.

The acquisition of the interests in Concert on 15 September 1998, Martin Dawes Telecommunications (MDT) on 8 March 1999 and other subsidiary companies and the consideration given comprised:

| | Concert £m | MDT £m | Other £m | Total £m |
|---|---|---|---|---|
| Minority interest | 39 | – | 14 | 53 |
| Fixed assets | | 34 | 1 | 35 |
| Current assets | | 101 | 1 | 102 |
| Current liabilities | | (152) | (3) | (155) |
| Long-term liabilities | | (3) | – | (3) |
| Group share of original book value of net assets (liabilities) | 39 | (20) | 13 | 32 |
| Fair value adjustment to achieve consistency of accounting policies | – | (9) | – | (9) |
| Fair value to the group | 39 | (29) | 13 | 23 |
| Goodwill | 568 | 160 | 14 | 742 |
| **Total cost** | **607** | **131** | **27** | **765** |
| Consideration: | | | | |
| Cash | 607 | 41 | 19 | 667 |
| Deferred | – | – | 8 | 8 |
| Loan notes 1999/2006 | – | 90 | – | 90 |
| **Total** | **607** | **131** | **27** | **765** |

MDT's profit after tax for the year to 31 December 1998 was £2m.

| 18. Tangible fixed assets | Land and buildings *(a)* £m | Plant and equipment £m | Assets in course of construction £m | Total £m |
|---|---|---|---|---|
| **Group** | | | | |
| **Cost** | | | | |
| Balances at 1 April 1998 | 2,862 | 28,679 | 974 | 32,515 |
| Acquisitions of subsidiary undertakings | 3 | 21 | 13 | 37 |
| Additions | 23 | 1,099 | 2,162 | 3,284 |
| Transfers | 205 | 1,814 | (2,019) | – |
| Disposals and adjustments | (94) | (1,640) | (9) | (1,743) |
| **Total cost at 31 March 1999** | **2,999** | **29,973** | **1,121** | **34,093** |
| **Depreciation** | | | | |
| Balances at 1 April 1998 | 1,329 | 14,002 | – | 15,331 |
| Acquisitions of subsidiary undertakings | – | 11 | – | 11 |
| Charge for the year | 117 | 2,464 | – | 2,581 |
| Disposals and adjustments | (71) | (1,560) | – | (1,631) |
| **Total depreciation at 31 March 1999** | **1,375** | **14,917** | **–** | **16,292** |
| **Net book value at 31 March 1999** | 1,624 | 15,056 | 1,121 | 17,801 |
| Engineering stores | – | – | 53 | 53 |
| **Total tangible fixed assets at 31 March 1999** | **1,624** | **15,056** | **1,174** | **17,854** |
| Net book value at 31 March 1998 | 1,533 | 14,677 | 974 | 17,184 |
| Engineering stores | – | – | 68 | 68 |
| Total tangible fixed assets at 31 March 1998 | 1,533 | 14,677 | 1,042 | 17,252 |

| **18. Tangible fixed assets** (continued) | Land and buildings *(a)* £m | Plant and equipment £m | Assets in course of con-struction £m | Total £m |
|---|---|---|---|---|
| **Company** | | | | |
| **Cost** | | | | |
| Balances at 1 April 1998 | 901 | 26,526 | 821 | 28,248 |
| Additions | 6 | 463 | 2,123 | 2,592 |
| Transfers | 121 | 1,754 | (1,875) | – |
| Disposals and adjustments | (57) | (1,653) | (95) | (1,805) |
| **Total cost at 31 March 1999** | **971** | **27,090** | **974** | **29,035** |
| **Depreciation** | | | | |
| Balances at 1 April 1998 | 396 | 13,021 | – | 13,417 |
| Charge for the year | 46 | 2,195 | – | 2,241 |
| Disposals and adjustments | (40) | (1,553) | – | (1,593) |
| **Total depreciation at 31 March 1999** | **402** | **13,663** | **–** | **14,065** |
| **Net book value at 31 March 1999** | **569** | **13,427** | **974** | **14,970** |
| Engineering stores | – | – | 52 | 52 |
| **Total tangible fixed assets at 31 March 1999** | **569** | **13,427** | **1,026** | **15,022** |
| Net book value at 31 March 1998 | 505 | 13,505 | 821 | 14,831 |
| Engineering stores | – | – | 68 | 68 |
| Total tangible fixed assets at 31 March 1998 | 505 | 13,505 | 889 | 14,899 |

| | Group | | Company | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| *(a)* The net book value of land and buildings comprised: | | | | |
| Freehold | **1,317** | 1,281 | **331** | 312 |
| Long leases (over 50 years unexpired) | **126** | 92 | **106** | 73 |
| Short leases | **181** | 160 | **132** | 120 |
| Total net book value of land and buildings | **1,624** | 1,533 | **569** | 505 |

| *(b)* Expenditure on tangible fixed assets comprised: | Group | |
|---|---|---|
| | **1999 £m** | 1998 £m |
| Plant and equipment: | | |
| Transmission equipment | **1,416** | 1,219 |
| Exchange equipment | **411** | 512 |
| Other network equipment | **558** | 502 |
| Computers and office equipment | **464** | 372 |
| Motor vehicles and other | **230** | 230 |
| Land and buildings | **205** | 211 |
| Decrease in engineering stores | **(15)** | (16) |
| Total expenditure on tangible fixed assets | **3,269** | 3,030 |

| 19. Fixed asset investments | Interests in associates and joint ventures *(a)* Shares £m | Loans £m | Share of post acquisition profits (losses) £m | Other participating interests £m | Other investments *(g)* £m | Total £m |
|---|---|---|---|---|---|---|
| **Group** | | | | | | |
| **Cost** | | | | | | |
| Balances at 1 April 1998 | 1,533 | 151 | (286) | 164 | 3,381 | 4,943 |
| Additions | 1,209 | 112 | – | 65 | 38 | 1,424 |
| Disposals | – | – | – | – | (3,059) | (3,059) |
| Share of losses less retained profits for the year | – | – | (364) | – | – | (364) |
| Repayments and other transfers | 146 | (17) | (16) | (66) | (147) | (100) |
| Currency movements | 50 | 1 | 4 | – | 2 | 57 |
| **Balances at 31 March 1999** | **2,938** | **247** | **(662)** | **163** | **215** | **2,901** |
| **Provisions and amounts written off** | | | | | | |
| Balances at 1 April 1998 | (1,005) | – | – | – | (2,230) | (3,235) |
| Goodwill amortisation for the year | (17) | – | – | – | – | (17) |
| Disposals | – | – | – | – | 2,242 | 2,242 |
| Increase in the year | (1) | – | – | – | (58) | (59) |
| **Balances at 31 March 1999** | **(1,023)** | **–** | **–** | **–** | **(46)** | **(1,069)** |
| **Net book value at 31 March 1999** | **1,915** | **247** | **(662)** | **163** | **169** | **1,832** |
| Net book value at 31 March 1998 | 528 | 151 | (286) | 164 | 1,151 | 1,708 |

| | Subsidiary undertakings *(a)* Shares £m | Loans £m | Associates and joint ventures £m | Other participating interests £m | Other investments *(g)* £m | Total £m |
|---|---|---|---|---|---|---|
| **Company** | | | | | | |
| **Cost** | | | | | | |
| Balances at 1 April 1998 | 6,658 | 10 | 32 | 164 | 1,608 | 8,472 |
| Additions | 8,612 | – | 35 | 65 | 26 | 8,738 |
| Disposals | (2,009) | – | – | – | (32) | (2,041) |
| Repayments and other transfers | (875) | – | (10) | (66) | (1,391) | (2,342) |
| Currency movements | – | – | 1 | – | – | 1 |
| **Balances at 31 March 1999** | **12,386** | **10** | **58** | **163** | **211** | **12,828** |
| **Provisions and amounts written off** | | | | | | |
| Balances at 1 April 1998 | (475) | – | (15) | – | (174) | (664) |
| Decrease (increase) in the year | 212 | – | – | – | (33) | 179 |
| Disposals and transfers | – | – | – | – | 28 | 28 |
| **Balances at 31 March 1999** | **(263)** | **–** | **(15)** | **–** | **(179)** | **(457)** |
| **Net book value at 31 March 1999** | **12,123** | **10** | **43** | **163** | **32** | **12,371** |
| Net book value at 31 March 1998 | 6,183 | 10 | 17 | 164 | 1,434 | 7,808 |

**19. Fixed asset investments** (continued)

*(a)* Subsidiary undertakings, associates and joint ventures
Details of the principal operating subsidiary undertakings, joint ventures and associates are set out on pages 102 and 103.

| *(b)* Associates and joint ventures | **1999 £m** | 1998 £m |
|---|---|---|
| Associates: | | |
| Goodwill | **227** | – |
| Share of other net assets | **191** | 143 |
| Total – associates | **418** | 143 |
| Joint ventures: | | |
| Goodwill | **409** | – |
| Loans | **247** | 151 |
| Share of other net assets | **426** | 99 |
| Total – joint ventures | **1,082** | 250 |
| Net book value at 31 March | **1,500** | 393 |

*(c)* MCI Communications Corporation
In September 1994, the company completed the acquisition of a 20% equity interest in MCI (a major carrier of long-distance telecommunications services in the United States) represented by a holding of 136 million unlisted Class A common shares, whereupon MCI became the group's most significant associate. On 3 November 1996, the company entered into a merger agreement with MCI whereby the group would acquire the entire share capital of MCI, not already owned. On 21 August 1997, the terms of the merger agreement were modified. On 1 October 1997, WorldCom announced its intention to offer shares in its company to MCI shareholders as an alternative to the proposed merger and, following an improved offer from WorldCom on 9 November 1997, the company agreed with WorldCom and MCI that it would support the proposed merger of MCI with WorldCom. On 15 September 1998, MCI and WorldCom merged to form MCI WorldCom.

On completion of the merger, the company sold the group's holding of 136 million unlisted Class A common shares in MCI to WorldCom for US$51 per share in cash. The consideration of US$6,936m was equivalent to £4,133m at the exchange rate ruling on 15 September 1998. The group also held 0.7 million listed common shares in MCI, most of which were purchased in November 1995. These shares were exchanged for MCI WorldCom common shares on completion of the merger and subsequently sold in the market for £26m.

As a consequence of the termination of the company's merger agreement with MCI and the company's agreement with WorldCom and MCI, the group ceased treating MCI as an associate on 31 October 1997. The group's share of its associates' results for the year ended 31 March 1998 included a loss before tax of £27m for its share of MCI's results up to that date (1997 – £175m profit).

At 31 March 1998, the group's investment in MCI was stated at £813m. Goodwill, amounting to £2,214m written off to group reserves in prior years in respect of this investment, was accounted for at the completion of the MCI/WorldCom merger in determining the profit on the sale of the shares which the group recognised *(note 6).*

In the period 1 April 1997 to 31 October 1997, the group's turnover with MCI amounted to £108m (1997 – £134m) and in the same period the group purchased £56m (1997 – £87m) in services and products from MCI.

*(d)* Binariang and LG Telecom
On 9 October 1998, the group completed its acquisition of a 33.3% interest in Binariang, a leading Malaysian telecommunications company. And on 14 October 1998, the group completed its acquisition of a 23.5% interest in LG Telecom, a major Korean mobile telecommunications company.

The acquisition of the interests in Binariang and LG Telecom comprised:

| | Binariang £m | LG Telecom £m |
|---|---|---|
| Group share of original book value of net assets | 60 | 98 |
| Fair value adjustment to achieve consistency of accounting policies | (9) | (58) |
| Fair value to the group | 51 | 40 |
| Goodwill | 228 | 194 |
| Total cost | **279** | **234** |

**19. Fixed asset investments** (continued)

*(e)* Airtel Movil SA

Following the clearance in 1998 by the European Commission of the alliance between the company, AirTouch and other investors in Airtel Movil SA, a leading Spanish mobile telecommunications company, the group's 15.8% investment in Airtel was reclassified as a joint venture on 1 April 1998. Airtel is jointly controlled by the company as a consequence of the alliance agreement. During the year ended 31 March 1999, the group acquired an additional 2% interest in Airtel for £55m.

In summary, the acquisition of the cumulative 17.8% interest in Airtel comprised:

| | £m |
|---|---|
| Group share of original book value of net assets | 62 |
| Fair value adjustment to achieve consistency of accounting policies | (19) |
| Fair value to the group | 43 |
| Goodwill | 158 |
| Total cost | **201** |

*(f)* Cegetel
On 24 September 1997, the group completed its acquisition of a 26% interest in Cegetel, a leading French telecommunications company. Of the cost of the investment in the associated undertaking of £1,029m, goodwill arising of £862m has been written off against reserves.

The acquisition of the interest in Cegetel comprised:

| | £m |
|---|---|
| Group share of original book value of net assets | 483 |
| Fair value adjustment to achieve consistency of accounting policies | (316) |
| Fair value to the group | 167 |
| Goodwill | 862 |
| Total cost | **1,029** |

*(g)* Other investments
Other investments include ordinary shares of the company, with a net book value of £18m (1998 – £29m) and a market value of £70m (1998 – £68m), held in trust for the BT Executive Share Plan, the BT Performance Share Plan and the BT Deferred Bonus Plan *(note 31).* Also, in the group balance sheet at 31 March 1999, listed investments were held with a book value of £132m (1998 – £117m) and a market value of £206m (1998 – £154m).

*(h)* Subsidiary company acquisition
In February 1997, the group entered into an agreement to purchase from Banco Santander SA its 50% holding in the share capital of BT Telecomunicaciones SA, a joint venture between a wholly-owned subsidiary of the company and Banco Santander SA, for the equivalent of £76m. The transaction was completed in July 1997.

*(i)* Other related party transactions with associates and joint ventures
In the year ended 31 March 1999, the group's turnover with its other associates and joint ventures amounted to £129m (1998 – £74m, 1997 – £23m) and the group purchased £1m (1998 – £9m, 1997 – £30m) in services and products from these undertakings.

## 20. Debtors

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Trade debtors *(a)* | **2,190** | 1,801 | **1,959** | 1,679 |
| Amounts owed by subsidiary undertakings | **–** | – | **2,294** | 1,649 |
| Amounts owed by joint ventures (trading) | **114** | 56 | **114** | 42 |
| Amounts owed by associates (trading) | **16** | 62 | **8** | 15 |
| Other debtors | **282** | 249 | **278** | 201 |
| Advance corporation tax recoverable *(b)* | **–** | – | **–** | 116 |
| Accrued income | **1,209** | 1,046 | **1,171** | 1,014 |
| Prepayments | **184** | 173 | **152** | 202 |
| Total debtors | **3,995** | 3,387 | **5,976** | 4,918 |
| Total debtors included amounts receivable after more than one year: | | | | |
| Accrued income | **–** | 97 | **–** | 97 |
| Advance corporation tax recoverable *(b)* | **–** | – | **–** | 116 |
| Total | **–** | 97 | **–** | 213 |

*(a)* The group's trade debtors are stated after deducting £262m (1998 – £227m) for doubtful debts. The amount charged to the group profit and loss account for doubtful debts for the year ended 31 March 1999 was £231m (1998 – £218m, 1997 – £188m).

