BT GROUP PLC
Form 6-K
May 23, 2013
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of

the Securities Exchange Act 1934

Report on Form 6-K dated May 23, 2013

BT Group plc

(Translation of registrant s name into English)

BT Centre

81 Newgate Street

London EC1A 7AJ

England

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F x Form 40-F ¨

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ¨ No x

Enclosure: BT Group plc Annual Report & Form 20-F 2013 as sent to shareholders

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BT Group plc

By: /s/ Dan Fitz

Name: Dan Fitz
Title: Company Secretary

Date: May 23, 2013

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Welcome to BT Group plc s Annual Report & Form 20-F 2013

In this report you will find information on: our strategy; how we deliver our strategy; how we have performed; and how we govern our business.

business

This is the BT Annual Report for the year ended 31 March 2013. It complies with UK regulations and comprises part of the Annual Report on Form 20-F for the US Securities and Exchange Commission to meet US regulations. This annual report has been sent to shareholders who have elected to receive a copy. The separate Summary financial statement & notice of meeting 2013 has been issued to shareholders who have elected to receive a shorter document.

Please see cautionary statement regarding forward-looking statements on page 177.

In this document, references to BT Group , BT , the group , the company , we or our are to BT Group plc (whic includes the activities of British Telecommunications plc) and its subsidiaries and lines of business, internal service unit, or any of them as the context may require.

A reference to a year expressed as 2012/13 is to the financial year ended 31 March 2013 and a reference to a year expressed as 2013 is to the calendar year. This convention applies similarly to any reference to a previous or subsequent year. References to this year , the year and the current year are to the financial year ended 31 March 2013. References to last year and the prior year are to the financial year ended 31 March 2012.

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Chairman s introduction

We are making long-term investments in our future, and that of the UK.

Our shareholders

We have made good progress this year in a number of areas and delivered strong financial results. For 2012/13 the Board is proposing a final dividend of 6.5p, up 14%. This gives a full year dividend of 9.5p, also up 14% reflecting our performance this year. We continue to pursue a prudent financial strategy. As well as investing in the future of our business, we will continue to reduce net debt, support our pension fund and pay progressive dividends to you, our shareholders. We expect dividends to grow by 10%-15% per year for the next two years.

Our contribution

In the current uncertain environment, it is tempting for companies to focus on short-term targets rather than the long-term health of their business. At BT, we have continued to make strategic investments that position us well for the future. In the last four years, we have invested over £10bn in our capital investment programmes, with much of this supporting the national infrastructure upon which the UK relies.

Our fibre broadband network will bring significant economic benefits to the UK. The investments we are making in TV and mobile will bring new and innovative services for people to enjoy. We are creating jobs at the same time. This year we hired around 1,600 engineers to help with our fibre programme and we insourced around 4,000 jobs.

We played a vital role in making London 2012 the most connected Olympic and Paralympic Games ever and are supporting the British Paralympic team as they prepare for the next Games. During the year we also set ourselves three stretching Better Future goals to achieve by the end of 2020. By extending the reach of fibre broadband, helping our customers reduce their carbon footprint and using our skills and technology to help generate money for good causes, we will make a major contribution to both society and the environment.

Our global presence

We aim to support our multinational customers wherever they are. But to do this most effectively we need fair access to telecoms networks around the world. We continue to lobby to reduce trade barriers and press for policy and regulatory change to ensure a more level competitive playing field. This includes working with the European Commission on current initiatives to complete the digital Single Market, and on bilateral trade liberalisation negotiations. We hope the EU-US trade talks will deepen transatlantic economic integration, reduce non-tariff barriers and ensure fair access to the US telecoms market. Truly competitive telecoms markets will boost trade in all business sectors and support growth, innovation and jobs.

Our people

Our performance in the year reflects the expertise, hard work and commitment of our people. I am delighted that around 20,000 of them were able to benefit from employee share option plans, each making a gain of around £8,400 on average. We are investing more than ever in our people, making sure they have the skills and support they need to better serve our customers.

The Board

The Board has a key role in setting the strategic direction of the company and played a full part in assessing and approving the major investments we made this year. You can read about the Board s activities in the Governance section.

Our future

Our aim remains to drive profitable revenue growth. The investments we are making support this ambition. We believe our strategy of improving customer service, transforming our cost base and investing for the future will continue to deliver long-term value for our shareholders.

Sir Michael Rake

Chairman

9 May 2013

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Strategy

In this section we explain our aim and the strategy we are following to achieve it. We set out our business model and the key role that our people play. We describe our assets and resources and how we measure our progress using three key performance indicators. Finally, we describe the principal risks our business faces and what we do to mitigate these.

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Chief Executive s introduction

We have a lot more to do, but we are now a lot better positioned to do it.

Making a difference

Communications services are increasingly important in today s world. Our customers rely more and more on our services and our networks whether they are one of the 10m households we serve, our hundreds of wholesale providers, or the largest global businesses. This is a big opportunity for BT; it is also a big responsibility. All of us in BT recognise that what we do as a business makes a real difference to our customers and the societies in which we operate. That is why we are investing in new infrastructure, technology and services. We are proud to make a difference and I d like to thank our people for making it happen.

Opportunities across the whole business

At the start of the global economic downturn we made a bold commitment to invest in fibre broadband. That £2.5bn investment programme has already brought fibre within reach of more than half of the UK s homes and businesses increasing by more than 100,000 premises per week. Delivery is on budget and 18 months ahead of our schedule. We believe that, together with government support and subject to an acceptable investment environment, we can pass more than 90% of premises with our network in the next three to four years.

We are also investing in the next generation of TV. We will offer a complete package of phone, broadband and TV. We are rolling out new services and providing new channels and on-demand content. The launch of BT Sport this summer will bring real competition to the pay-TV market. Our three channels BT Sport 1, BT Sport 2 and ESPN will provide premium sports content including Premier League first picks, exclusive rugby coverage and women s tennis. By offering BT Sport for free with BT broadband, we are making world-class sport affordable. Superb production facilities, backed up by a team of top sporting and broadcasting talent, promise to make this a great service.

We have also invested in 4G mobile spectrum which will allow us to offer enhanced mobile broadband services to consumers and businesses helping our customers to stay best connected wherever they are. The spectrum allows us to build on our existing strength in wi-fi where usage of our 5m wi-fi hot spots tripled in the year to 13bn minutes.

We are seeing the benefits of our investments in the high-growth regions of Asia Pacific, Latin America, Turkey, the Middle East and Africa with double-digit growth in revenue across these markets in the year. Our services are helping multinationals expand into these regions, and local companies become better connected internationally. BT Global Services won total orders of £6.3bn in the year despite tough conditions in Europe and the financial services sector.

Customer service

While our global customer service improved during the year, some of the wettest weather on record triggered a surge of faults in our UK network. Despite significantly more resources in our engineering teams, customers sometimes waited longer than they should for repairs and provision.

While such exceptional weather is unlikely again, we re making investments in customer service to make us more responsive and better equipped to deal with variable weather and increased demand. This will help us get back on track with the improved service levels we delivered in the previous few years.

Overall in the year, we did what we said we would do. We delivered strong financial results, and made substantial investments. BT is a better and stronger company than a year ago.

There s a lot more to do, and many challenges, but BT s future has rarely looked so exciting.

Ian Livingston

Chief Executive

9 May 2013

Our strategy

Our aim is to drive shareholder value by making BT a better business with a better future. This year we made further progress towards this goal, and the investments we are making position us well for the future. Our strategy is delivering results.

We are a leading communications services provider. In the UK, we sell products and services to consumers and small and medium-sized enterprises (SMEs). Around the world, as well as in the UK, we provide managed networked IT services for large multinational corporations, domestic businesses and national and local government organisations. We also sell wholesale telecoms services to communications providers (CPs) in the UK and internationally.

Our strategy is built on Customer service delivery, Cost transformation and Investing for the future.

These are the foundations for making BT a better business. They build on one another. The better we serve our customers, the less time and money we need to spend fixing faults and the things that go wrong. The more we save through transforming our costs, the more we can invest in giving customers what they need now and in the future. By investing in the six strategic priorities shown above we aim to grow the value of our business.

Customer service delivery

We constantly try to improve the service we provide to our customers. In practice that means understanding what they need, making it easy for them to deal with us, keeping our promises, keeping them informed, and acting quickly to fix things if they go wrong.

Right First Time (RFT) is our key metric for customer service (see page 22). It is simply about getting it right for the customer, first time.

RFT improved each year from 2006/07 to 2011/12 and we made further progress in the first quarter of this financial year. But record rainfall then led to flooding across the UK, causing a higher number of faults in the network. To make sure we fixed these faults as quickly as possible, we had to transfer resources away from provisioning new orders. As a result, customers had to wait longer for those orders, we had more calls from customers than we forecast and it took us longer than normal to answer those calls. We did, however, hire extra engineers to help with repair work and new orders (see page 60) and by February 2013 we had managed to get provision lead times back to the levels we have committed to.

Overall, we did not improve our service as we aimed to this year, and our RFT measure declined by 4%. While we did not achieve our group RFT target, BT Global Services achieved its target helped by an increase in the number of major contract milestones delivered on time and fewer reported customer incidents.

Copper cable theft remains a problem. This year we have worked more closely with the police and government to tackle it. We have set up a nationwide cable alarming system and taken other measures such as forensically marking our cables. Because of this work, we have had 28% fewer customer faults due to cable theft this year, and 50% fewer attacks on our network. A new Scrap Metal Dealers Act should clamp down further on the illegal trade in stolen metal when it comes into effect later this year.

We are improving processes across the business to make sure we keep appointment slots, repair faults more quickly and fulfil new orders faster. We are also working to improve how we interact with our customers through the use of better quality contact information, customer portals and self-service channels that give customers more ways to resolve their problems quickly. We have successfully piloted new voice recognition capabilities to make it easier for customers to get the right help when calling us. We are now rolling this service out more widely.

Improved BT Home Hub diagnostics for our TV and broadband services will locate and resolve faults more quickly with fewer calls and engineering visits. We will also create an integrated customer experience across our consumer channels voice, social media, email, chat forums and videos.

We encourage our customers to provide us with feedback so that we can serve them better. We believe that the changes we are making will deliver a better customer experience and lead to further cost transformation benefits.

You can read more about customer service delivery across our lines of business in the Performance section on page

Cost transformation

We achieved further efficiency savings across our business. We have cut waste, applied best practice and freed up resources to invest in our future. More and more, we have focused on end-to-end processes that span our whole business. We also started the next phase of our group-wide restructuring programme which will generate further savings and improve customer service.

Specific activities during the year included:

- reviewing our entire stock and supply chain. This has given us better controls over our stock as well as improving how we distribute and store it
- improving our process for fixing faults for BT Global Services and BT Wholesale customers. We have upgraded our systems, migrated work to four strategic service centres and made it easier for different teams to work together
- rationalising our network and IT infrastructure. For example, we closed a major legacy network which served the financial services sector and migrated those customers onto our global MPLS platform, giving them improved service and reliability. We have also put programmes in place to rationalise our legacy UK backhaul and global IP networks
- combining BT Innovate & Design and BT Operate into our new BT Technology, Service & Operations unit (BT TSO)

improving product and software development across all lines of business through better prioritisation, quality and automation of testing

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improving the productivity of our field engineers by reducing the number of administrative tasks they have to do
reducing our travel and subsistence spend by £14m or 12%. Buying more efficiently and reducing travel by using our own conferencing services has saved us time and money, and reduced carbon emissions.

Overall, we cut operating costs by £1.2bn or 9%, with savings across all our main cost categories. Together with capital expenditure (excluding purchases of telecommunications licences), we have achieved total savings of £4.7bn over the last four years.

We will continue our drive on cost transformation. In 2013/14 we will launch a pan-BT Continuous Improvement Initiative to help our people take more responsibility for improving the processes around them. We want to transform the service we deliver, analysing and improving the end-to-end processes that span lines of business, operational platforms and products. This will help us to drive out failures in these processes. We are focusing on seven priority areas, targeting issues including early life failures (those that occur near the start of a new service), repeat visits and how we respond to major incidents.

To find more opportunities to reduce costs and to run our business better we will keep benchmarking ourselves against other large telecoms operators and the best companies in other industries around the world.

You can read about the contributions our lines of business have made to our cost transformation in the Performance section on page

Investing for the future

We are investing in the future of our business to help drive profitable revenue growth and deliver long-term value for our shareholders. The more we can save through our cost transformation activities, the more we can invest in the long-term value of our business without affecting our financial performance in the short-term.

In 2012/13 we made a number of key investments around our six strategic priorities which position us well for the future.

TV and broadband are increasingly complementary as viewing becomes more interactive. We are making significant investments in TV to improve what we offer, rolling out new services and providing new channels and on-demand content.

For SMEs, we have invested in improving our range of IT services and acquired Tikit (one of the largest independent suppliers of technology services to legal and accountancy firms).

We also successfully bid for 4G mobile spectrum which will allow us to offer an enhanced range of converged fixed and mobile broadband services to both consumer and business customers, building on our existing strength in wi-fi.

We continued to invest in our IP Exchange platform to meet the growing demand for IP interconnect services resulting from the massive growth in voice over IP (VoIP) traffic worldwide.