*(b)* Advance corporation tax recoverable

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Advance corporation tax on final dividend *(a)* | **–** | 184 | **–** | 184 |
| Amount offset against deferred tax provision *(note 24)* | **–** | (184) | **–** | (68) |
| Balance included within debtors | **–** | – | **–** | 116 |

*(a)* Advance corporation tax is not paid on dividends that are paid after 5 April 1999.

## 21. Current asset investments

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Listed investments | **359** | 150 | **5** | 5 |
| Other short-term deposits and investments | **2,919** | 581 | **1,892** | 10 |
| Total current asset investments | **3,278** | 731 | **1,897** | 15 |
| Market value of listed investments | **361** | 150 | **5** | 5 |

| 22. Loans and other borrowings | Average effective interest rates *(a)* % | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|---|
| US dollar 9⅜% guaranteed bonds 1998 | 7.1 | **–** | 149 | **–** | – |
| US dollar 9⅜% guaranteed notes 1999 | 9.6 | **–** | 179 | **–** | – |
| US dollar 8¾% guaranteed bonds 1999 | 8.8 | **124** | 119 | **–** | – |
| Zero coupon bonds 2000 | | | | | |
| (less unamortised discount £19m (1998 – £38m)) | 6.9 | **181** | 162 | **181** | 162 |
| US dollar 6¾% notes 2002 | | | | | |
| (less unamortised discount £7m (1997 – £9m)) | 7.1 | **922** | 886 | **922** | 886 |
| 12¼% bonds 2003 | 12.3 | **180** | 180 | **180** | 180 |
| 7⅛% bonds 2003 (less unamortised discount £3m (1998 – £3m)) | 7.3 | **497** | 497 | **497** | 497 |
| 12¼% bonds 2006 | 12.3 | **229** | 229 | **229** | 229 |
| US dollar 7% notes 2007 | | | | | |
| (less unamortised discount £3m (1997 – £3m)) | 7.1 | **617** | 593 | **617** | 593 |
| US dollar 9⅝% guaranteed debentures 2019 *(note 8)* | 9.8 | **–** | 119 | **–** | – |
| 8⅝% bonds 2020 (less unamortised discount £4m (1998 – £5m)) | 8.8 | **296** | 295 | **296** | 295 |
| Total listed bonds, debentures and notes | | **3,046** | 3,408 | **2,922** | 2,842 |
| Lease finance | | **15** | 10 | **2** | 2 |
| Bank loans due 1999-2009 | 9.0 | **789** | 792 | **–** | – |
| Other loans | 6.6 | **111** | 10 | **1** | – |
| Bank overdrafts and other short-term borrowings | 7.3 | **27** | 74 | **794** | 1,237 |
| Commercial paper | 7.1 | **345** | 476 | **345** | 476 |
| Loans from subsidiary undertakings | | **–** | – | **7,475** | 2,851 |
| Total loans and other borrowings | | **4,333** | 4,770 | **11,539** | 7,408 |

Apart from the lease finance and £13m bank overdrafts and other short-term borrowings at 31 March 1999, all borrowings are unsecured. Lease finance is repayable by instalments.

## 22. Loans and other borrowings (continued)

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Repayments fall due as follows: | | | | |
| Within one year, or on demand | **947** | 881 | **7,250** | 3,282 |
| Between one and two years | **13** | 459 | **934** | 432 |
| Between two and three years | **3** | 12 | **0** | 280 |
| Between three and four years | **1,190** | 2 | **1,177** | 1 |
| Between four and five years | **559** | 1,143 | **557** | 1,141 |
| After five years | **1,621** | 2,273 | **1,621** | 2,272 |
| Total due for repayment after more than one year | **3,386** | 3,889 | **4,289** | 4,126 |
| Total loans and other borrowings | **4,333** | 4,770 | **11,539** | 7,408 |

*(a)* Average effective interest rates

The average interest rates on page 79 take into account the effect of interest rate swaps. The interest basis of interest rate swap agreements used, the notional amounts, their average maturities and weighted average interest rates are shown below:

| | Average maturity | Notional amount £m | Average interest receivable rate % | Average interest payable rate % |
|---|---|---|---|---|
| Pay fixed interest and receive variable interest | Over 5 years | 1,006 | 5.3 | 8.4 |
| Pay variable interest and receive fixed interest | Under 5 years | 365 | 9.5 | 5.6 |

The rates of the variable rate portion of the swaps are based on quoted rates. In calculating the average variable rates, the latest rates agreed with the counterparty on each swap have been used. Changes in interest rates will affect the variable rate information disclosed above.

*(b)* Unused committed lines of credit for short-term financing available at 31 March 1999 totalled approximately £150m (1998 – £786m), which was in support of a commercial paper programme or other borrowings. These lines of credit are available for up to one year.

## 23. Other creditors

| | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Trade creditors | **2,344** | 1,971 | **1,739** | 1,550 |
| Amounts owed to subsidiary undertakings | **–** | – | **1,261** | 870 |
| Amounts owed to joint ventures (trading) | **2** | 2 | **–** | – |
| Amounts owed to associates (trading) | **–** | 37 | **–** | – |
| Corporation and windfall taxes | **1,230** | 833 | **867** | 589 |
| Other taxation and social security | **314** | 309 | **323** | 308 |
| Other creditors | **1,133** | 1,056 | **926** | 953 |
| Accrued expenses | **445** | 392 | **351** | 302 |
| Deferred income | **815** | 745 | **742** | 735 |
| Dividends | **799** | 736 | **799** | 736 |
| Total other creditors | **7,082** | 6,081 | **7,008** | 6,043 |

| 24. Provisions for liabilities and charges | Deferred taxation *(a)* £m | Pension provisions £m | Other provisions *(b)* £m | Total £m |
|---|---|---|---|---|
| **Group** | | | | |
| Balances at 1 April 1998 | 274 | 1,224 | 112 | 1,610 |
| Charged (credited) against profit for the year | 76 | 176 | (1) | 251 |
| Utilised in the year | – | (447) | (23) | (470) |
| **Total provisions at 31 March 1999** | **350** | **953** | **88** | **1,391** |
| **Company** | | | | |
| Balances at 1 April 1998 | 68 | 1,224 | 45 | 1,337 |
| Charged against profit for the year | 66 | 164 | – | 230 |
| Utilised in the year | – | (435) | (16) | (451) |
| **Total provisions at 31 March 1999** | **134** | **953** | **29** | **1,116** |

| *(a)* Deferred taxation | Group | | Company | |
|---|---|---|---|---|
| The elements of deferred taxation provided in the accounts at 31 March were as follows: | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Tax effect of timing differences due to: | | | | |
| Excess capital allowances | **696** | 712 | **538** | 598 |
| Pension provisions | **(287)** | (367) | **(287)** | (367) |
| Other | **(59)** | (71) | **(117)** | (163) |
| Total deferred taxation provided | **350** | 274 | **134** | 68 |
| Advance corporation tax recoverable | **–** | (184) | **–** | (68) |
| Total provision for deferred taxation | **350** | 90 | **134** | – |
| The total potential liability to deferred taxation at 31 March was as follows: | | | | |
| Tax effect of timing differences due to: | | | | |
| Excess capital allowances | **2,591** | 2,576 | **2,433** | 2,463 |
| Pension provisions | **(287)** | (367) | **(287)** | (367) |
| Other | **(59)** | (71) | **(117)** | (163) |
| Total | **2,245** | 2,138 | **2,029** | 1,933 |
| Advance corporation tax recoverable | **–** | (184) | **–** | (184) |
| Total potential liability for deferred taxation | **2,245** | 1,954 | **2,029** | 1,749 |

*(b)* Provisions comprise amounts provided for legal or constructive obligations arising from redundancies, insurance claims and litigation.

### 25. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 1999 was £2,625,000,001. At 31 March 1999 it was divided into 10,500,000,004 ordinary shares of 25p each (1998 – 10,500,000,000 ordinary shares and one special rights redeemable preference share of £1). The special rights redeemable preference share was reclassified as four ordinary shares on 15 July 1998.

The allotted, called up and fully paid share capital of the company was £1,617m at 31 March 1999 (1998 – £1,603m), representing 6,469,435,043 ordinary shares (1998 – 6,411,214,670 ordinary shares).

Of the authorised but unissued share capital at 31 March 1999, 243 million ordinary shares were reserved to meet options granted under the employee share option schemes described in *note 31.*

Ordinary shares allotted during the year were as follows:

| | Number | Nominal value £ | Consideration*(a)* £ |
|---|---|---|---|
| Savings related schemes | 45,740,934 | 11,435,233 | 145,915,084 |
| Other share option schemes | 3,698,425 | 924,606 | 13,017,217 |
| Stock purchase plan | 411,918 | 102,980 | 2,301,074 |
| Scrip dividend | 8,369,096 | 2,092,274 | – |
| **Totals for the year ended 31 March 1999** | **58,220,373** | **14,555,093** | **161,233,375** |

*(a)* Consideration excludes contributions from group undertakings as described in *note 26(d).*

During the year ended 31 March 1999 a number of shareholders elected to take all or part of their dividends in shares at a value of £74m. The nominal value of the shares issued has been funded out of the capital redemption reserve and the amount of the dividend has been added back to the profit and loss reserve.

| 26. Reconciliation of movement in shareholders' funds | Share capital £m | Share premium account *(a)* £m | Capital redemption reserve £m | Other reserves £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|---|---|
| **Group** | | | | | | |
| Balances at 31 March 1996 | 1,573 | 531 | 750 | 27 | 9,797 | 12,678 |
| Goodwill, arising on acquisition of subsidiaries, associates and joint ventures *(b)* | – | – | – | – | (199) | (199) |
| Goodwill, previously written off to reserves, taken back to the profit and loss account | – | – | – | – | 5 | 5 |
| Employee share option schemes – 64 million shares issued *(note 31)* | 16 | 144 | – | – | – | 160 |
| Currency movements (including £29 million net gains in respect of foreign currency borrowings) *(c)* | – | – | – | – | (76) | (76) |
| Profit for the financial year | – | – | – | – | 2,077 | 2,077 |
| Dividends (54.85p net per ordinary share) | – | – | – | – | (3,510) | (3,510) |
| Other movements | – | – | – | – | (19) | (19) |
| Balances at 31 March 1997 | 1,589 | 675 | 750 | 27 | 8,075 | 11,116 |
| Goodwill, arising on acquisition of subsidiaries, associates and joint ventures *(b)* | – | – | – | – | (937) | (937) |
| Goodwill, previously written off to reserves, taken back to the profit and loss account | – | – | – | – | 5 | 5 |
| Employee share option schemes – 52 million shares issued *(note 31)* | 13 | 217 | – | – | – | 230 |
| Movement relating to BT's employee share ownership trust *(d)* | – | – | – | – | (85) | (85) |
| Currency movements (including £31 million net gains in respect of foreign currency borrowings) *(c)* | – | – | – | – | (74) | (74) |
| Profit for the financial year | – | – | – | – | 1,702 | 1,702 |
| Dividends (19.0p net per ordinary share) | – | – | – | – | (1,216) | (1,216) |
| Scrip dividend – 4 million shares issued *(note 25)* | 1 | – | (1) | – | 18 | 18 |
| Other movements | – | – | – | – | 26 | 26 |
| Balances at 31 March 1998 | 1,603 | 892 | 749 | 27 | 7,514 | 10,785 |
| Goodwill, previously written off to reserves, taken back to the profit and loss account *(note 6)* | – | – | – | – | 2,214 | 2,214 |
| Employee share option schemes – 50 million shares issued *(d) (note 31)* | 12 | 314 | – | – | – | 326 |
| Movement relating to BT's employee share ownership trust *(d)* | – | – | – | – | (165) | (165) |
| Currency movements (including £22 million net losses in respect of foreign currency borrowings) *(c)* | – | – | – | – | 45 | 45 |
| Profit for the financial year | – | – | – | – | 2,983 | 2,983 |
| Dividends (20.4p net per ordinary share) | – | – | – | – | (1,322) | (1,322) |
| Scrip dividend – 8 million shares issued *(note 25)* | 2 | – | (2) | – | 74 | 74 |
| **Balances at 31 March 1999** | **1,617** | **1,206** | **747** | **27** | **11,343** | **14,940** |

**26. Reconciliation of movement in shareholders' funds** (continued)

| | Share capital £m | Share premium account *(a)* £m | Capital redemption reserve £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|---|
| **Company** | | | | | |
| Balances at 31 March 1996 | 1,573 | 531 | 750 | 11,194 | 14,048 |
| Employee share option schemes – 64 million shares issued *(note 31)* | 16 | 144 | – | – | 160 |
| Profit for the financial year *(e)* | – | – | – | 1,475 | 1,475 |
| Dividends (54.85p net per ordinary share) | – | – | – | (3,510) | (3,510) |
| Currency movements (including £29m net gain in respect of foreign currency borrowings) | – | – | – | (155) | (155) |
| Balances at 31 March 1997 | 1,589 | 675 | 750 | 9,004 | 12,018 |
| Employee share option schemes – 52 million shares issued *(note 31)* | 13 | 217 | – | – | 230 |
| Movement relating to BT's employee share ownership trust *(d)* | – | – | – | (85) | (85) |
| Profit for the financial year *(e)* | – | – | – | 2,146 | 2,146 |
| Dividends (19.0p net per ordinary share) | – | – | – | (1,216) | (1,216) |
| Scrip dividend – 4 million shares issued *(note 25)* | 1 | – | (1) | 18 | 18 |
| Currency movements (including £31m net gain in respect of foreign currency borrowings) | – | – | – | (66) | (66) |
| Balances at 31 March 1998 | 1,603 | 892 | 749 | 9,801 | 13,045 |
| Employee share option schemes – 50 million shares issued *(d) (note 31)* | 12 | 314 | – | – | 326 |
| Movement relating to BT's employee share ownership trust *(d)* | – | – | – | (165) | (165) |
| Profit for the financial year *(e)* | – | – | – | 3,785 | 3,785 |
| Dividends (20.4p net per ordinary share) | – | – | – | (1,322) | (1,322) |
| Scrip dividend – 8 million shares issued *(note 25)* | 2 | – | (2) | 74 | 74 |
| Currency movements | – | – | – | 1 | 1 |
| **Balances at 31 March 1999** | **1,617** | **1,206** | **747** | **12,174** | **15,744** |

*(a)* The share premium account, representing the premium on allotment of shares and the capital redemption reserve is not available for distribution.

*(b)* Aggregate goodwill at 31 March 1999 in respect of acquisitions completed prior to 1 April 1998 of £1,389m (1998 – £3,603m, 1997 – £2,671m) has been written off against retained earnings in accordance with the group's accounting policy. The goodwill written off in the year ended 31 March 1998 mainly arose in connection with the acquisition of the interest in Cegetel; that written off in the year ended 31 March 1997 mainly arose in connection with the acquisition of shares not already owned in BT Telecomunicaciones SA and the acquisition of Syntegra Groep BV. The goodwill written off against retained earnings will be charged in the profit and loss account on the subsequent disposal of the business to which it related.

*(c)* The cumulative foreign currency translation adjustment, which decreased retained earnings at 31 March 1999, was £85m (1998 – £130m decrease, 1997 – £56m decrease).

*(d)* During the year ended 31 March 1999 the company issued shares at a market value of £311m (1998 – £203m) in respect of the exercise of options awarded under its principal savings-related share option scheme. Employees paid £146m (1998 – £118m) to the group for the issue of these shares and the balance of £165m (1998 – £85m) comprised contributions to the qualifying employee share ownership trust from group undertakings.

*(e)* The profit for the financial year, dealt with in the profit and loss account of the company and after taking into account dividends from subsidiary undertakings, was £3,785m (1998 – £2,146m, 1997 – £1,475m). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.

| 27. Financial commitments and contingent liabilities | Group 1999 £m | Group 1998 £m | Company 1999 £m | Company 1998 £m |
|---|---|---|---|---|
| Contracts placed for capital expenditure not provided in the accounts | **1,109** | 1,047 | 1,008 | 965 |
| Operating lease payments payable within one year of the balance sheet date were in respect of leases expiring: | | | | |
| Within one year | **3** | 9 | **1** | 3 |
| Between one and five years | **29** | 39 | **19** | 21 |
| After five years | **116** | 135 | **93** | 94 |
| Total payable within one year | **148** | 183 | **113** | 118 |

Future minimum operating lease payments for the group at 31 March 1999 were as follows:

| Payable in the year ending 31 March: | 1999 £m |
|---|---|
| 2000 | **148** |
| 2001 | **137** |
| 2002 | **130** |
| 2003 | **125** |
| 2004 | **120** |
| Thereafter | **1,238** |
| Total future minimum operating lease payments | **1,898** |

Operating lease commitments were mainly in respect of leases of land and buildings.

At 31 March 1999, there were no contingent liabilities or guarantees other than those arising in the ordinary course of the group's business and on these no material losses are anticipated. The group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations. Otherwise, the group generally carries its own risks.

The company has guaranteed certain borrowings of subsidiary undertakings amounting to £979m (1998 – £1,330m).

In July 1998, the company and AT&T announced the formation of a global venture for the two companies' trans-border telecommunications activities. This venture will be jointly owned. The company will be transferring to it the majority of its cross-border international networks, its international traffic, its business with selected multi-national customers and its international products for business customers, as well as Concert. The formation of the venture is subject to regulatory clearances which are expected to be obtained later in 1999.

Satellite consortia, in which the company has participating interests, are organisations without limited liability. At 31 March 1999, the company's share of the aggregate borrowings of these consortia amounted to £144m (1998 – £188m).

Outstanding at 31 March 1999 and 1998 were warrants entitling the holders to subscribe in 1999 for US dollar 8.765% guaranteed bonds at par, repayable in 2009, to be issued by the group with a total principal value equivalent to £124m (1998 – £119m).

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group.

During the year ended 31 March 1999, all material outstanding US class actions brought by MCI shareholders arising out of the then-proposed merger of the company with MCI and involving claims made against the company and directors of the company who served as directors of MCI were dismissed.

### 28. Pension costs

The total pension cost of the group expensed within staff costs was £176m (1998 – £177m, 1997 – £291m), of which £167m (1998 – £169m, 1997 – £281m) related to the group's main pension scheme, the BT Pension Scheme (BTPS). The reduction in the cost in the years ended 31 March 1998 and 1999 compared with the year ended 31 March 1997 was mainly attributable to the greater than assumed return on the BTPS assets in the three-year period to 31 December 1996, ie between the last two actuarial valuations.

The pension costs for the years ended 31 March 1998 and 31 March 1999 were based on the valuation of the BTPS at 31 December 1996. The pension cost for the year ended 31 March 1997 was based on the valuation of the BTPS at 31 December 1993. The valuations, carried out by professionally qualified independent actuaries, used the projected unit method. The valuations were determined using the following long-term assumptions:

| | Rates (per annum) | |
|---|---|---|
| ` | **1996** | 1993 |
| | **%** | % |
| Return on existing assets, relative to market values | **8.0** | 8.6 |
| Return on future investments | **8.4** | 9.7 |
| Real equity dividend growth | **0.75** | 0.5 |
| Average increase in retail price index | **4.0** | 5.0 |
| Average future increases in wages and salaries | **5.8** | 6.8 |

At 31 December 1996, the assets of the BTPS had a market value of £19,879m and were sufficient to cover 100.3% of the benefits that had accrued to members by that date, after allowing for expected future increases in wages and salaries but not taking into account the costs of providing incremental pension benefits for employees taking early retirement under release schemes since that date. This cost, which amounted to £279m in the year ended 31 March 1999 (1998 – £224m), will be taken into account at the next planned actuarial valuation at 31 December 1999. The incremental pension cost of employees taking early retirement in the year ended 31 March 1997, which amounted to £258m, was included in redundancy costs charged to the profit and loss account in that year.

In the year ended 31 March 1999, the group made regular contributions of £239m (1998 – £238m, 1997 – £232m) and a special contribution of £200m.

Certain activities of the BTPS are carried out at the company's pension centre, all costs of which are borne by the company. These costs have not been apportioned for accounting purposes between those attributable to the BTPS and those attributable to the company because functions maintained for both entities cannot be meaningfully divided between them. The company occupies seven properties owned by the scheme on which an annual rental of £3m is payable.

The BTPS assets are invested in UK and overseas equities, UK and overseas properties, fixed interest and index linked securities, deposits and short-term investments. At 31 March 1999, the UK equities included 46 million (1998 – 42 million) ordinary shares of the company with a market value of £463m (1998 – £270m).

## 29. Directors

### Directors' emoluments

The emoluments of the directors for the year ended 31 March 1999 and the gains made by them on the exercise of share options were, in summary, as follows:

| | **1999 £000** | 1998 £000 | 1997 £000 |
|---|---|---|---|
| Salaries | **1,695** | 1,578 | 1,543 |
| Performance-related bonus | **1,515** | 882 | 636 |
| Deferred bonus in shares | **1,513** | 222 | – |
| Other benefits | **123** | 114 | 94 |
| | **4,846** | 2,796 | 2,273 |
| Payments to non-executive directors *(a)* | **283** | 259 | 273 |
| Total emoluments | **5,129** | 3,055 | 2,546 |
| Gain on the exercise of share options *(b)* | **932** | 857 | 93 |

*(a)* Payments to non-executive directors include fees paid to their principal employer of £9,500 (1998 – £38,000, 1997 – £31,000).

*(b)* The gain for the year ended 31 March 1999 includes £41,000 attributable to a former director.

More detailed information concerning directors' remuneration, shareholdings, pension entitlements, share options and other long-term incentive plans is shown in the report on directors' remuneration on pages 47 to 55.

| **30. People employed** | **1999** Year end '000 | **1999** Average '000 | 1998 Year end '000 | 1998 Average '000 | 1997 Year end '000 | 1997 Average '000 |
|---|---|---|---|---|---|---|
| Number of employees in the group: | | | | | | |
| UK | **118.9** | **119.8** | 120.2 | 124.9 | 123.3 | 125.8 |
| Non-UK | **5.8** | **5.1** | 4.5 | 4.3 | 4.2 | 3.8 |
| Total employees | **124.7** | **124.9** | 124.7 | 129.2 | 127.5 | 129.6 |

## 31. Employee share schemes

The company has a share ownership scheme used for employee share allocations (profit sharing), savings-related share option schemes for its employees and those of participating subsidiaries and further share option schemes for selected group employees. It also has an executive share plan, a performance share plan and a deferred bonus plan.

An employee stock purchase plan was established in 1998 for employees in the United States. Under this plan, employees may purchase American Depositary Shares (ADSs) on a monthly basis at a price equal to the lower of (i) 85% of the average trading price of the ADSs on the New York Stock Exchange on the date on which the purchase rights are granted and, (ii) 85% of the average trading price of the ADSs on the date of purchase. During the year ended 31 March 1999, the discounted price was US$92.20 per ADS and 0.4 million shares were issued under this plan.

### Share option schemes

The major share option scheme, the BT Employee Sharesave Scheme, is savings related and the share options are normally exercisable on completion of a three or five-year Save As You Earn contract. A similar savings related scheme exists for group employees based outside the UK. Under the other share option schemes, share options are normally exercisable between the third and tenth anniversaries of the date of grant. Options outstanding under these share option schemes at 31 March 1998 and 1999, together with their exercise prices and dates, were as follows:

**31. Employee share schemes** (continued)

| Normal dates of exercise | Option price per share | Number of ordinary shares 1999 millions | 1998 millions |
|---|---|---|---|
| Savings-related schemes: | | | |
| 1998 | 320p | **–** | 45 |
| 1999 | 341p | **25** | 27 |
| 1999 | 300p | **7** | 8 |
| 2000 | 404p | **5** | 5 |
| 2000 | 306p | **43** | 47 |
| 2001 | 267p | **64** | 68 |
| 2001 | 583p | **4** | – |
| 2002 | 359p | **50** | 53 |
| 2003 | 518p | **39** | – |
| Other share option schemes: | | | |
| 1993-2009 | 289p to 1053p | **6** | 8 |
| Total options outstanding | | **243** | 261 |

In the period 1 April 1999 to 25 May 1999, no share options were granted, and options over one million shares were exercised or lapsed.

During the year ended 31 March 1999, BT granted options over 46 million shares (1998 – 60 million, 1997 – 79 million) substantially all under the employee sharesave schemes. The weighted average fair value of share options granted during the year ended 31 March 1999 has been estimated on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used in that model: an expected life extending one month later than the first exercise date; estimated annualised dividend yield of approximately 3% (1998 – 5%, 1997 – 5%); risk free interest rates of 7% (1998 – 7%, 1997 – 7%) on options exercisable three years after the date of grant and 7% (1998 – 8%, 1997 – 8%) on options exercisable five years after the date of grant; and expected volatility of approximately 30% (1998 – 18%, 1997 – 18%).

The weighted average fair value of the share options granted in the year ended 31 March 1999 was 313p (1998 – 80p, 1997 – 85p) for options exercisable three years after the date of grant and 309p (1998 – 120p, 1997 – 107p) for options exercisable five years after the date of grant. The total value of share options granted by BT in the year ended 31 March 1999 was £139m (1998 – £70m, 1997 – £83m). In accordance with UK accounting practices, no compensation expense is recognised for the fair value of options granted. See *United States Generally Accepted Accounting Principles – IV Accounting for share options* for the treatment under US GAAP.

Options granted, exercised and lapsed under these share option schemes during the years ended 31 March 1997, 1998 and 1999 and options exercisable at 31 March 1997, 1998 and 1999 were as follows:

| | Savings related schemes millions | Other share option schemes millions | Total millions | Exercise price range | Weighted average exercise price |
|---|---|---|---|---|---|
| Outstanding, 31 March 1996 | 238 | 19 | 257 | 211p–460p | 294p |
| Granted | 79 | – | 79 | 267p–300p | 271p |
| Exercised | (61) | (3) | (64) | 211p–430p | 251p |
| Lapsed | (7) | (2) | (9) | 244p–430p | 299p |
| Outstanding, 31 March 1997 | 249 | 14 | 263 | 243p–460p | 297p |
| Granted | 60 | – | 60 | 359p–596p | 363p |
| Exercised | (46) | (6) | (52) | 243p–430p | 275p |
| Lapsed | (10) | – | (10) | 243p–430p | 313p |
| Outstanding, 31 March 1998 | 253 | 8 | 261 | 262p–596p | 316p |
| Granted | 45 | 1 | 46 | 518p–1053p | 536p |
| Exercised | (46) | (3) | (49) | 262p–583p | 321p |
| Lapsed | (15) | – | (15) | 265p–773p | 328p |
| **Outstanding, 31 March 1999** | **237** | **6** | **243** | **267p–1053p** | **356p** |
| Exercisable, 31 March 1997 | – | 11 | 11 | 243p–460p | 337p |
| Exercisable, 31 March 1998 | – | 7 | 7 | 262p–460p | 362p |
| Exercisable, 31 March 1999 | – | 4 | 4 | 289p–460p | 369p |

**31. Employee share schemes** (continued)

**BT Executive Share Plan, BT Performance Share Plan and BT Deferred Bonus Plan**

The BT Executive Share Plan (ESP), formerly the BT Long Term Remuneration Plan, and the BT Performance Share Plan (PSP) were introduced for employees of the group in 1994 and 1995, respectively. Under the plans, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants. Participants will only be entitled to these shares in full at the end of a five-year period under the ESP and the end of a three-year period, which may be extended to four or five years, under the PSP if, at the end of the applicable period, the company has met the relevant pre-determined corporate performance measure and, normally, if the participants are still employed by the group. Awards of shares were granted in each of the years from 1994 to 1998 under the ESP and from 1995 to 1997 under the first performance cycle of the PSP. Further awards of shares were granted in 1998 under the second three-year performance cycle of the PSP. The corporate performance measure assesses the company's overall performance against those top 100 companies listed on the London Stock Exchange, as rated by the Financial Times (the FT-SE 100 index), at the beginning of the relevant performance period.

The first three-year performance cycle of the PSP ended on 31 July 1998 and on the basis of the corporate measure, the company's Total Shareholder Return compared with the FT-SE 100 companies, 90% of the shares vested on 19 August 1998 in 745 participants and 5.0 million shares were transferred to those participants.

The BT Deferred Bonus Plan (DBP) was established in 1998 and the first awards were granted to employees of the group in July 1998. Under this plan, shares in the company are acquired by an employee share ownership trust and transferred to participants at the end of three years if he or she has continued to be employed by the group throughout that period.

At 31 March 1999, 5.6 million shares in the company (1998 – 4.6 million) were held in trust for the ESP, 0.9 million shares (1998 – 5.8 million) were held in trust for the PSP and 0.4 million shares (1998 – nil) were held in trust for the DBP. Dividends earned on the shares during the conditional periods are reinvested in company shares for the potential benefit of the participants. Additional information relating to the plans is as follows:

| | ESP | | PSP | | DBP | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Value of range of possible future transfers: nil to | **56.1** | 29.5 | **9.2** | 37.9 | **3.8** | – | **69.1** | 67.4 |
| Provision for the costs of the plans charged to the profit and loss account in year | **6.6** | 2.5 | **16.0** | 6.8 | **5.4** | 2.2 | **28.0** | 11.5 |
| Nominal value of shares held in trust | **1.4** | 1.1 | **0.2** | 1.5 | **0.1** | – | **1.7** | 2.6 |
| Market value of shares held in trust | **56.9** | 30.0 | **9.5** | 38.0 | **3.8** | – | **70.2** | 68.0 |

The values of possible future transfers of shares under the plans were based on the company's share price at 31 March 1999 of 1,011p (1998 – 650p). The provisions for the costs of the ESP and PSP were based on best estimates of the company's performance over the plans' conditional periods, relating to those portions of the plan conditional periods from commencement up to the financial year end.