We have made further investments in the high-growth regions of the world. We improved our product portfolio and invested in people and infrastructure in Asia Pacific, Latin America, Turkey, the Middle East and Africa. These investments are helping our multinational customers expand into these regions and support local companies as they grow internationally.

We are supporting the launch of 4G services in the UK by investing in backhaul capacity at key mobile base station sites.

We have invested in expanding our Ethernet portfolio and footprint in response to growing data traffic and demand for higher capacity and greater flexibility in our wholesale customers networks.

And we have accelerated our fibre rollout. It should be available to two-thirds of UK homes and businesses during spring 2014, more than 18 months ahead of our original schedule.

We believe our fibre investment will support a more connected society, transforming the way people use the internet, giving them better access to information, education and jobs. We are also investing in products and services that will allow our customers to reduce their own carbon footprints.

You can read about how our lines of business have been investing for the future in the Performance section on page

Our strategic priorities

We made further progress against our six strategic priorities in the year.

You can read more about how our lines of business did in the Performance section on page

Driving broadband-based consumer services

Broadband is now available to virtually all UK homes and businesses and is increasingly at the centre of people s lives. Our investments in broadband-based services are helping everyone get much more from it.

We differentiate our products from those of competitors by offering the most comprehensive broadband service with a range of packages to choose from. For example, our newly-launched BT Totally Unlimited Broadband lets people download as much as they like with no speed restrictions.

We provide lots of extra features, like our free BT Home Hub, free BT Wi-fi connectivity over the world s largest in-country wi-fi network and free BT Cloud storage. We offer our broadband service together with voice and TV in competitively-priced bundles. Bundling helps us keep existing customers and attract new ones.

Fibre broadband lets people do even more. BT Infinity sales have accelerated and we are selling faster and higher tier options to existing customers while attracting people away from other providers.

Broadband will increasingly be at the heart of how people watch TV. We are extending our appeal to all segments of the TV market. We have launched YouView from BT to allow customers who currently only take Freeview to try pay-TV. Extra TV, our package of 22 TV channels, targets households currently subscribing to basic pay-TV channels from Sky or Virgin. And we are launching our BT Sport channels this summer, for customers who want a wide choice of premium sports but at much better value than currently available.

Our future plans include:

- launching BT Sport
- completing the rollout of Extra TV across our multicast IP network
- further improving our TV channel line-up and on-demand content
- encouraging customers to switch to BT Infinity through marketing campaigns, competitive pricing and by offering Extra TV and BT Sport to BT Infinity customers over their broadband connection.

Being the Brand for Business for UK SMEs

We want to be the first choice for SMEs for all their fixed and mobile communications and IT needs. We aim to offer a wide range of products and services so they do not have to rely on multiple suppliers.

In fixed communications we face stiff competition in a fragmented market, but we have maintained a clear leading position.

We are still ahead because we consciously build on our advantages: the national coverage of our services and sales teams; the breadth of our portfolio of services; the strength of our sales channels; and our brand. We are looking to improve the products and services we sell (and how we sell them) to defend and grow our position in the market. We are developing new IP-based voice and data products, which will help drive penetration of fibre broadband. We are also improving processes and systems so our people can give our customers a better service.

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In our IT services businesses, our focus is on providing service, rather than hardware alone (which tends to be low margin). Where we can, we will cross-sell our networking and IT solutions. We also encourage customers to take higher-value products and services such as managed hosted data and applications, and cloud services.

Our future plans include:

- strengthening our product portfolio in unified communications and VoIP so SMEs can make the most of these growing technologies
- developing our mobile services capabilities, in particular building on our investment in 4G spectrum. We will combine fixed and mobile services to give our customers the best possible connection wherever they are
- growing our IT services businesses, building on synergies between them to improve their positions in the market.

BT Global Services a global leader

We are a leader in the worldwide market for managed networked IT services. We are truly global with one of the largest networks in the world and more than 60% of our people based outside the UK.

Our customers tell us there are a number of things which make us stand out: our global assets, people and technology; industry experience and solutions; our consulting capability; our innovation; and our strength in the UK.

Our future plans are to invest and build on these strengths.

- We are supporting our multinational customers by investing in high-growth regions
- We are developing our industry expertise. For example, we will build on years of experience supporting the financial services sector where our award-winning products and services support millions of financial transactions every day
- We will invest in our BT Advise team of around 4,000 experts who share their knowledge and skills with our customers
- We will use our strength in the UK, including our fibre broadband network, to keep innovating our products and services. For example, we are improving our conferencing services by using Dolby s high-definition audio technology.

We will use feedback from our customers to improve our service to them. And we plan to drive down cost and become a more agile and competitive organisation. That way, we will be able to take advantage of opportunities in the managed networked IT services market more quickly.

By building a better business, we will strengthen our position as a global leader.

The wholesaler of choice

We want to be the wholesaler of choice in the UK and international telecoms services markets. We give CPs access to our platforms, skills and technology, making our investments and economies of scale work for them. Our approach promotes competition, gives end-customers more choice, avoids duplicating infrastructure and encourages innovation by helping CPs find new ways to serve their customers.

We are Europe s largest telecoms wholesaler and BT Global Services sells our wholesale services to more than 1,200 telecoms companies around the world.

Openreach provides local access and backhaul services; its networks are already the most extensive in Great Britain, allowing CPs to provide ADSL broadband to 99% of homes and businesses and fibre broadband to over half.

BT Wholesale aims to meet CPs needs where they cannot be met by Openreach s products alone. This typically involves using our network coverage and scale to provide nationwide voice, broadband and data end-to-end products. We also create managed services which combine those products with third-party components and professional services, using our deep expertise in solution design, build, delivery and operation.

BT Wholesale leads the market in mobile Ethernet backhaul services and in wholesale broadband. Our Wholesale Broadband Connect (WBC) next generation copper broadband product is now in exchanges serving more than 90% of UK premises. More than 70 CPs are now trialling or selling its fibre-based variant.

A key area of investment over the past few years has been IP Exchange which was developed in our Adastral Park research and development centre. IP Exchange provides a common gateway to allow interworking between different CPs IP voice, data and multimedia services. This year it handled 7.75bn voice minutes globally.

We expect a variety of issues, such as regulatory charge controls and competitive pressures, to affect our wholesale business in 2013/14. So we are working to identify growth opportunities that will help us offset their impact.

Our future plans include:

- launching new hosted communications services that will expand our IP voice portfolio and combine it with our data and broadband products
- extending our broadband, Ethernet and Mobile Ethernet Access Service (MEAS) footprints
- adding new features to IP Exchange, including the support of video and 4G mobile services, and introducing more global nodes
- improving our customers experience, for example, by introducing a new online portal that will offer better tools for pricing, ordering and support
- further reducing our cost base
- increasing the skills and productivity of our people.