## 32. Auditors

The auditors' remuneration for the year ended 31 March 1999 for the group was £2,491,000 (1998 – £2,396,000, 1997 – £2,135,000), including £1,216,000 (1998 – £1,216,000, 1997 – £1,167,000) for the company.

The following fees were paid or are payable to the company's auditors, PricewaterhouseCoopers, in the UK for the year ended 31 March 1999 (1998 and 1997 – Coopers & Lybrand):

| | **1999 £000** | 1998 £000 | 1997 £000 |
|---|---|---|---|
| Audit of the company's statutory accounts | **1,216** | 1,216 | 1,167 |
| Audits of the UK subsidiary undertakings' statutory accounts | **605** | 510 | 396 |
| Other services, including regulatory audits and tax compliance work *(a)* | **8,855** | 4,724 | 4,620 |
| Total | **10,676** | 6,450 | 6,183 |

*(a)* Fees for the year ended 31 March 1999 comprise work carried out by Coopers & Lybrand and Price Waterhouse in the three months to 30 June 1998 and work carried out by PricewaterhouseCoopers subsequent to that date. Includes fees for regulatory, taxation and global venture-related work of £4,483,000 (1998 – £2,488,000, 1997 – £3,117,000). Fees for other services in the years ended 31 March 1998 and 1997 comprise fees solely to Coopers & Lybrand.

In addition, fees of £6,418,000 were paid or are payable to other international members of Coopers & Lybrand, Price Waterhouse or PricewaterhouseCoopers for the year ended 31 March 1999 in respect of audit and other services to the company's subsidiary undertakings outside the UK and in respect of other services to the group. Fees of £1,283,000 and £865,000 were paid for work carried out by Price Waterhouse inside and outside the UK, respectively, before 1 July 1998.

## 33. Financial instruments and risk management

The group holds or issues financial instruments mainly to finance its operations; for the temporary investment of short-term funds; and to manage the currency and interest rate risks arising from its operations and from its sources of finance. In addition, various financial instruments – for example, trade debtors and trade creditors – arise directly from the group's operations.

The group finances its operations primarily by a mixture of issued share capital, retained profits and long-term loans. Short-term loans, principally by issuing commercial paper, are also used as a cost-effective and liquid source of funds. The group borrows in the major debt markets in major currencies usually at fixed rates of interest. Typically, but not exclusively, the bond markets provide the most cost-effective means of long-term borrowing. The group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates. The derivatives used for this purpose are principally interest rate swaps, currency swaps and forward currency contracts.

The types of financial instrument used for investment of short-term funds are prescribed in group treasury policies with limits on the exposure to any one organisation. Short-term investing in financial instruments is undertaken on behalf of the group by external substantial fund managers who are limited to dealing in debt instruments and are given strict guidelines on credit, diversification and maturity profiles.

Taken as a whole, risks arising from the group's financial instruments are limited. At 31 March 1999 and after taking into account interest rate swaps, the group's borrowings were at fixed rates, fixed for an average period of seven years. This reflects the profile of the capital intensive nature of the group's assets.

The group uses financial instruments to hedge some of its currency exposures arising from its non-UK assets, liabilities and forward purchase commitments. The group also hedges some of its interest liabilities. The financial instruments used comprise borrowings in foreign currencies, forward foreign currency exchange contracts and interest and currency swaps.

There has been no material change in the nature of the risk profile between the year end and the date of these financial statements.

The notional amounts of derivatives summarised below do not necessarily represent amounts exchanged by the parties and, thus, are not necessarily a measure of the exposure of the group through its use of derivatives. The amounts exchanged are calculated on the notional amounts and other terms of the derivatives which relate to interest and exchange rates.

*(a)* Interest rate risk management
The group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and periods for which interest rates on borrowings are fixed. By swapping fixed rates on long-term borrowings into floating rates, the group has obtained lower effective floating-rate borrowings than those available if borrowing directly at a floating rate. Under interest rate swaps, the group agrees with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount.

At 31 March 1999, the group had outstanding interest rate swap agreements having a total notional principal amount of £1,371m (1998 – £1,489m).

**33. Financial instruments and risk management** (continued)

*(b)* Foreign exchange risk management
Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investments, interest expense and purchase and sale commitments denominated in foreign currencies (principally US dollars and the euro). The remaining terms of the currency swaps are up to 15 years and the terms of currency forward exchange contracts are typically less than one year. The purpose of the group's foreign currency hedging activities is to protect the group from the risk that the eventual net inflows and net outflows will be adversely affected by changes in exchange rates.

At 31 March 1999, the group had outstanding foreign currency swap agreements and forward exchange contracts having a total notional principal amount of £5,152m (1998 – £4,476m).

The fair values of forward foreign currency contracts at 31 March 1999 were £3,100m (1998 – £3,037m) for purchases of currency and £1,626m (1998 – £892m) for sales of currency. These fair values have been estimated by calculating their present values using the market discount rates, appropriate to the terms of the contracts, in effect at the balance sheet dates.

At 31 March 1999, the group had deferred unrealised gains of £24m (1998 – £nil) and losses of £29m (1998 – £36m), based on dealer-quoted prices, from hedging purchase and sale commitments. At 31 March 1999, the group also had deferred realised net gains of £1m (1998 – £12m net losses). These are included in the profit and loss account as part of the hedged purchase or sale transaction when it is recognised, or as gains or losses when a hedged transaction is no longer expected to occur.

*(c)* Concentrations of credit risk and credit exposures of financial instruments
The group considers that it is not exposed to major concentrations of credit risk. The group, however, is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not expect any counterparties to fail to meet their obligations. Based on interest and exchange rates in effect at 31 March 1999, the group had a maximum credit exposure of £127m (1998 – £118m) to one counterparty under foreign currency and interest rate swap agreements. The group limits the amount of credit exposure to any one counterparty. The group does not normally see the need to seek collateral or other security.

*(d)* Fair value of financial instruments
The following table shows the carrying amounts and fair values of the group's financial instruments at 31 March 1999 and 1998. The carrying amounts are included in the group balance sheet under the indicated headings, with the exception of derivative amounts related to borrowings, which are included in debtors or other creditors as appropriate. The fair values of the financial instruments are the amount at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

| | Carrying amount | | Fair value | |
|---|---|---|---|---|
| | **1999 £m** | 1998 £m | **1999 £m** | 1998 £m |
| Non-derivatives: | | | | |
| Assets | | | | |
| Cash at bank and in hand | **102** | 62 | **102** | 62 |
| Short-term investments *(i)* | **3,278** | 731 | **3,286** | 731 |
| Liabilities | | | | |
| Short-term borrowings *(ii)* | **372** | 550 | **372** | 550 |
| Long-term borrowings, excluding finance leases *(iii)* | **3,946** | 4,210 | **4,479** | 4,665 |
| Derivatives relating to investments and borrowings (net) *(iv)*: | | | | |
| Assets | **100** | 48 | **–** | – |
| Liabilities | **–** | – | **142** | 114 |

*(i)* The fair values of listed short-term investments were estimated based on quoted market prices for those investments. The carrying amount of the other short-term deposits and investments approximated to their fair values due to the short maturity of the instruments held.

*(ii)* The fair value of short-term borrowings approximated to carrying value due to the short maturity of the instruments.

*(iii)* The fair value of the group's bonds, debentures, notes and other long-term borrowings has been estimated on the basis of quoted market prices for the same or similar issues with the same maturities where they existed, and on calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates, where market prices of similar issues did not exist.

*(iv)* The fair value of the group's outstanding foreign currency and interest rate swap agreements was estimated by calculating the present value, using appropriate discount rates in effect at the balance sheet dates, of affected future cash flows translated, where appropriate, into pounds sterling at the market rates in effect at the balance sheet dates.

### 33. Financial instruments and risk management (continued)

The following information is provided in accordance with the requirements of FRS13 – "Derivatives and other financial instruments: disclosures". As permitted by the FRS, comparative figures are not provided since this is the first accounting period in which the FRS has come into effect. Except for disclosures under *currency exposures* below, the financial information excludes all of the group's short-term debtors and creditors.

*Financial liabilities*

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial liabilities at 31 March 1999 was:

| Currency: | Fixed rate financial liabilities £m | Floating rate financial liabilities £m | Financial liabilities on which no interest is paid £m | Total £m |
|---|---|---|---|---|
| Sterling | 2,395 | 1,592 | – | 3,987 |
| US dollar | 1,662 | (1,654) | – | 8 |
| Euro | 303 | 2 | 24 | 329 |
| Other | – | 9 | – | 9 |
| **Total** | **4,360** | **(51)** | **24** | **4,333** |

For the fixed rate financial liabilities, the average interest rates and the average periods for which the rates are fixed are:

| Currency: | Weighted average interest rate % | Weighted average period for which rate is fixed Years |
|---|---|---|
| Sterling | 9.5 | 9 |
| US dollar | 7.2 | 5 |
| Euro | 5.6 | 8 |
| **Total** | **8.4** | **7** |

The floating rate financial liabilities bear interest at rates fixed in advance for periods ranging from one day to six months by reference to LIBOR. The financial liabilities on which no interest is paid are due to mature within two months of the balance sheet date.

The maturity profile of financial liabilities is as given in *note 22.*

*Financial assets*

After taking into account the various interest rate swaps and forward foreign currency contracts entered into by the group, the interest rate profile of the group's financial assets at 31 March 1999 was:

| Currency: | Fixed rate financial assets £m | Floating rate financial assets £m | Total £m |
|---|---|---|---|
| Sterling | 273 | 2,651 | 2,924 |
| US dollar | – | 369 | 369 |
| Euro | – | 57 | 57 |
| Other | – | 30 | 30 |
| **Total** | **273** | **3,107** | **3,380** |

The sterling fixed rate financial assets yield interest at a weighted average of 5.5% for a weighted average period of 15 months.

The floating rate financial assets bear interest at rates fixed in advance for periods up to one year by reference to LIBOR.

**33. Financial instruments and risk management** (continued)

*Currency exposures*

The table below shows the group's currency exposures in terms of those transactional exposures that give rise to currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the group that are not denominated in the operating (or "functional") currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in non-UK operations. As at 31 March 1999, these exposures were as follows:

| | Net foreign currency monetary assets (liabilities) | | | | |
|---|---|---|---|---|---|
| Functional currency of group operation: | Sterling £m | US dollar £m | Euro £m | Other £m | Total £m |
| Sterling | – | 517 | 38 | 25 | 580 |
| Euro | (6) | – | – | (18) | (24) |
| Other | (16) | 5 | – | – | (11) |
| | **(22)** | **522** | **38** | **7** | **545** |

The amounts shown in the table above take into account the effect of any currency swaps, forward contracts and other derivatives entered into to manage those currency exposures.

As at 31 March 1999, the group also held various forward currency contracts that the group had taken out to hedge expected future foreign currency purchases and sales.

*Fair values of financial assets held for trading*

| | **£m** |
|---|---|
| Net gain included in profit and loss account | **104** |
| Fair value of financial assets held for trading at 31 March 1999 | **1,944** |

The net gain was derived from government bonds, commercial paper and similar debt instruments.

*Hedges*

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging and those recognised in the year ended 31 March 1999 are as follows:

| | **Gains £m** | **Losses £m** |
|---|---|---|
| Gains and losses: | | |
| recognised in the year but arising in previous years *(a)* | **28** | **26** |
| unrecognised at 31 March 1999 | **38** | **279** |
| carried forward in the balance sheet at 31 March 1999, pending recognition in the profit and loss account *(a)* | **45** | **38** |
| expected to be recognised in the year ended 31 March 2000 *(a)* | **27** | **26** |

*(a)* Excluding gains and losses on hedges accounted for by adjusting the carrying amount of a fixed asset.

**34. Effect of accounting policy changes**

In accordance with the Companies Act, the following disclosure is given on the effect of the changes in accounting policy on the group's profit for the year ended 31 March 1999.

| | £m |
|---|---|
| Profit for the financial year, as reported | 2,983 |
| Effect of capitalising and amortising goodwill on acquisitions on or after 1 April 1998 | 17 |
| Effect of capitalising computer software on non-network systems (net of £33m tax) | (73) |
| Profit for the financial year under the previous accounting policies | 2,927 |

**35. Segmental analysis**

The following information is provided as required by the US accounting standard, SFAS No. 131, on disclosures about segments of an enterprise. The information presented is required to be based on the segmental operating results regularly reviewed by the group's chief operating decision maker (the CEO).

The group is a unitary business providing an integrated range of services and is managed on this basis. For the purposes of exercising day-to-day managerial and budgetary control, the business is divided internally into divisions but these divisions are not self-standing businesses. Control is exercised by comparing performance against budgets agreed in advance. The CEO reviews the turnover and operating results for each main division. The group's capital expenditure programmes are largely centrally driven and are not necessarily linked to individual divisions. For this reason it is group policy not to allocate certain assets to individual divisions, although depreciation charges are allocated.

Since September 1997, the group has been organised into two main divisions BT UK and BT Worldwide (formerly named BT Global and Global Communications) in order to reflect the group's two distinctive geographical operating regions and customer groups. Substantially all of the group's operations are within the UK and, of those, the majority of which are currently managed by BT UK. BT UK is subdivided into several operating sub-divisions, the principal three during the 12 months to 30 September 1998 being the Business and Consumer Divisions providing the customer facing links for the fixed network and Networks & Systems providing the UK fixed network as a platform for the selling divisions' services. From 1 October 1998, BT UK has been progressively reorganised into ten separate business units, the majority of which may not meet the requirements of an "operating segment" as defined in SFAS No. 131. During the year ending 31 March 2000, a new division will be formed to integrate the group's solutions business.

Prior to 30 September 1998, the Consumer Division provided fixed network telecommunication services for residential customers, principally the provision of exchange lines to customers' homes and calls to and from those homes. The Business Division provided fixed network services to businesses and organisations other than multinational companies, principally the provision of exchange lines, private circuits and calls to and from the places of business and customer premises equipment. The Networks and Systems Division built, maintained and operated the company's fixed telecommunications network in the UK. Other units within BT UK provided the group's mobile telecommunication services, classified advertising directories and outsourcing services.

BT Worldwide provided telecommunication services to multinational companies, including those based in the UK, and international incoming, outgoing and transit telecommunication services. It was responsible for managing Concert Communications and the group's other non-UK operations, and investments in non-UK joint ventures and associates.