The best network provider

Our network in the UK is a critical national asset and we take our guardianship of it seriously. We aim to be the best network provider in the UK by investing in it and by providing the best services over it. We continue to upgrade capacity, offer new services and make it more efficient and reliable.

More than 15m premises can now get our fibre broadband, giving us the largest fibre broadband footprint in the UK. These premises have access to download and upload speeds of up to 80Mbps and 20Mbps respectively using fibre-to-the-cabinet (FTTC), or 330Mbps and 30Mbps using fibre-to-the-premises (FTTP).

We will bring fibre to two-thirds of UK premises during spring 2014. With EU, national and regional government funding, we believe we can bring fibre to more than 90% of UK premises in the next three to four years.

We are rolling out national Ethernet products, with a wide range of ways to connect to our network. These include high bandwidth Ethernet fibre connections, cost-effective Ethernet bonded copper solutions (Ethernet in the First Mile) and more recently, Ethernet over our fibre broadband network. High levels of service availability and flexibility, combined with nationwide coverage, make our Ethernet services an attractive choice for customers.

Our future plans include:

- making FTTP available throughout the fibre broadband footprint with our FTTP-on-Demand service. We launched this service in April 2013 in a subset of our footprint
- increasing FTTC speeds above 80Mbps using vectoring, a technology we will be trialling further during 2013/14

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- further increasing FTTP speeds building on trials conducted in 2012/13
- extending the choices available to CPs for the delivery of fibre broadband. We plan to introduce a new option in 2013/14 that will allow CPs to use their own modem rather than an Openreach one
- assessing the longer-term opportunities for wider and deeper fibre deployment in the access network
- extending our Ethernet footprint
- upgrading our core network with the latest generation of high-speed optical equipment that provides multiple 100Gbps connections.

A responsible and sustainable business leader

Our aim is to create a better future by generating value for our business and our stakeholders. Doing this in a responsible and sustainable way contributes to this aim. Our customers want to buy services from a company they can trust to act responsibly and sustainably. This year corporate and government customers asked us about our sustainability credentials in over £2.8bn worth of contracts that we bid for.

During the year we set ourselves three stretching goals to achieve by the end of 2020. They will help us make a major contribution to both society and the environment.

The *Committee for Sustainable and Responsible Business* oversees our corporate responsibility, environment and community activities, and our Better Future programme. It is supported by our Sustainable Business Leadership team which comprises senior executives from across our business units and is charged with delivering our programme and embedding it throughout the group.

You can read more in the Report of the Committee for Sustainable and Responsible Business on page

Each year we use a materiality process to work out the social and environmental issues that are important to our stakeholders and relevant to our business. It helps us focus on the right things. We measure and report our progress against seven non-financial performance indicators which reflect these issues. They are summarised on page 61.

To find out more, take a look at our Better Future report at www.bt.com/betterfuture

Better business

Our stakeholders expect us to invest in our networks, community and people and to run our business with high ethical, environmental and supply chain standards. You will see from much of what we describe elsewhere in our report, that it is our people and values that help us achieve this.

Working ethically is not just the right thing to do, it is also important to regulators and customers. Our statement of business practice, The Way We Work (www.bt.com/twww), is available in several languages. We are currently revising it to provide more guidance and examples. We also have a number of ethical policies including Anti-Corruption and Bribery , Gifts and Hospitality and Charitable Donations and Sponsorship .

We encourage our people to get involved in their local communities and we run a volunteering programme to help them do so. In 2012/13 our people volunteered 43,600 days, worth an estimated £13m to those communities. Overall we invested £27m in responsible and sustainable business activities this year, meeting our target to invest at least 1% of our prior year s adjusted profit before taxation.

Our payroll giving scheme has over 11,000 BT members and donated to more than 2,000 charities in 2011/12. Payroll donations from the UK, Ireland and the United States, rose to £2.9m, which was supported by an additional £1m contribution by BT.

Creating a better future

Our society faces the challenge of living within immediate financial constraints and the planet s ever-tighter resources.

Communication technology has a significant role to play in helping businesses and people do this. It helps them swap physical products with their virtual, streamed or digital equivalents. It helps avoid travel. And it provides solutions that help businesses manage their resources as efficiently as possible.

It also has the power to make a difference to people s lives; giving them better access to information, education and jobs and helping them work together. Our people, networks and technology can make these connections happen.

Connected Society

We aim to help improve society through the power of digital connections.

We want everyone to be part of a connected society. By the end of 2012/13 over half the people in the UK could access fibre-based products and services. Our goal is for more than nine out of ten people to have access by the end of 2020. We now believe that we can achieve this much sooner.

For years, our digital inclusion programmes have helped people overcome any fears of moving online. Our Get IT Together campaign helps people in the UK discover the digital world with the help of a friend or family member. Our Including You website offers help and support to customers with impairments, helping them and their carers get more out of our products and services.

Read more

www.bt.com/ngb

www.bt.com/getittogether

www.bt.com/includingyou

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Net Good

Our vision is to help society live within the constraints of our planet s resources through our products and people.

Our 2020 goal is to help our customers reduce carbon emissions by at least three times the end-to-end carbon impact of our business.

We have calculated our end-to-end impact as 5.0 megatonnes (Mt) of CO_2 equivalent (CO_2 e) emissions. This is made up of 3.2Mt (64%) from our supply chain, 0.4Mt (8%) from our operations and 1.4Mt (28%) from the BT products used by our customers.

Today, we estimate that customers using our products and services avoid generating at least 5.0Mt of carbon emissions through travelling less, for example. This is equivalent to our current business impact. We plan to achieve our 2020 goal by growing our product portfolio in this area whilst cutting our end-to-end emissions.

This year, we set up the Better Future Supplier Forum (www.bt.com/betterfuturesupplierforum) to encourage our suppliers to develop products and propositions more sustainably.

BT TSO is responsible for managing our energy consumption and direct carbon emissions see page 35. We have signed contracts delivering 100% renewable electricity in the UK and Spain. We have met our target to reduce our UK emissions by 80% from our 1996/97 base year, three years early.

Improving Lives

We believe our people and products can help improve the lives of hundreds of millions of people around the world. Our 2020 goal is to use our skills and technology to help generate more than £1bn for good causes. In 2012/13 we helped raise £59m.

We have a long history of working with amazing causes to improve lives. We have supported ChildLine for more than 25 years. Our technology and people are the backbone of telethons such as the annual Children in Need appeal and UNICEF s Soccer Aid.

Last year, supporting our £1bn goal, our people helped raise £25m across our MyDonate telethon platform for our charity partners including Comic Relief and Children in Need. We have been working with Comic Relief since the charity was formed in 1985 and this year we managed 458,000 incoming donation calls and co-ordinated more than 10,000 volunteers across 147 UK call centres, including around 1,000 BT volunteers in seven BT call centres.

Our MyDonate website is changing the way people give to charity online. We are helping UK charities and their supporters to fundraise online free of charge, with every penny donated going to their cause. This year 3,600 charities used it to raise funds.

Read more

www.bt.com/mydonate

www.rednoseday.com/partners/bt

Our business model

We have a sustainable business model which supports our aim to deliver value to shareholders and customers. It is built around our strategy of Customer service delivery, Cost transformation and Investing for the future.

We make money by selling our services in the UK and around the world through our customer-facing lines of business. These services often use the same underlying networks, platforms and people. The communications market is very competitive, particularly in the UK. We never forget that customers have a choice.

We sell our services through a range of channels including online, contact centres and desk or field-based account managers. Our revenue is largely subscription or contract based. People, households and SMEs pay for standalone or bundled services monthly, quarterly or annually (typically on 12-24 month contracts). Large corporate and public sector customers typically buy managed networked IT services, usually on contracts spanning several years. Contract durations with our wholesale customers range from just one month for regulated products, to five years or more for major managed services deals.

What sets us apart

We have a unique combination of people, brand, networks and technology. And we have the financial strength to make long-term investments in the future of our business.

A committed, skilled and engaged group of employees is key to our business. We have launched a new long-term initiative to make our people feel more empowered, invest in their skills and capabilities and improve our ways of working.

Our assets and resources that help us to deliver our strategy are described on page 20. As well as our brand and networks they include the innovation activities we undertake to maintain our technology advantage. They also include our platforms, our properties and suppliers.

Delivering value

Combining the things that set us apart with our products and our customer service delivers value to our customers.

Improving our customer service helps our customers but also allows us to cut the cost of serving them. By reducing the number of times things go wrong, we spend less time and money putting things right. This reinforces our financial strength and helps us to invest in the things that set us apart. A virtuous circle.

That is why the three foundations of our strategy Customer service delivery, Cost transformation and Investing for the future are at the heart of the way we run our business.

The cash that we generate from our customers and cost transformation helps us reward our shareholders. And it means we can fulfil our financial obligations to our people and the pension scheme, and to our lenders and suppliers.

What we do matters. We make connections, create possibilities and deliver value. And we give back to the communities we work in.

We measure how we are doing using three Key Performance Indicators (KPIs): adjusted earnings per share; normalised free cash flow; and customer service improvement (see page 4).

We believe our business model is sustainable

We are confident our business model is sustainable and that we will be able to deliver value in the long-term.

Our Enterprise Risk Management framework (see page 23) helps us to mitigate the challenges that we face, based on our view of the markets in which we operate. Our knowledge of market trends is maintained through dedicated insight teams. Governance committees make sure that the investments we make are appropriate and will deliver products and services that are attractive to customers.

We see more and more demand for our products and services because they play such an integral role in modern life. Customers rely on us. They trust us with their confidential information and their businesses. We take this responsibility seriously.

Our people

Every day our people touch the lives of millions, helping them communicate, do business and be entertained and informed. We are investing not only in our future but more than ever in our people.

At 31 March 2013, we had 87,900 full-time equivalent employees of which 73,200 were based in the UK.

Building our strengths and capabilities

We are introducing new ways of working that will equip and empower our people to continuously improve their work and better serve our customers. We are setting up a BT Academy to be the vehicle for delivering world-class leadership and critical skills development, as well as being an enabler of cultural change. It will allow us to quickly share the BT way which are the methods based on BT at its best.

In Openreach we invested in tools and improved the skills of more than 11,000 engineers, delivering more than 200,000 hours of classroom or simulated workplace training.

We have particularly focused on training to support the planning and rollout of our fibre network across the UK. This investment in skills and capabilities will help our people do things better every day to meet our performance targets and improve quality and customer service.

Engagement

Our employee engagement index is one of the seven performance indicators that we use to measure how we are doing as a responsible and sustainable business leader (see page 61). It is based on a five point scale and measured 3.69, a small improvement on our score last year. We will continue our wide-ranging programme of activities to support and involve our people and aim to further improve engagement in the coming years.

	2012/13	2011/12	2010/11
Employee engagement index	3.69	3.68	3.61

Our communication with BT people is based on two-way conversation. Proper dialogue helps us keep them engaged about where we are heading as a business, and makes it easier to track their feedback.

We keep our people informed about company results, major business decisions and other things that affect them. We use a variety of print and digital communication channels to do this. We give our people plenty of chances for direct discussion with leaders, so they can ask questions that matter to them. These are either online chats, town hall meetings or round-table events.

We also carry out surveys to ask our people for their opinion. These help us measure how engaged they are overall, so we can spot issues that we need to look into. In April 2013 we updated our company values to better reflect the type of company our people think we are and should be.

We have a record of stable industrial relations and constructive relationships with the recognised unions in the UK and with works councils elsewhere in Europe. In the UK, we recognise two main trade unions the Communication Workers Union (CWU), which represents people in engineering, administrative and clerical positions, and Prospect, which represents managerial and professional employees. We also deal with unions around the world and operate a pan-European works council, the BT European Consultative Committee.

Talent and diversity

We gain significant advantage by spotting and developing our own talent as well as bringing in the best skills from outside.

We offer employees who show significant potential a range of support mechanisms and development opportunities. These include access to senior leaders, talent events designed to build knowledge, visibility and networks, and support from Human Resources in creating tailored development plans.

Our customer and supplier base is incredibly diverse and our diverse mix of employees helps us to understand their needs. We demonstrate our commitment to equality from board-level down: 30% of our Board is female, exceeding our aim of at least 25%. We were ranked in The Times Top 50 Employers for Women but recognise we need to do more to increase the proportion of our people that are female, particularly in senior executive roles.

Safety and wellbeing

We aim to improve the overall wellbeing of the company by providing information, guidance and instruction to make sure our people are protected and work together to protect others. We provide safe systems of work, equipment, support services and access to specialist advice, all of which allow our people to understand the way in which they need to work and any risks associated with their activities.

Through our wellbeing framework, we create workplaces which support our employees and where we can each contribute to the health of our business, and of society as a whole.

This year, we continued to partner with Business in the Community (BITC) to develop our wellbeing framework and in April 2013 we were ranked as a top five company by BITC for public reporting of employee engagement and wellbeing. Through this initiative we aim to remain at the forefront of good people management.