In the year ended 31 March 1997 and until 30 September 1997, the group was organised into the following divisions: three customer facing divisions, Global Communications, National Business Communications and Personal Communications; the Networks & Systems operating division; and a number of other support units. These divisions broadly equated to the BT Global Division, Business Division, Consumer Division and Networks and Systems Division described above. Mobile Communications were reported separately.

The following information for the years ended 31 March 1998 and 1999 is based on the divisional organisation of the group at 1 April 1998, described above. As already noted, the BT UK organisation was changed progressively from 1 October 1998 into a substantially different form and financial information in its new form is being made available to the senior management of the group with respect to accounting periods from 1 April 1999. It has not been practicable to restate the segment information for the year ended 31 March 1997 onto the segment basis presented for the following two years.

**35. Segmental analysis** (continued)

| YEAR ENDED 31 MARCH 1999 | Turnover External £m | Turnover Internal £m | Depreciation and amortisation £m | Operating profit (loss) of associates and joint ventures £m | Total operating profit (loss) £m |
|---|---|---|---|---|---|
| Business Division | 5,624 | 294 | 106 | – | 1,535 |
| Consumer Division | 6,168 | 140 | 113 | (7) | 1,998 |
| Networks & Systems | 108 | – | 1,716 | (3) | 96 |
| Other, including Mobile Communications | 2,682 | 2,189 | 321 | (32) | 96 |
| Eliminations | – | (2,351) | – | – | – |
| **Total BT UK** | **14,582** | **272** | **2,256** | **(42)** | **3,725** |
| BT Worldwide | 2,361 | 984 | 145 | (292) | (327) |
| Other | 10 | 847 | 180 | (8) | 76 |
| Eliminations | – | (2,103) | – | – | – |
| **Group totals** | **16,953** | **–** | **2,581** | **(342)** | **3,474** |
| YEAR ENDED 31 MARCH 1998 | | | | | |
| Business Division | 5,611 | 419 | 121 | – | 1,447 |
| Consumer Division | 5,885 | 101 | 127 | – | 1,438 |
| Networks & Systems | 148 | – | 1,720 | (2) | 61 |
| Other, including Mobile Communications | 1,661 | 1,759 | 251 | (5) | 271 |
| Eliminations | – | (878) | – | – | – |
| **Total BT UK** | **13,305** | **1,401** | **2,219** | **(7)** | **3,217** |
| Global Communications | 2,262 | 150 | 70 | (217) | (105) |
| Other | 73 | 1,029 | 106 | 28 | 349 |
| Eliminations | – | (2,580) | – | – | – |
| **Group totals** | **15,640** | **–** | **2,395** | **(196)** | **3,461** |
| YEAR ENDED 31 MARCH 1997 | | | | | |
| National Business Communications | 5,129 | 185 | 98 | – | 1,475 |
| Personal Communications | 5,644 | 31 | 106 | – | 1,449 |
| Global Communications | 2,995 | 165 | 107 | (30) | 380 |
| Networks & Systems | 143 | – | 1,609 | (3) | 79 |
| Other, including Mobile Communications | 1,024 | 642 | 345 | 217 | 46 |
| Eliminations | – | (1,023) | – | – | – |
| **Group totals** | **14,935** | **–** | **2,265** | **184** | **3,429** |

Transactions between divisions are at prices set in accordance with those agreed with Oftel where the services provided are subject to regulation. Other transactions are at arms length. Internal supplies of services from Networks & Systems are accounted for by that division as negative costs.

**35. Segmental analysis** (continued)

Information about geographic areas:

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Turnover with external customers: | | | |
| Attributable to UK | **15,612** | 14,384 | 13,743 |
| Attributable to non-UK countries *(a)* | **1,341** | 1,256 | 1,192 |
| **Group turnover** | **16,953** | 15,640 | 14,935 |

*(a)* Turnover attributable to non-UK countries comprises the external turnover of group companies and branches operating outside the UK, income from non-UK operators for calls terminating in or in transit through the UK and turnover with non-UK joint ventures and associates.

| | **1999 £m** | 1998 £m |
|---|---|---|
| Group fixed assets are located: | | |
| In the UK | **18,247** | 17,115 |
| Outside the UK | **2,181** | 1,845 |
| **Total** | **20,428** | 18,960 |

# *United States Generally Accepted Accounting Principles*

The group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the UK (UK GAAP), which differ in certain significant respects from those applicable in the US (US GAAP).

**I Differences between United Kingdom and United States generally accepted accounting principles**
The following are the main differences between UK and US GAAP which are relevant to the group's financial statements.

**(a) Pension costs**
Under UK GAAP, pension costs are accounted for in accordance with UK Statement of Standard Accounting Practice No. 24, costs being charged against profits over employees' working lives. Under US GAAP, pension costs are determined in accordance with the requirements of US Statements of Financial Accounting Standards (SFAS) Nos. 87 and 88. Differences between the UK and US GAAP figures arise from the requirement to use different actuarial methods and assumptions and a different method of amortising surpluses or deficits.

**(b) Accounting for redundancies**
Under UK GAAP, the cost of providing incremental pension benefits in respect of workforce reductions is taken into account when determining current and future pension costs, unless the most recent actuarial valuation under UK actuarial conventions shows a deficit. In this case, the cost of providing incremental pension benefits is included in redundancy charges in the year in which the employees agree to leave the group.

Under US GAAP, the associated costs of providing incremental pension benefits are charged against profits in the period in which the termination terms are agreed with the employees.

**(c) Capitalisation of interest**
Under UK GAAP, the group does not capitalise interest in its financial statements. To comply with US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in fixed assets, and depreciated over the lives of the related assets. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 1999 under US GAAP, gross capitalised interest of £499m (1998 – £525m) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of 2 to 25 years.

**(d) Goodwill**
Under UK GAAP, in respect of acquisitions completed prior to 1 April 1998, the group wrote off goodwill arising from the purchase of subsidiary undertakings, associates and joint ventures on acquisition against retained earnings. The goodwill is reflected in the net income of the period of disposal, as part of the calculation of the gain or loss on divestment. Under US GAAP, such goodwill is held as an intangible asset in the balance sheet and amortised over its useful life and only the unamortised portion is included in the gain or loss recognised at the time of divestment. Gross goodwill under US GAAP at 31 March 1999 of £1,957m (1998 – £925m) was subject to amortisation over periods of 3 to 20 years. Goodwill relating to MCI was unchanged for the period from 31 October 1997 when the investment ceased to have associated company status until disposal on 15 September 1998. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred. Under UK GAAP, goodwill arising on acquisitions completed on or after 1 April 1998 is generally accounted for in line with US GAAP.

**(e) Mobile cellular telephone licences, software and other intangible assets**
Certain intangible fixed assets recognised under US GAAP purchase accounting requirements are subsumed within goodwill under UK GAAP. Under US GAAP these separately identified intangible assets are valued and amortised over their useful lives.

**(f) Investments**
Under UK GAAP, investments are held on the balance sheet at historical cost. Under US GAAP, trading securities and available-for-sale securities are carried at market value with appropriate valuation adjustments recorded in profit and loss and shareholder's equity, respectively. The net unrealised holding gain on available-for-sale securities for the year ended 31 March 1999 was £76m (1998 – £1,315m relating primarily to the investment in MCI, 1997 – £nil).

**(g) Deferred taxation**
Under UK GAAP, provision for deferred taxation is generally only made for timing differences which are expected to reverse. Under US GAAP, deferred taxation is provided on a full liability basis on all temporary differences, as defined in SFAS No. 109.

At 31 March 1999, the adjustment of £1,424m (1998 – £2,095m) reconciling ordinary shareholders' equity under UK GAAP to the approximate amount under US GAAP included the tax effect of other US GAAP adjustments. This comprised an adjustment increasing non-current assets by £59m (1998 – £76m decrease); an adjustment increasing current assets by £50m (1998 – £68m increase); £nil adjustment (1998 – £184m decrease) to current liabilities; an adjustment decreasing minority interests by £11m (1998 – £3m decrease) and an adjustment increasing long-term liabilities by £1,544m (1998 – £2,274m increase).

**(h) Dividends**

Under UK GAAP, dividends are recorded in the year in respect of which they are declared (in the case of interim or any special dividends) or proposed by the board of directors to the shareholders (in the case of final dividends). Under US GAAP, dividends are recorded in the period in which dividends are declared.

**II Net income and shareholders' equity reconciliation statements**

The following statements summarise the material estimated adjustments, gross of their tax effect, which reconcile net income and shareholders' equity from that reported under UK GAAP to that which would have been reported had US GAAP been applied.

**Net income**

| YEAR ENDED 31 MARCH | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Net income applicable to shareholders under UK GAAP | **2,983** | 1,702 | 2,077 |
| Adjustments for: | | | |
| Pension costs | **(104)** | (66) | 83 |
| Redundancy charges | **(284)** | (253) | 156 |
| Capitalisation of interest, net of related depreciation *(a)* | **(19)** | (38) | (23) |
| Goodwill amortisation *(a)* | **85** | (71) | (73) |
| Mobile licences, software and other intangible asset capitalisation and amortisation, net *(a)* | **(226)** | 42 | 77 |
| Investments | **(6)** | 5 | – |
| Deferred taxation *(a)* | **220** | 163 | (148) |
| Other items *(a)* | **(60)** | (37) | – |
| Net income as adjusted for US GAAP | **2,589** | 1,447 | 2,149 |
| Basic earnings per American Depositary Share as adjusted for US GAAP *(b)* | **£4.02** | £2.27 | £3.39 |
| Diluted earnings per American Depositary Share as adjusted for US GAAP *(b)* | **£3.93** | £2.23 | £3.36 |

**Shareholders' equity**

| AT 31 MARCH | **1999 £m** | 1998 £m |
|---|---|---|
| Shareholders' equity under UK GAAP | **14,940** | 10,785 |
| Adjustments for: | | |
| Pension costs | **(1,730)** | (1,347) |
| Redundancy costs | **(46)** | (41) |
| Capitalisation of interest, net of related depreciation | **245** | 299 |
| Goodwill, net of accumulated amortisation | **293** | 2,118 |
| Mobile licences, software and other intangible asset capitalisation and amortisation | **628** | 930 |
| Investments | **5** | 1,266 |
| Deferred taxation | **(1,424)** | (2,095) |
| Dividend declared after the financial year end | **799** | 736 |
| Other items | **(36)** | (36) |
| Shareholders' equity as adjusted for US GAAP | **13,674** | 12,615 |

*(a)* The disposal of the group's interest in MCI shares during the year ended 31 March 1999 gave rise to adjustments; increasing net income by £163m relating to goodwill and £95m relating to deferred taxation and decreasing net income by £197m relating to software and other intangible assets, £60m relating to foreign exchange translation differences and £5m relating to the capitalisation of interest.

*(b)* Each American Depositary Share is equivalent to 10 ordinary shares of 25p each.

**III Minority Interests**

Under US GAAP, the minority interest charge would have been reduced by £12m (1998 – £5m, 1997 – £nil) after adjusting for goodwill amortisation and accounting for associates and joint ventures. Net assets attributable to minority interests would have been £88m higher (1998 – £81m higher) after adjusting for goodwill, investments and other items.

**IV Accounting for share options**

Under UK GAAP, the company does not recognise compensation expense for the fair value, at the date of grant, of share options granted under the employee share option schemes. Under US GAAP, the company adopted the disclosure-only option in SFAS No. 123 "Accounting for Stock-Based Compensation" in the year ended 31 March 1997. Accordingly, the company accounts for share options in accordance with APB Opinion No. 25 "Accounting for Stock Issued to Employees", under which no compensation expense is recognised. Had the group expensed compensation cost for options granted in accordance with SFAS No. 123, the group's pro forma net income, basic earnings per share and diluted earnings per share under US GAAP would have been £2,560m (1998 – £1,432m, 1997 – £2,126m), 39.7p (1998 – 22.4p, 1997 – 33.6p) and 38.8p (1998 – 22.1p, 1997 – 33.2p), respectively. The SFAS No. 123 method of accounting does not apply to share options granted before 1 January 1995, and accordingly, the resulting pro forma compensation costs may not be representative of that to be expected in future years. See note 31 for the SFAS No. 123 disclosures of the fair value of options granted under employee schemes at date of grant.

**V Consolidated statements of cash flows**

Under UK GAAP, the Consolidated Statements of Cash Flows are presented in accordance with UK Financial Reporting Standard No. 1 (FRS 1). The statements prepared under FRS 1 present substantially the same information as that required under SFAS No. 95.

Under SFAS No. 95 cash and cash equivalents include cash and short-term investments with original maturities of three months or less. Under FRS 1 cash comprises cash in hand and at bank and overnight deposits, net of bank overdrafts.

Under FRS 1, cash flows are presented for operating activities; returns on investments and servicing of finance; taxation; capital expenditure and financial investments; acquisitions and disposals; dividends paid to the company's shareholders; management of liquid resources and financing. SFAS No. 95 requires a classification of cash flows as resulting from operating, investing and financing activities.

Cash flows under FRS 1 in respect of interest received, interest paid (net of that capitalised under US GAAP) and taxation would be included within operating activities under SFAS No. 95. Cash flows from purchases, sales and maturities of trading securities, while not separately identified under UK GAAP, would be included within operating activities under US GAAP. Capitalised interest, while not recognised under UK GAAP, would be included in investing activities under US GAAP. Dividends paid would be included within financing activities under US GAAP.

The following statements summarise the statements of cash flows as if they had been presented in accordance with US GAAP, and include the adjustments which reconcile cash and cash equivalents under US GAAP to cash at bank and in hand reported under UK GAAP.

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Net cash provided by operating activities | **3,876** | 3,847 | 5,066 |
| Net cash used in investing activities | **(950)** | (4,198) | (2,589) |
| Net cash used in financing activities | **(1,665)** | (1,647) | (1,517) |
| Net increase (decrease) in cash and cash equivalents | **1,261** | (1,998) | 960 |
| Effect of exchange rate changes on cash | **33** | 21 | (14) |
| Cash and cash equivalents under US GAAP at beginning of year | **366** | 2,343 | 1,397 |
| Cash and cash equivalents under US GAAP at end of year | **1,660** | 366 | 2,343 |
| Short-term investments with original maturities of less than 3 months | **(1,558)** | (304) | (2,317) |
| Cash at bank and in hand under UK GAAP at end of year | **102** | 62 | 26 |

**VI Current asset investments**

Under US GAAP, investments in debt securities would be classified as either trading, available-for-sale or held-to-maturity. Trading investments would be stated at fair values and the unrealised gains and losses would be included in income. Securities classified as available-for-sale would be stated at fair values, with unrealised gains and losses, net of deferred taxes, reported in shareholders' equity. Debt securities classified as held-to-maturity would be stated at amortised cost. The following analyses do not include securities with original maturities of less than three months.