We track our performance in lots of different ways. But our sickness absence rate (SAR) is a key measure. In 2012/13 we missed our target to cut our SAR to 2.05% after some of our people experienced more strain caused in part by the bad weather. Our sick pay costs were £84.6m in the year.

Sickness absence rate (SAR[a])

	2012/13	2011/12	2010/11
Sickness absence rate	2.29%	2.16%	2.41%
Sick pay costs	£84.6m	£80.0m	£90.1m

[a] SAR is a 12-month rolling average of the percentage of calendar days lost.

Recruitment and flexibility

As our markets and environment change, the skills we need change too. If we no longer need a particular skill or role, our transition centre helps people learn new things and look for alternative roles in the business. Since April 2006, more than 21,000 BT people have gone through the centre.

This year we recruited around 1,600 engineers to help with our accelerated fibre rollout and to improve customer service. We have created new roles by bringing work into BT which we used to outsource. This year we brought around 4,000 roles back into the business.

We have also created our own recruitment team, which advertises vacancies and deploys people across the business.

We want to foster a culture where everyone can do well. So we work with agencies to help recruit people with disabilities. And we cover the cost of rehabilitation and retention services to help our people stay with us when their circumstances change. We supported nearly 1,000 existing employees with disabilities through our Enable programme, which provides specialist advice with tailored adjustments to keep people in productive work.

Apprentices are a core part of our recruitment strategy. They bring new skills and innovation to the business and help shape the future workforce of the company. Through the apprenticeship scheme young people are able to join career paths that can, and often do, lead to senior management roles within the company. Our apprentices regularly receive external recognition. This year three of our apprentices won regional apprentice of the year with the National Apprenticeship Service and we also had two national winners in the STEMNET and ITP awards.

Pay and benefits

We pay our people competitively. We compare salaries with other companies in the markets we work in, so we know we pay fairly too.

Engineers and support people get paid in the same way across-the-board. Managers pay and bonuses are linked to how we are performing as a business and how they contribute to that personally.

We offer our most senior managers long-term incentives. This approach strengthens further the alignment of rewards for executives with the creation of shareholder value. The amount we pay out in these plans depends on our corporate performance over a three-year period. In accordance with our regulatory obligations, there are different arrangements for the most senior managers in Openreach whose incentives are tied to the business performance of Openreach rather than the wider BT Group.

We operate savings-related share option plans (saveshare) in over 25 countries. Around 60% of our people take part in one or more of these. This year around 20,000 of our people benefited from saveshare receiving, on average, BT shares worth over £12,000, a gain of around £8,400. Over the next two years, around 34,500 of our people could each receive shares worth over £28,000 on average (based on the share price as at 31 March 2013).

We also provide pension and retirement benefits as well as statutory retirement arrangements.

You can find details of the BT Pension Scheme on page

Volunteering

The BT Volunteering Programme is recognised for its range and diversity and in 2012 received a Big Society Award from the Prime Minister. All our people can volunteer and in the year BT people volunteered 43,600 days in work time to activities like digital inclusion and helping the vulnerable get online.

The programme includes a number of projects which help us apply our skills and services to support communities and it also encourages people to choose activities they are passionate about. For example, more than 800 employees serve their communities as school governors, more than 150 as military reservists, more than 70 as special constables, and more than 1,000 as youth leaders.

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Our assets and resources

These are what we need to help us deliver our strategy. Many of them set us apart from our competitors and give us an advantage in our markets.

Brand and reputation

The BT brand is an important business asset. Superbrands, a respected assessment of brand strength, ranked BT as the UK s 62nd strongest Consumer Superbrand in 2013 (up more than 100 places from 2012) and the 12th strongest Business Superbrand (17th in 2012). In both cases, we came top in our category.

Our partnership with London 2012 strengthened our brand. As a sponsorship programme, we benefited in a number of ways. First, the Games network we built showcased our expertise on the world s biggest stage and was vital to the success of the event.

Second, our communications services for the Games showed the world what we do in the UK every day, helping to bring people together to share in occasions big and small.

Third, our sponsorship and in particular our work with the British Paralympic Association demonstrated our belief in the power of communication to make a better world.

Independent research by Nielsen (London 2012 s official market research provider) showed that we were the domestic sponsor most associated with the Games and the single sponsor most recognised for providing expertise and services to support the event.

Our own research showed that consumers and BT people valued our brand more because of our involvement. In September 2012 more than 70% of our people said that the London 2012 sponsorship made them proud to work for BT.

Our brand health research shows an increase in emotional engagement with the BT brand amongst consumers and SMEs in the year. Brand engagement amongst large corporate and public sector customers also improved, driven by a particularly strong performance in non-UK markets.

Some of the highest scores in our surveys indicate that our brand strengths are around being trusted and liked, and being seen as relevant and innovative.

Networks and platforms

Networks

Our networks are the foundation of the products and services our customers rely on around the world. We have domestic network assets, which provide in-country services, and global assets, which provide international services.

Our largest assets are in the UK where we offer the widest range of network services, access technologies and coverage. Our UK fixed-line network is one of our most valuable assets and our fibre broadband investment is key to sustaining its value for the UK.

We are growing our Ethernet footprint in response to strong demand and growing data traffic. We have around 1,170 Ethernet fibre nodes located across the UK with BT Wholesale increasing the number of Ethernet circuits installed in the year by 63%. The total number of Ethernet circuits provided by Openreach increased by 15%, with growth strongest at speeds of 1Gbps and above. We also deployed the world s largest high-density wi-fi service at the London 2012 Olympic Park and installed more than 1,500 wireless access points across all of the Olympic venues.

We also have deep in-country networks in Germany, Italy, the Netherlands, the Republic of Ireland and Spain. In Latin America we operate networks in Argentina, Brazil, Colombia and Mexico.

Our major global asset is our MPLS platform, which is designed to carry different network services over one common infrastructure. This lowers costs and reduces the time to offer new services.

From this platform we offer our two most popular virtual private network (VPN) services: IP Connect and Ethernet Connect. IP Connect is available in more than 170 countries. This year we invested in 10 new IP Connect points of presence (POPs), six new Ethernet access countries and five new network-to-network interfaces. Ethernet Connect has grown substantially in the last year. We invested in 10 new Ethernet Connect POPs, and the service is now available in 43 countries.

Our internet platform is available in 38 countries. We have also invested in six new gateways from our internet platform to IP Connect, increasing coverage and reducing the cost of internet access.

We have a large broadband satellite network as shown on the map on page 21.

We are expanding our UK and global IP Exchange service (GIPX). We have more than 150 customers in the UK alone on this product and we have plans in place to add new features to support services such as HD voice and video calling.

This year we:

- expanded further in the high-growth regions of Asia Pacific, Latin America, Turkey, the Middle East and Africa
- upgraded capacity in Europe and around the world
- simplified our networks closing some legacy services and migrating customers onto newer and better services, and lowering our costs
- upgraded our European fibre backbone that is the foundation of our services in nine European countries and 77 cities
- invested in a new fibre backbone in South Africa.

To make sure their own networks are performing at their best, customers can use our BT Connect Applications portfolio. This is available globally and can be used to accelerate, optimise and monitor traffic across their networks.

Platforms

Our platforms are the processes and technology that deliver our network products and services. They are critical to running our business.

For example, our service management platform comprises our service delivery and workflow management processes. It lets us co-ordinate everything we need to do to give our customers their service. It also keeps our customers updated on the progress of their orders.

Our billing and payments platform is made up of the systems and processes that work out charges, produce bills and collect payments from our customers.

The number of platforms we own has grown over time as we have bought companies, won outsourced contracts and brought in new technologies. We continue to improve our platforms. We modernise and rationalise them, make them simpler, more reliable and more flexible and make them cheaper to run.

While our UK data centre and IT infrastructure grew in the year, we spent 8% less on associated energy costs. We have programmes in place to help us cut our IT energy use over the coming years including using fewer IT applications.

Properties

At 31 March 2013 we occupied around 6,400 properties in the UK and around 1,750 in the rest of the world. Most of our UK properties are owned by and leased from Telereal Trillium, part of the William Pears Group.

Of our UK properties, around 90% are operational telephone exchanges housing telecoms equipment. Our general purpose properties are mainly offices, engineering depots and data centres. Outside the UK, around 90% of our properties are operational sites housing data hosting and telecoms equipment.

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As part of our cost transformation, we continued to consolidate office space and dispose of redundant premises. This property rationalisation will continue under our restructuring programme.

Innovation

We have to create propositions that our customers find attractive and want to buy. Innovation, supported by our global research and development, has therefore always been at the core of our business.

Our open innovation model gives us access to thinking from outside BT, from small, start-up companies to some of the best universities around the world. We have teams working with customers, partners and universities in the US, Asia, Europe and the Middle East. They help us to maintain our view of global developments in new technologies, business propositions and market trends. This year we opened a new research laboratory with Tsinghua University in China.

In 2012/13 we filed patent applications for 69 inventions. We routinely seek patent protection in different countries and at 31 March 2013 we had a worldwide portfolio of more than 4,400[a] patents and applications. We support the UK Government s new Patent Box initiative that recognises those companies investing in UK research, patents and innovation. This initiative could provide tax relief on profits from certain BT products which are based on our patented inventions.

This year we invested £544m (2011/12: £560m) in research and development to cultivate innovation. Our research, development and testing is done at global development centres located in the UK, US and Asia, and is headquartered at Adastral Park in the UK. These centres help us draw together complementary skills and resources more easily (both our own and third-party). They reduce turnaround time, ensure tighter feedback loops and help us get products and services into the market sooner.

[a] On average, we file with four member states of The Patent Cooperation Treaty and three member states of the European Patent Convention.

This year we opened a new development centre in Kuala Lumpur, Malaysia, and recently opened a new building for our centre in Bangalore, India. These complement our existing centres in Belfast, Glasgow, Cardiff, Adastral Park and Dallas and give us local technical expertise and spread our development more evenly around the world.

Our people help us innovate and improve our service to customers. This year our award-winning internal New Ideas Scheme received more than 1,000 submissions to improve service, generate revenue or reduce costs. Our My Customer Challenge Cup competition encourages our people to identify areas where customer service is not as good as it should be, and work together to make improvements.

Our customers also play a part. We run innovation showcases allowing them to discuss applications and solutions with our experts. In turn, we get to hear firsthand what they need.

This year, our research and development focused on:

- improving broadband coverage. We have field-tested broadband amplifiers and regenerators to extend the reach of our ADSL2+ and fibre services. We have also trialled TV white space radio technology to connect remote communities cost-effectively
- improving broadband speed. We have been trialling new techniques such as vectoring on FTTC lines (a solution which improves speed and stability by reducing interference) and bonding. We have been researching solutions for delivering ultra high-speed broadband (up to 1Gbps) over the final copper drop. And we have trialled the world s first 10Gbps XGPON technology to a customer over a fibre network

transforming our costs. We have built tools to help us speed up network design, use equipment in the best possible way and minimise the cost of build. We are using them to design our FTTP network and support the sale of Ethernet products. We also used them to speed up the design of the London 2012 venue networks
improving video delivery. We have changed the way we deliver TV content. This means we avoid having to duplicate TV content streams over our network, so we will be able to cut costs and give our customers more channels.

Suppliers

Our suppliers from across the world play a vital role in helping us to provide our products and services and deliver our strategy. We work with around 17,400 suppliers, spending approximately £9.7bn a year with them. The top 100 account for around 62% of our annual spend.

The number of suppliers we use is broadly the same as last year. However, the mix of suppliers is constantly evolving as we look to benefit from new and improved products and services.

Our approach to procurement

We want to get the most from our suppliers especially from their diversity, skills and innovation. As part of our cost transformation programme we have concentrated on generating the best value from our largest suppliers. A category approach for the majority of other spend, using competition and supplier negotiations, has achieved cost savings.

We also have a programme looking at our smaller suppliers. This seeks to make sure we get the most from them and that we are not taking on suppliers we do not need.

We have a team of around 300 procurement people in 27 countries working with suppliers on this strategy.

Supplier selection

It is important to us that we know who we are doing business with and who is acting on our behalf. So we choose suppliers using an established set of principles that makes sure both we and the supplier act ethically and responsibly.

We check that the goods and services we buy are made, delivered and disposed of in a socially and environmentally responsible way, by measuring factors such as energy use, environmental impact and labour standards.

You can find out more at www.selling2bt.bt.com

Supply chain human rights

We want our suppliers employees to experience workplace conditions that meet the standards we have developed. We send our suppliers an ethical standards questionnaire and follow up with any suppliers identified as high or medium risk. This year we again met our target to achieve 100% follow-up within three months.

Payment of suppliers

This year the average number of days between invoice date and supplier payment was 60 days (2011/12: 61 days).

In the UK we have a financing scheme that offers contracted suppliers the chance to be paid early. This can be particularly attractive for SMEs. We also follow the Better Payment Practice Code.

You can find out more about the Better Payment Practice Code at www.payontime.co.uk

How we measure our progress

We have three key performance indicators: adjusted earnings per share, normalised free cash flow and customer service improvement.

Adjusted earnings per share

This is the adjusted profit after taxation attributable to our shareholders divided by the weighted average number of shares in issue. As it excludes the impact of specific items it provides a measure of our financial performance in a consistent manner over time.