At 31 March 1999, the group held trading investments (as defined by US GAAP) at a carrying amount of £1,678m (1998 – £384m) with fair values totalling £1,678m (1998 – £389m). Held-to-maturity securities at 31 March 1998 and 1999 consisted of the following:

| | Amortised cost £m | Estimated fair value £m |
|---|---|---|
| UK Government securities and other UK listed investments | 25 | 25 |
| Commercial paper, medium term notes and other investments | 18 | 18 |
| **Total at 31 March 1999** | **43** | **43** |
| UK Government securities and other UK listed investments | 25 | 25 |
| Commercial paper, medium term notes and other investments | 18 | 18 |
| Total at 31 March 1998 | 43 | 43 |

| The contractual maturities of the held-to-maturity debt securities at 31 March 1999 were as follows: | Cost £m | Fair value £m |
|---|---|---|
| Maturing on or before 31 March 2000 | 30 | 30 |
| Maturing after 31 March 2000 | 13 | 13 |
| **Total at 31 March 1999** | **43** | **43** |

**VII Pension costs**

The following position for the main pension scheme is computed in accordance with US GAAP pension accounting rules under SFAS No. 87 and SFAS No. 88, the effect of which is shown in the above reconciliation statements.

The pension cost determined under SFAS No. 87 was calculated by reference to an expected long-term rate of return on scheme assets of 7.7% (1998 – 8.2%, 1997 – 9.2%). The components of the pension cost for the main pension scheme comprised:

| | **1999 £m** | 1998 £m | 1997 £m |
|---|---|---|---|
| Service cost | **387** | 327 | 268 |
| Interest cost | **1,653** | 1,554 | 1,645 |
| Expected return on scheme assets | **(1,712)** | (1,595) | (1,668) |
| Amortisation of prior service costs | **24** | 24 | 24 |
| Amortisation of net obligation at date of limited application of SFAS No. 87 | **52** | 52 | 52 |
| Recognised gains | **(137)** | (129) | (123) |
| Additional cost of termination benefits | **279** | 224 | 258 |
| Pension cost for the year under US GAAP | **546** | 457 | 456 |

**VII Pension costs** (continued)

The information required to be disclosed in accordance with SFAS No. 132 concerning the funded status of the main scheme at 31 March 1998 and 31 March 1999, based on the valuations at 1 January 1998 and 1 January 1999, respectively, is given below.

| **Changes in benefit obligation** | **1999 £m** | 1998 £m |
|---|---|---|
| Benefit obligation at the beginning of the year | **23,513** | 20,733 |
| Service cost | **387** | 327 |
| Interest cost | **1,653** | 1,554 |
| Employees' contributions | **163** | 157 |
| Additional cost of termination benefits | **279** | 224 |
| Actuarial movement *(a)* | **2,361** | 1,618 |
| Other changes | **25** | 7 |
| Benefits paid | **(1,223)** | (1,107) |
| Benefit obligation at the end of the year | **27,158** | 23,513 |
| **Changes in scheme assets** | | |
| Fair value of scheme assets at the beginning of the year | **22,666** | 19,879 |
| Actual return on scheme assets | **3,050** | 3,494 |
| Employers' contributions *(b)* | **439** | 236 |
| Employees' contributions | **163** | 157 |
| Other changes | **25** | 7 |
| Benefits paid | **(1,223)** | (1,107) |
| Fair value of scheme assets at the end of the year | **25,120** | 22,666 |
| **Funded status under US GAAP** | | |
| Projected benefit obligation in excess of scheme assets | **(2,038)** | (847) |
| Unrecognised net obligation at date of initial application of SFAS No. 87 *(c)* | **210** | 262 |
| Unrecognised prior service costs *(d)* | **199** | 223 |
| Other unrecognised net actuarial gains | **(1,039)** | (2,199) |
| Accrued pension cost under US GAAP | **(2,668)** | (2,561) |

*(a)* The actuarial movements in the years ended 31 March 1998 and 1999 are significant due to the decline in the discount rates used to calculate the benefit obligation as a result of the fall in long-term interest rates in 1997 and 1998.

*(b)* The employers' contributions for the year ended 31 March 1999 include a special contribution of £200m paid on 31 March 1999.

*(c)* The unrecognised net obligation at the date of initial application is being amortised over 15 years from 1 April 1988.

*(d)* Unrecognised prior service costs on scheme benefit improvements, are being amortised over periods of 15 or 16 years commencing in the years of the introduction of the improvements.

The benefit obligation for the main pension scheme was determined using the following assumptions at 1 January 1998 and 1 January 1999:

| | **1999 per annum %** | 1998 per annum % |
|---|---|---|
| Discount rate | **5.5** | 7.2 |
| Rate of future pay increases | **4.8** | 5.8 |

The determination also took into account requirements in the scheme as to future pension increases.

# *Subsidiary undertakings, joint ventures and associates*

Brief details of principal operating subsidiary undertakings, joint ventures and associates at 31 March 1999, all of which were unlisted unless otherwise stated, were as follows:

| **Subsidiary undertakings** | Activity | Group interest in allotted capital *(b)* | Country of operations *(c)* |
|---|---|---|---|
| BT Australasia Pty Limited *(a)* | Communication related services and products provider | 100% ordinary<br>100% preference | Australia |
| BT Cableships Limited *(a)* | Cableship owner | 100% ordinary | International |
| BT Communications Management Limited *(a)* | Telecommunication services provider | 100% ordinary | International |
| BT Communications Services KK *(a)* | Communication related services and products provider | 70% ordinary | Japan |
| BT (Hong Kong) Limited *(a)* | Communication related services and products provider | 100% ordinary<br>100% preference | Hong Kong |
| BT Network Information Services Company Limited *(a)* | Communication related services and products provider | 70% ordinary effective interest | Japan |
| BT North America Inc *(a)* | Communication related services and products provider | 100% common | USA |
| BT Property Limited *(a)* | Property holding company | 100% ordinary | United Kingdom |
| BT Subsea Cables Limited | Cable maintenance and repair | 100% ordinary | United Kingdom |
| BT Telecomunicaciones SA *(a)* | Communication related services and products provider | 100% ordinary | Spain |
| BT (Worldwide) Limited *(a)* | International telecommunication network systems provider | 100% ordinary | International |
| Cellnet Group Limited | Holding company for the BT Cellnet group *(d)* | 60% ordinary | United Kingdom |
| Concert Communications Company *(a)* | Telecommunication services and network systems provider | 100% ordinary | International |
| Farland BV *(a) (c)* | Provider of trans-border fibre network across BT's partners in Europe | 100% ordinary | International |
| Manx Telecom Limited *(a)* | Telecommunication services supplier | 100% ordinary | Isle of Man |
| Martin Dawes Telecommunications Limited *(a) (e)* | Cellular telecommunication services provider | 48% ordinary effective interest | United Kingdom |
| Syntegra SA *(a)* | Systems integration and application development | 100% ordinary | France |
| Syntegra Groep BV *(a)* | Systems integration and application development | 100% common | Netherlands |
| Telecom Securicor Cellular Radio Limited *(a)* | Mobile cellular telephone system provider and operator | 60% ordinary | United Kingdom |
| Yellow Pages Sales Limited *(a)* | Yellow Pages sales contractor | 100% ordinary | United Kingdom |

*(a)* Held through intermediate holding company.

*(b)* The proportion of voting rights held corresponds to the aggregate interest percentage held by the holding company and subsidiary undertakings, unless otherwise stated.

*(c)* All overseas undertakings are incorporated in their country of operations. Subsidiary undertakings operating internationally are all incorporated in England and Wales, except Farland BV, which is incorporated in the Netherlands.

*(d)* In May 1999, Cellnet was rebranded BT Cellnet.

*(e)* Held by Telecom Securior Cellular Radio Limited.

| | | Share capital | | |
|---|---|---|---|---|
| **Joint ventures** | Activity | Issued *(a)* | Percentage owned | Country of operations *(b)* |
| Airtel Movil SA *(c)* | Mobile cellular telephone system provider and operator | Ptas 78 billion | 17.8% | Spain |
| Albacom SpA | Communication related services and products provider | ITL 343.4 billion | 23% | Italy |
| Bharti Cellular Limited | Mobile cellular telephone system provider and operator | Rs1.05 billion | 39.5% | India |
| British Interactive Broadcasting Limited | Digital tv interactive service provider | £0.1m | 32.5% | United Kingdom |
| Clear Communications Limited | Communication related services and products provider | NZ$102m | 25% | New Zealand |
| LG Telecom Limited | Mobile cellular telephone system provider and operator | Won 653.5 billion | 23.5% | Republic of Korea |
| Springboard Internet Services Limited | Internet service provider | £8.3m | 33% | United Kingdom |
| Sunrise Communications AG | Communication related services and products provider | SFr 19.7m | 24.4% | Switzerland |
| Telenordia AB | Communication related services and products provider | SKr104m | 33.3% | Sweden |
| Telfort BV | Communication related services and products provider | NLG 0.5m | 50% | Netherlands |
| VIAG INTERKOM GmbH & Co | Communication related services and products provider | Partnership | 45% | Germany |

*(a)* Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments, except Sunrise Communications AG, are held through intermediate holding companies.

*(b)* All overseas undertakings are incorporated in their country of operations.

*(c)* Airtel Movil SA is being accounted for as a joint venture because of the relationship with other shareholders.

| | | Share capital | | |
|---|---|---|---|---|
| **Associates** | Activity | Issued *(a)* | Percentage owned | Country of operations *(b)* |
| Binariang Berhad *(c)* | Communication related services and products provider | Myr 157.9m | 33.3% | Malaysia |
| Cegetel SA | Communication related services and products provider | FFr9.55 billion | 26% | France |
| The Link Stores Limited | Telecommunications equipment retailer | £80 | 40% | United Kingdom |

*(a)* Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments are held through intermediate holding companies.

*(b)* All overseas undertakings are incorporated in their country of operations.

*(c)* Certain exchange control constraints operate in Malaysia.

# *Quarterly analysis of turnover and profit*

(UNAUDITED) YEAR ENDED 31 MARCH 1999

| Quarters | 1st £m | 2nd £m | 3rd £m | 4th £m | **Total £m** |
|---|---|---|---|---|---|
| Total turnover – ongoing activities | 4,239 | 4,403 | 4,684 | 4,897 | **18,223** |
| Group's share of associates' and joint ventures' turnover | (196) | (246) | (410) | (418) | **(1,270)** |
| Group turnover – ongoing activities | 4,043 | 4,157 | 4,274 | 4,479 | **16,953** |
| Other operating income | 37 | 34 | 31 | 66 | **168** |
| Group operating profit – ongoing activities | 898 | 913 | 1,012 | 993 | **3,816** |
| Group's share of operating loss of associates and joint ventures | (78) | (56) | (101) | (107) | **(342)** |
| Total operating profit – ongoing activities | 820 | 857 | 911 | 886 | **3,474** |
| Profit on sale of fixed asset investments and group undertakings *(a)* | – | 1,107 | – | – | **1,107** |
| Net interest payable | (97) | (86) | (53) | (50) | **(286)** |
| Profit on ordinary activities before taxation | 723 | 1,878 | 858 | 836 | **4,295** |
| Tax on profit on ordinary activities: | | | | | |
| Corporation and similar taxes | (224) | (544) | (266) | (259) | **(1,293)** |
| Profit on ordinary activities after taxation | 499 | 1,334 | 592 | 577 | **3,002** |
| Minority interests | (13) | – | 3 | (9) | **(19)** |
| Profit for the financial period | 486 | 1,334 | 595 | 568 | **2,983** |
| Basic earnings per share | 7.6p | 20.7p | 9.2p | 8.8p | **46.3p** |
| Basic earnings per share before exceptional items | 7.6p | 8.7p | 9.3p | 9.1p | **34.7p** |
| Diluted earnings per share | 7.4p | 20.2p | 9.0p | 8.6p | **45.3p** |
| Diluted earnings per share before exceptional items | 7.4p | 8.5p | 9.1p | 8.9p | **34.0p** |
| *(a)* Including gain on MCI shares sold | – | 1,133 | – | – | **1,133** |

(UNAUDITED) YEAR ENDED 31 MARCH 1998

| Quarters | 1st £m | 2nd £m | 3rd £m | 4th £m | **Total £m** |
|---|---|---|---|---|---|
| Total turnover – ongoing activities | 3,844 | 4,003 | 4,083 | 4,109 | **16,039** |
| – discontinued activities | 584 | 580 | 208 | – | **1,372** |
| Total turnover, including discontinued activities | 4,428 | 4,583 | 4,291 | 4,109 | **17,411** |
| Group's share of associates' and joint ventures' turnover | (630) | (632) | (352) | (157) | **(1,771)** |
| Group turnover – ongoing activities | 3,798 | 3,951 | 3,939 | 3,952 | **15,640** |
| Other operating income *(a)* | 25 | 26 | 279 | 42 | **372** |
| Group operating profit – ongoing activities | 891 | 813 | 1,149 | 804 | **3,657** |
| Group's share of operating profit (loss) of associates and joint ventures | 28 | (68) | (81) | (75) | **(196)** |
| Total operating profit (loss): | | | | | |
| Ongoing activities | 862 | 783 | 1,062 | 729 | **3,436** |
| Discontinued activities | 57 | (38) | 6 | – | **25** |
| | 919 | 745 | 1,068 | 729 | **3,461** |
| Profit (loss) on sale of fixed asset investments and group undertakings | 20 | (2) | 45 | – | **63** |
| Net interest payable | (58) | (59) | (94) | (99) | **(310)** |
| Profit on ordinary activities before taxation | 881 | 684 | 1,019 | 630 | **3,214** |
| Tax on profit on ordinary activities: | | | | | |
| Corporation and similar taxes | (278) | (215) | (285) | (199) | **(977)** |
| Windfall tax | – | (510) | – | – | **(510)** |
| Profit (loss) on ordinary activities after taxation | 603 | (41) | 734 | 431 | **1,727** |
| Minority interests | (4) | 6 | (14) | (13) | **(25)** |
| Profit (loss) for the financial period | 599 | (35) | 720 | 418 | **1,702** |
| Basic earnings (loss) per share | 9.4p | (0.5p) | 11.3p | 6.5p | **26.6p** |
| Basic earnings per share before exceptional items | 9.4p | 7.4p | 8.3p | 6.5p | **31.7p** |
| Diluted earnings (loss) per share | 9.3p | (0.5p) | 11.1p | 6.4p | **26.2p** |
| Diluted earnings per share before exceptional items | 9.3p | 7.3p | 8.2p | 6.4p | **31.2p** |
| *(a)* Including MCI merger break up fee net of expenses | – | – | 238 | – | **238** |

# *Financial statistics*

**Financial ratios**

YEARS ENDED 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Basic earnings per share – pence | 27.8 | 31.6 | 32.8 | 26.6 | **46.3** |
| Growth in dividends per share % *(a)* | 6.0 | 5.6 | 6.1 | 6.4 | **7.4** |
| Return on capital employed % *(b)* | 15.7 | 18.4 | 19.1 | 19.5 | **18.4** |
| Gearing – net debt to equity % *(c)* | 17.8 | 7.4 | 1.6 | 36.1 | **6.3** |
| Interest cover *(d)* | 10.3 | 16.9 | 19.7 | 11.2 | **12.1** |
| Dividend cover *(a) (e)* | 1.6 | 1.7 | 1.7 | 1.8 | **1.7** |

*(a)* 1997 and 1998 figures exclude the effects of the special dividend of 35p per share paid in September 1997.

*(b)* The ratio is based on profit before tax and interest on long-term borrowings, to average capital employed. Capital employed is represented by total assets less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation. Year-end figures are used in the computation of the average, except in the case of short-term investments and borrowings where average daily balances are used in their place.

*(c)* The ratio is based on borrowings net of cash and short-term investments to capital and reserves and minority interests.

*(d)* The number of times net interest payable is covered by operating profit. In 1995 and 1997, net interest excludes the premium paid on the repurchase of bonds.

*(e)* The number of times dividends are covered by earnings. The figure for 1998 excludes the effect of the windfall tax charge and the figure for 1999 excludes the gain on sale of the MCI shares.

**Expenditure on research and development**

YEARS ENDED 31 MARCH

| | 1995<br>£m | 1996<br>£m | 1997<br>£m | 1998<br>£m | **1999<br>£m** |
|---|---|---|---|---|---|
| Total expenditure | 271 | 282 | 291 | 307 | **268** |

**Expenditure on tangible fixed assets**

YEARS ENDED 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Plant and equipment | | | | | |
| Transmission equipment | 1,060 | 1,114 | 1,131 | 1,219 | **1,416** |
| Exchange equipment | 605 | 566 | 445 | 512 | **411** |
| Other network equipment | 378 | 491 | 503 | 502 | **558** |
| Computers and office equipment | 343 | 333 | 350 | 372 | **464** |
| Motor vehicles and other | 214 | 195 | 175 | 230 | **230** |
| Land and buildings | 75 | 87 | 143 | 211 | **205** |
| Decrease in engineering stores | (4) | (15) | (28) | (16) | **(15)** |
| Total expenditure on tangible fixed assets | 2,671 | 2,771 | 2,719 | 3,030 | **3,269** |
| Decrease (increase) in creditors | (33) | (224) | 104 | (10) | **(49)** |
| Cash outflow on purchase of tangible fixed assets | 2,638 | 2,547 | 2,823 | 3,020 | **3,220** |

Financial statistics have been restated where necessary to provide consistency with the presentation of the 1999 financial year figures.

# Operational statistics and regulatory information

## Call growth

YEARS ENDED 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| % growth in fixed network call volumes over the previous year: | | | | | |
| Inland | 7 | 6 | 7 | 7 | **9** |
| International *(a)* | 5 | 9 | 7 | 9 | **11** |

*(a)* Outgoing, incoming and transit.

Growth is estimated by reference to turnover growth attributable to calls, adjusted to eliminate the effect of price changes.

## Exchange line connections

AT 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Business ('000) | 6,459 | 6,798 | 7,160 | 7,521 | **7,982** |
| % growth over previous year | 5.4 | 5.2 | 5.3 | 5.0 | **6.1** |
| Residential ('000) | 20,613 | 20,500 | 20,393 | 20,130 | **20,067** |
| % growth (reduction) over previous year | 0.7 | (0.5) | (0.5) | (1.3) | **(0.3)** |
| Total exchange line connections ('000) | 27,072 | 27,298 | 27,553 | 27,651 | **28,049** |
| % growth over previous year | 1.8 | 0.8 | 0.9 | 0.4 | **1.4** |

## BT Cellnet (Cellular telephones in the UK)

AT 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Digital GSM ('000) | 34 | 353 | 1,125 | 2,303 | **4,163** |
| Analogue ('000) | 1,700 | 2,036 | 1,573 | 774 | **359** |
| Total ('000) | 1,734 | 2,389 | 2,698 | 3,077 | **4,522** |
| % growth over previous year | 70.2 | 37.8 | 12.9 | 14.0 | **47.0** |

## Optical fibre

AT 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Fibre – kilometres in the network ('000) | 2,782 | 3,043 | 3,302 | 3,591 | **4,058** |

## Payphones

AT 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Total public payphones in the UK ('000) | 129 | 133 | 136 | 138 | **142** |

## People employed

AT 31 MARCH

| | 1995 | 1996 | 1997 | 1998 | **1999** |
|---|---|---|---|---|---|
| Total employees ('000) | 137.5 | 130.7 | 127.5 | 124.7 | **124.7** |

## Classified directory business in the UK

The company is providing the following information with respect to its classified directory business in the UK in accordance with undertakings made with the Office of Fair Trading in 1996. For the year ended 31 March 1999, the classified directory business of BT made an operating profit of £190m (1998 – £179m) on turnover of £439m (1998 – £420m) and, at 31 March 1999, it employed net assets of £151m (1998 – £136m). Since the classified directory business is integrated with the company's wider operations, this financial information incorporates the effects of certain apportionments and allocations of expenditures and assets.

BT is required to submit annual audited accounts in respect of the classified directory business to the Director of the Office of Fair Trading within nine months of the company's financial year end. Copies of these accounts, when available, may be obtained free of charge from the *Financial Director, Yellow Pages at Queens Walk, Reading, RG1 7PT.*

# Additional information for shareholders

**Background**

The company was incorporated under the laws of England and Wales on 1 April 1984 as a public limited company wholly owned by Her Majesty's Government of the United Kingdom. In a series of three offers to the public, HM Government reduced its holding from 100% in December 1984 to less than 1% in July 1993. HM Government now owns less than 0.2% of the outstanding ordinary shares.

**Listings**

The principal listing of BT's ordinary shares is on the London Stock Exchange. The shares are also listed on the Tokyo Stock Exchange. American Depositary Shares (ADSs), each representing 10 ordinary shares, have been issued by Morgan Guaranty Trust Company of New York, as Depositary for the American Depositary Receipts (ADRs) evidencing the ADSs, and are listed on the New York Stock Exchange. ADSs also trade, but are not listed, on the London Stock Exchange. Trading on the New York Stock Exchange is under the symbol "BTY". BT shares are traded on the Tokyo Stock Exchange under the Code "9484".

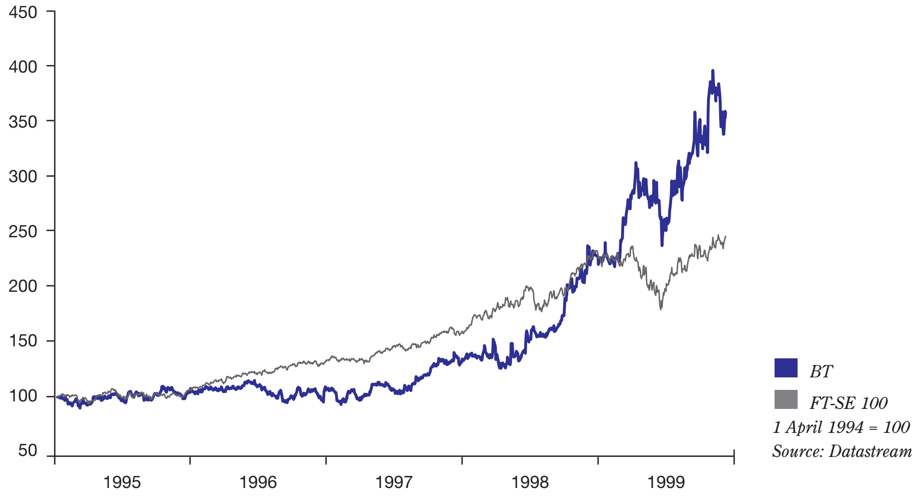
**Share and ADS prices**

| | Pence per ordinary share | | US$ per ADS | |
|---|---|---|---|---|
| | High pence | Low pence | High $ | Low $ |
| YEAR ENDED 31 MARCH 1997 | | | | |
| 1 April – 30 June 1996 | 382½ | 326½ | 58⅝ | 49¼ |
| 1 July – 30 September 1996 | 397 | 336 | 60½ | 53 |
| 1 October – 31 December 1996 | 410 | 345 | 68¾ | 54⅛ |
| 1 January – 31 March 1997 | 461½ | 393 | 73¾ | 66⅜ |
| YEAR ENDED 31 MARCH 1998 | | | | |
| 1 April – 30 June 1997 | 482½ | 424 | 78¾ | 69½ |
| 1 July – 30 September 1997 | 501½ | 379½ | 82½ | 60⅞ |
| 1 October – 31 December 1997 | 483½ | 439½ | 81¾ | 71⅞ |
| 1 January – 31 March 1998 | 685 | 480¾ | 113⅞ | 79⅞ |
| YEAR ENDED 31 MARCH 1999 | | | | |
| 1 April – 30 June 1998 | 757 | 630 | 125 7/16 | 102¼ |
| 1 July – 30 September 1998 | 902 | 745½ | 148¾ | 124¼ |
| 1 October – 31 December 1998 | 908 | 676 | 154¼ | 116⅜ |
| 1 January – 31 March 1999 | 1,118½ | 899½ | 179 15/16 | 148¼ |
| YEAR ENDING 31 MARCH 2000 | | | | |
| 1 April – 18 May 1999 | 1,089 | 970 | 175⅛ | 159 |

The prices are the highest and lowest closing middle market prices for BT ordinary shares, as derived from the Daily Official List of the London Stock Exchange and the highest and lowest sales prices of ADSs, as reported on the New York Stock Exchange composite tape.

Fluctuations in the exchange rate between the pound sterling and the US dollar affect the dollar equivalent of the pound sterling price of the company's ordinary shares on the London Stock Exchange and, as a result, are likely to affect the market price of the ADSs on the New York Stock Exchange.

**Relative TSR performance over the five financial years to 31 March 1999**




Total Shareholder Return (TSR) is the measure of the returns that a company has provided for its shareholders, and is therefore a good indicator of a company's overall performance. The TSR indices on the above graph are the product of share price movement plus gross dividends reinvested in the shares to July 1997 and net dividends thereafter.

**Analysis of shareholdings**

**Size of shareholding**

| AT 31 MARCH 1999 | Number of shareholders | Percentage of total | Ordinary shares of 25p each: Number of shares held (millions) | Ordinary shares of 25p each: Percentage of total |
|---|---|---|---|---|
| 1 – 399 | 859,404 | 45.1 | 183 | 2.8 |
| 400 – 799 | 550,734 | 29.0 | 298 | 4.6 |
| 800 – 1,599 | 332,355 | 17.5 | 363 | 5.6 |
| 1,600 – 9,999 | 154,331 | 8.1 | 412 | 6.4 |
| 10,000 – 99,999 | 3,589 | 0.2 | 89 | 1.4 |
| 100,000 – 999,999 | 1,291 | 0.1 | 452 | 7.0 |
| 1,000,000 – 4,999,999 | 393 | – | 833 | 12.9 |
| 5,000,000 and above *(a)(b)(c)* | 175 | – | 3,839 | 59.3 |
| Total | 1,902,272 | 100.0 | 6,469 | 100.0*(d)* |

*(a)* Under the BT Executive Share Plan, the BT Performance Share Plan and the BT Deferred Bonus Plan 6.9 million shares were held in trust in respect of contingent awards of shares which have been granted to 905 participants.

*(b)* Under the BT Employee Share Ownership Scheme 32 million shares were held in trust on behalf of 126,851 participants who were beneficially entitled to the shares.

*(c)* Approximately 93 million shares were represented by ADSs and a further 11 million shares were held by a nominee of the Tokyo Stock Exchange on behalf of investors. Analysis by size of holding is not available for these holdings.

*(d)* 18.9% of the shares were in 1,857,208 individual holdings, of which 165,266 were joint holdings, and 81.1% of the shares were in 45,064 institutional holdings.

So far as the company is aware, no person is the beneficial owner of more than 10% of the company's ordinary shares, nor is the company directly or indirectly owned or controlled by another corporation or by HM Government or any other foreign government. There are no arrangements known to the company the operation of which may at a subsequent date result in a change in control of the company.

At 18 May 1999, there were 6,470,161,894 ordinary shares outstanding. At the same date, approximately 9.2 million ADSs (equivalent to 92 million ordinary shares, or approximately 1.4% of the total number of ordinary shares outstanding on that date) were outstanding and were held by 2,172 record holders of ADRs.

**CREST: London Stock Exchange settlement system**

The company's ordinary shares are settled in CREST, the computerised system for settling sales and purchases of shares. CREST is a voluntary system which enables shareholders, if they wish, to hold and transfer their shareholdings electronically rather than by paper. Shareholders who wish to retain their certificates are able to do so.

**Personal equity plans (PEPs) and individual savings accounts (ISAs)**

PEPs are no longer eligible for new subscriptions. Information about investing in BT shares through an ISA may be obtained from Halifax Share Dealing Limited, Westbank, Water Lane, Leeds LS11 5TL (telephone 0990 33 66 44). ISAs are also offered by other organisations.

**Dividends**

The Board expects to recommend in respect of each financial year an interim and a final divided, which will normally be payable in February and September, respectively. The proposed 1999 final dividend will be paid on 20 September to shareholders on the register on 20 August 1999.

The dividends paid or payable on BT shares and ADSs for the last five years are shown in the following table. The dividends on the ordinary shares exclude the associated tax credit. The dividends on the ADSs paid before 5 April 1999 include the associated UK tax credit available to certain beneficial owners who are resident in the United States or Canada for tax purposes, but before deduction of UK withholding taxes. The amounts shown are not those that were actually paid to holders of ADSs. For the tax treatment of dividends paid on or after 6 April 1999 see *Taxation of dividends* below. Dividends have been translated from pounds sterling into US dollars using exchange rates prevailing on the date the ordinary dividends were paid.

| | Per ordinary share | | | Per ADS | | | Per ADS | | |
|---|---|---|---|---|---|---|---|---|---|
| YEARS ENDED 31 MARCH | Interim pence | Final pence | Total pence | Interim £ | Final £ | Total £ | Interim US$ | Final US$ | Total US$ |
| 1995 | 7.05 | 10.65 | 17.70 | 0.881 | 1.331 | 2.212 | 1.375 | 2.055 | 3.430 |
| 1996 | 7.45 | 11.25 | 18.70 | 0.931 | 1.406 | 2.337 | 1.422 | 2.181 | 3.603 |
| 1997 *(a)* | 7.90 | 11.95 | 19.85 | 0.987 | 1.494 | 2.481 | 1.582 | 2.391 | 3.973 |
| 1998 | 7.55 | 11.45 | 19.00 | 0.944 | 1.431 | 2.375 | 1.540 | 2.400 | 3.940 |
| 1999 | 8.10 | 12.30 | 20.40 | 1.012 | *(b)* | *(b)* | 1.644 | *(b)* | *(b)* |

*(a)* In addition a special dividend of 35p per share, excluding the associated tax credit or £4.375 (US$7.002) per ADS, including the UK associated tax credit, was paid at the same time as the final dividend for the 1997 financial year.

*(b)* Qualifying holders of ADSs on record as of 20 August 1999 are entitled to receive the final dividend which will be paid on 27 September 1999, subject to approval at the annual general meeting. The US dollar amount of the final dividend of £1.23 per ADS to be paid to holders of ADSs will be based on the exchange rate in effect on 20 September 1999, the date of payment to holders of ordinary shares. This dividend will be the first to be paid under the new arrangements described in *Taxation of dividends* below.

The dividends for the 1998 and 1999 financial years include an adjustment to take account of the effect of the 1997 special dividend.

The level of dividends will continue to be influenced by such factors as the effects of competition and regulation in the UK, together with investment needs and opportunities in the UK and in other countries. Past relationships between the interim and final dividends are not necessarily indicative of the future.

As dividends paid by the company are in pounds sterling, exchange rate fluctuations will affect the US dollar amounts received by holders of ADSs on conversion by the Depositary of such cash dividends.

The expected dividend payment dates in 2000 are:

| | |
|---|---|
| 2000 interim dividend payable | February 2000 |
| 2000 final dividend payable | September 2000 |

**Dividend mandate**

Any shareholder wishing dividends to be paid directly into a bank or building society account should contact the Registrar for a dividend mandate form. Dividends paid in this way will be paid through the Bankers Automated Clearing System (BACS).

**Share dividend plan**

Shareholders could elect to receive additional shares in lieu of a cash dividend under the BT share dividend plan for the following three dividends:

| | Date paid | Price per share pence |
|---|---|---|
| 1998 interim | 16 February 1998 | 480.35 |
| 1998 final | 21 September 1998 | 835.00 |
| 1999 interim | 15 February 1999 | 950.20 |

**Dividend investment plan**

The share dividend plan has now been withdrawn and is being replaced by a dividend investment plan which will be available to ordinary shareholders in respect of the proposed 1999 final dividend to be paid on 20 September 1999. The last date for lodging mandates for the BT dividend investment plan in respect of the final dividend is 20 August 1999. Under the plan, the cash from participants' dividends is used to buy further BT shares in the market.

**ADR Shareholder Services Programme**

Details of the Morgan Guaranty Trust shareholder services programme, including reinvestment of dividends, are available from Morgan Guaranty Trust Company of New York on 1 800 749 1687 (toll free in the United States) or +1 781 575 4328 (from outside the United States), or on written request to the ADR Depositary.

**Results announcements**

Expected announcements of results:

| | |
|---|---|
| 1st quarter | 29 July 1999 |
| 2nd quarter and half year | 11 November 1999 |
| 3rd quarter and nine months | February 2000 |
| 4th quarter and full year | May 2000 |
| 2000 annual report and accounts published | June 2000 |

**ShareGift**

The Orr Mackintosh Foundation operates a charity share donation scheme for shareholders with small parcels of shares whose value makes it uneconomic to sell them. Details of the scheme can be obtained from the BT Shareholder Helpline. Information is also available on the ShareGift Internet site **www.sharegift.org**

**Exchange rates**

BT publishes its consolidated financial statements expressed in pounds sterling. The following table details certain information concerning the exchange rates between pounds sterling and US dollars based on the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate).

| YEARS ENDED 31 MARCH | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|
| Period end | 1.62 | 1.53 | 1.64 | 1.68 | 1.61 |
| Average *(a)* | 1.57 | 1.52 | 1.60 | 1.65 | 1.65 |
| High | 1.64 | 1.56 | 1.71 | 1.70 | 1.72 |
| Low | 1.46 | 1.50 | 1.49 | 1.58 | 1.60 |

*(a)* The average of the Noon Buying Rates in effect on the last day of each month during the relevant period.

On 18 May 1999, the most recent practicable date for this annual report, the Noon Buying Rate was US$1.62 to £1.00.

**Taxation (US Holders)**

This is a summary only of the principal US federal income tax and UK tax consequences to beneficial owners of ADSs who either are resident in the United States or hold ordinary shares or ADSs as assets effectively connected with a US trade or business (US Holders). It is not a complete analysis or listing of all potential tax consequences of the purchase, ownership and disposal of ordinary shares or ADSs.

Investors are advised to consult their tax advisers with respect to the tax consequences of their holdings, including the consequences under applicable state and local laws. The statements of UK and US tax laws and practices set out below are based on the laws in force and as interpreted by the relevant taxation authorities as of the date of this annual report. The statements are subject to changes occuring after that date in UK or US law or practice, in the interpretation thereof by the relevant taxation authorities, or in any double taxation convention between the United States and the UK.

In particular, this summary is based on the current convention between the United States and the UK for the avoidance of double taxation with respect to taxes on income and capital gains (the Treaty) and the US Internal Revenue Code of 1986, as amended. The Treaty is currently under renegotiation.

### Taxation of dividends

For dividends paid on or before 5 April 1999, US Holders were generally entitled to receive the cash dividend plus a Treaty payment from the Inland Revenue of one quarter of the dividend, subject to a UK withholding tax of 15% of the aggregate amount paid. As an example for illustration purposes only, a US Holder who was entitled to a dividend of £80 was also entitled to a Treaty payment of £20, reduced by the withholding tax of 15% on the gross amount of £100, i.e, £15, leaving a net cash payment of £85. The full dividend plus the full Treaty payment including the UK tax withheld was taxable income for US purposes, and the US tax withheld generally was available as a US credit or deduction.

For dividends paid on or after 6 April 1999, the Treaty payment reduces to one ninth of the dividend (i.e. one tenth of the gross payment). As a result of the UK withholding tax (which cannot exceed the amount of the hypothetical Treaty payment), US Holders will no longer receive any Treaty payment. In the above example, the cash dividend would be £80, and the hypothetical Treaty payment would be £8.89 (one ninth of £80). However, since the UK withholding tax (15% of £88.89) would exceed the amount of the hypothetical Treaty payment, no Treaty payment will be made and the US Holder will receive only the cash dividend (here, £80). A US Holder will be taxable in the US on the full dividend and full hypothetical Treaty payment (£88.89), and will be treated as having paid a foreign tax equal to the hypothetical Treaty payment (here, £8.89). The foreign tax deemed paid generally will be available as a US credit or deduction.

For US federal income tax purposes, a distribution will be treated as ordinary dividend income to the extent paid out of current or accumulated earnings and profits, and thereafter as return of capital. Dividends paid by the company will not be eligible for the US dividends received deduction. The amount of any dividend paid in pounds sterling will equal its US dollar value based on the spot rate in effect on the date the dividend is received. Additional gain or loss resulting from a subsequent conversion or other disposition of the pounds sterling will be ordinary income or loss.

### Taxation of capital gains

Unless a US resident carries on a trade through a branch or agency in the UK, and the disposal of ordinary shares and/or ADSs is related to the activities of that trade, UK capital gains tax is not charged on US residents who dispose of ordinary shares and/or ADSs.

For US federal income tax purposes, a US Holder will recognise a gain or loss on the sale or other disposition of shares or ADSs. Such gain or loss will be a capital gain or loss if the shares or ADSs disposed of are held as capital assets. Capital gains of an individual US Holder are subject to US tax at preferential rates if specified holdings periods are met.

### US information reporting and back-up withholding

Dividends paid on and proceeds received from the sale or disposition of ordinary shares or ADSs may be subject to information reporting to the IRS and back-up withholding at a 31% rate. Back-up withholding will not apply, however, to a holder who provides a correct taxpayer identification number or certificate of foreign status and makes any other required certification or who is otherwise exempt.

### UK stamp duty

A transfer for value of an ordinary share will generally be subject to UK stamp duty or to UK stamp duty reserve tax. No UK stamp duty will be payable on the transfer of an ADS, provided that the separate instrument of transfer is not executed in, and always remains outside, the UK.

### Inheritance and gift taxes

US-domiciled holders of ordinary shares and ADSs generally will not be subject to UK inheritance tax on a gift of ordinary shares and/or ADSs if the gift would be subject to US federal gift tax. Similarly, ordinary shares and/or ADSs passing on the death of a US-domiciled shareholder generally will not be subject to UK inheritance tax if the estate would be subject to US estate tax.

## Exchange controls and other limitations affecting security holders

There are currently no government laws, decrees or regulations in the United Kingdom that restrict the export or import of capital, including, but not limited to, UK foreign exchange control restrictions, or that affect the remittances of dividends or other payments to non-resident holders of the company's ordinary shares, except as otherwise described in *Taxation (US Holders)* above and except in respect of the government of, or any resident of, Iraq or any person treated as so resident or in respect of the governments of the Federal Republic of Yugoslavia, and of Serbia. There are no limitations under the laws of the United Kingdom restricting the right of non-residents to hold or to vote shares in the company.

**Publications**

BT produces a series of documents reporting on the company's financial, economic, social and environmental performance. These publications are available to shareholders on request.

| Document | Publication date |
|---|---|
| Annual Review and summary financial statement | June |
| Annual Report and Form 20-F | June |
| Report for Shareholders | February and September |
| Quarterly results releases | February, May, July and November |
| Historical Cost Financial Statements for the Businesses and Activities (as required by Oftel) | July |
| Current Cost Financial Statements for the Businesses and Activities, including long-run incremental cost information for the Network Business (as required by Oftel) | September |
| Group Current Cost Financial Statements | September |
| Environmental Performance Report | October |
| Social Report *(An issue of responsibility)* | June |
| Statement of Business Practice | June |
| Sustainability Report | October |
| Quality of Service Report | May and November |

Most documents may be accessed on the Internet at **www.bt.com/shares**

For printed copies contact the BT Shareholder Helpline on **Free***fone 0808* **100 4141** or, alternatively, contact **The Registrar** in the UK, **BT North America Inc**. in the United States or **The Toyo Trust & Banking Co. Limited** in Japan at the addresses on page 115.

**The Registrar**
Lloyds TSB Registrars (450)
The Causeway
Worthing, West Sussex
BN99 6DA, United Kingdom

**BT Shareholder Helpline**
Tel **Free***fone 0808* **100 4141**
Fax (01903) 833062

From overseas:
Tel +44 1903 833950
Fax +44 1903 833062

e-mail bt@lloydstsb-registrars.co.uk

---

**BT North America Inc.**
Investor Relations
40 East 52nd Street
New York, NY 10022,
United States

Tel 1 800 331 4568
(toll free within the United States and Canada)
or +1 212 418 7787
(from outside the United States and Canada)
Fax +1 212 418 7788

**ADR Depositary**
Morgan Guaranty Trust Company
of New York
ADR Service Center
P.O. Box 8205
Boston, MA 02266-8205
United States

Tel 1 800 634 8366 (toll free)
or (781) 575 4328

e-mail adr@jpmorgan.com

---

**BT (Japan) KK**
ARK Mori Building
12-32 Akasaka 1-Chome
Minato-Ku, Tokyo 107-6024

Tel (03) 5562 6000

**Share Handling Agent in Japan**
The Toyo Trust & Banking Co. Limited

**Tokyo Office:**
10-11 Higashisuna 7-Chome
Koto-Ku, Tokyo 137-8081
(Corporate Agency Department)

Tel (03) 5683 5111

**Osaka Office:**
6-3 Fushimi-machi 3-Chome
Chuo-Ku, Osaka 541-8502
(Corporate Agency Department)

Tel (06) 222 3111

---

**Shareholder enquiries**
Lloyds TSB Registrars maintain BT's share register and the separate BT Employee Share Ownership Scheme register. They also provide a BT Shareholder Helpline service.

Shareholders should contact the Registrar (details above) if they have any enquiries about their shareholding.

**General enquiries**
British Telecommunications plc
BT Centre
81 Newgate Street
London EC1A 7AJ
United Kingdom

Tel (0171) 356 5000
Fax (0171) 356 5520

From overseas:
Tel +44 171 356 5000
Fax +44 171 356 5520

A full list of BT contacts, and an electronic feedback facility, is available at **www.bt.com/talk**

# Glossary of terms and US equivalents

| Term used in UK annual report | US equivalent or definition |
|---|---|
| Accounts | Financial statements |
| Advance corporation tax (ACT) | No direct US equivalent. Tax payable on cash dividends treated as advance payments on the company's UK income tax due |
| Associates | Equity investees |
| Capital allowances | Tax depreciation |
| Capital redemption reserve | Other additional capital |
| Creditors | Accounts payable and accrued liabilities |
| Creditors: amounts falling due within one year | Current liabilities |
| Creditors: amounts falling due after more than one year | Long-term liabilities |
| Debtors: amounts falling due after more than one year | Other non-current assets |
| Employee share schemes | Employee stock benefit plans |
| Employment costs | Payroll costs |
| Finance lease | Capital lease |
| Financial year | Fiscal year |
| Fixed asset investments | Non-current investments |
| Freehold | Ownership with absolute rights in perpetuity |
| Inland calls | Local and long-distance calls |
| Interests in associates and joint ventures | Securities of equity investees |
| Loans to associates and joint ventures | Indebtedness of equity investees not current |
| Net asset value | Book value |
| Operating profit | Net operating income |
| Other debtors | Other current assets |
| Own work capitalised | Costs of group's employees engaged in the construction of plant and equipment for internal use |
| Profit | Income |
| Profit and loss account (statement) | Income statement |
| Profit and loss account (under 'capital and reserves' in balance sheet) | Retained earnings |
| Profit for financial year | Net income |
| Profit on sale of fixed assets | Gain on disposal of non-current assets |
| Provision for doubtful debts | Allowance for bad and doubtful accounts receivable |
| Provisions | Long-term liabilities other than debt and specific accounts payable |
| Recognised gains and losses (statement) | Comprehensive income |
| Redundancy charges | Early release scheme expenses |
| Reserves | Shareholders' equity other than paid-up capital |
| Share premium account | Additional paid-in capital or paid-in surplus (not distributable) |
| Shareholders' funds | Shareholders' equity |
| Stocks | Inventories |
| Tangible fixed assets | Property, plant and equipment |
| Trade debtors | Accounts receivable (net) |
| Turnover | Revenues |

# Cross reference to Form 20-F

The information in this document that is referred to in the following table shall be deemed to be filed with the Securities and Exchange Commission for all purposes.

# Index

British Telecommunications plc
Registered office: 81 Newgate Street, London EC1A 7AJ
Registered in England: No. 1800000

Accredited with the Investors in People award, 1998
European Quality Awards prize winner, 1996 and 1997

Printed in England by Pindar plc on paper awarded the Nordic White Swan label,
an internationally recognised environmental standard.

British Telecommunications plc
Registered office: 81 Newgate Street, London EC1A 7AJ
Registered in England: No. 1800000

Accredited with the Investors in People award, 1998
European Quality Award prize winner, 1996 and 1997

Printed in England by the Howitt Group, Nottingham, on paper selected
using BT's environmental standards for paper procurement.