Read more about adjusted earnings per share on page

Normalised free cash flow

Free cash flow represents the cash we generate from operations after capital expenditure and finance costs. It shows what cash is available to invest in the business, repay debt, support the pension scheme and pay dividends.

Our key free cash flow measure changed from adjusted free cash flow to normalised free cash flow in 2012/13 following the £2.0bn lump sum pension deficit payment made in March 2012. The £520m tax credit relating to the deficit payment would have distorted our cash flow in 2012/13, as would the £202m payment for the 4G spectrum licence.

Normalised free cash flow is therefore before the impact of specific items, purchases of telecommunications licences, pension deficit payments and the tax benefit from pension deficit payments.

Read more about normalised free cash flow on page

Customer service improvement

Our strategy starts with customer service. Right First Time is our key measure and tracks how often we keep the promises we make to our customers. As well as improving service, keeping our promises means there is less work to put things right and so reduces our costs.

Read more about customer service improvement on page

Our risks

Like all businesses, we are affected by a number of risks and uncertainties. These may be impacted by internal and external factors, some of which we cannot control. Many of our risks are akin to those felt by similar companies in terms of scale and operation.

Principal risks and uncertainties

This section sets out the principal risks and uncertainties affecting us, but it is not exhaustive. These risks have the potential to impact our business, revenue, profits, assets, liquidity or capital resources.

As in the prior year, the uncertainties in the global economy and credit markets continue to present challenges, both to our business and to others. These challenges drive a number of the risks that we face and we focus our efforts on predicting and mitigating them. The principal risks we described last year have evolved, and so has our response to them.

Our Enterprise Risk Management framework provides reasonable (but cannot give absolute) assurance that significant risks are identified and addressed. There may be risks which are unknown or which are presently judged not to be significant but later prove to be significant.

In our principal risks section below, we explain what we are doing to prevent our main risks materialising, or to limit their impact.

Our principal risks and uncertainties should be considered in conjunction with the risk management process, the forward-looking statements for this document, and the cautionary statement regarding forward-looking statements.

You can read the cautionary statement regarding forward-looking statements on page

How we manage risk

We need to manage risk so we can meet our objectives, build shareholder value and promote our stakeholders interests. We have a group-wide risk management process. It has four stages which are summarised below.

Changes over the last year

Last year we improved the way we manage risk through better reporting, evaluation and training. This year we have further developed our approach including:

Scenario planning and war gaming. We have already used these techniques to good effect in understanding traditional physical business continuity threats. This year we have also applied them to some of the risks we highlight below

Assurance. Our line of business and service unit audit & risk committees have extended their focus on risk management across their business units. Their advice, analysis and reviews have helped us get better at dealing with risks inside our business

Guidance and toolkit refresh. We have updated our risk management policy and guidance. We have also added to the toolkit that our risk management specialists (and the wider business) use to put our risk management process into action.

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Our principal risks

Security and resilience

In keeping with other organisations that process and store data, we have a responsibility to many millions of customers, both business and consumer, to safeguard their electronic information and to maintain the continuity of services. This requires the highest levels of operational security and resilience, which can be threatened at any time by incidents such as malicious cyber-attacks, theft of copper cable and equipment, vandalism, sabotage, extreme weather, component overload, loss of power and human error. The volume of traffic through our systems and networks is increasing, and customer tolerance of interruptions reduces as the world becomes ever more dependent on information technology.

Changes over the last year

Concerted efforts to deter cable theft, supported by legislative changes and the well publicised arrest and prosecution of thieves, are beginning to reduce the number of service interruptions in the network. Theft of equipment from our premises has also fallen significantly. However, we are detecting more cyber-attacks aimed at stealing data or disrupting our own and our customers websites.

We have strengthened our defences against these cyber-attacks and now routinely cope with attacks

Major contracts

We have a number of complex and high-value national and multinational contracts with certain customers. The revenue arising from, and the profitability of these contracts are subject to a number of factors including: variation in cost; achievement of cost reductions anticipated in the contract pricing, both in terms of scale and time; delays in the delivery or achievement of agreed milestones owing to factors either within or outside of our control; changes in customers requirements, budgets, strategies or businesses; and the performance of our suppliers. Any of these factors could make a contract less profitable or even loss-making.

The degree of risk generally varies in proportion to the scope and life of the contract and is typically higher in the early stages of the contract. Some customer contracts require investment in the early stages, which is expected to be recovered over the life of the contract. Major contracts often involve the implementation of new systems and communications networks, transformation of legacy networks and the development of new technologies. The recoverability of these upfront costs may be impacted by delays or failure to meet milestones. Substantial performance risk exists in these contracts.

Changes over the last year

that a few years ago would have caused considerable risk of data loss. Our segregation and encryption of data has increased. In further recognition of the importance of people and behaviours in managing this risk, a campaign to raise staff and supplier awareness of cyber threats is proceeding in response to the increasing sophistication of attacks. We have also refreshed our data protection governance with the appointment of a Chief Privacy Officer.

We are upgrading much of our equipment to improve reliability, increase capacity and reduce energy consumption. Severe flooding across the UK in the year caused several service outages that demanded urgent action and resources to be diverted.

Impact

A breach of our security, or compromise of data and/or resilience affecting our operations, or those of our customers, could lead to an extended interruption to network services or even affect national infrastructure. Such failure may lead to a loss of customer confidence, termination of contracts, loss of revenue, and reduced cash generation through penalties and unplanned costs of restoration and improvement. Additional reputational damage and financial loss may arise from a legal or contractual failing such as breaching data protection or handling requirements. Failure or interruption of data transfer could also have a significant adverse effect on our business.

Risk mitigation

Our strategy for resilience is to combine formal business continuity planning with well-tested, rapid and flexible responses. We have a rolling programme of major incident simulations to test and refine our crisis management procedures. Our security defences range from physical protection of our assets, access controls, real-time analysis and sharing of intelligence, and continuous monitoring

The difficult economic and market conditions, particularly in Europe, have increased financial and operational pressures on our customers and have made the environment even more competitive. With our investment and expansion into high-growth regions, the landscape of our risks and opportunities naturally changes as we must deal with rapidly evolving geo-political risks and different trading environments and business practices. Our control and governance framework has been extended to include contracts between BT and UK local authorities seeking to extend the reach of fibre broadband in their regions.

For larger contracts, we have recently expanded the scope of independent reviews to critical stages of the contract lifecycle to help identify any key issues, risks and actions which need to be monitored.

Impact

Failure to manage and meet our commitments under these contracts, as well as changes in customers requirements, budgets, strategies or businesses, may lead to a reduction in our expected future revenue, profitability and cash generation. Unexpectedly high costs associated with the delivery of contracts could also negatively impact profitability. We may lose revenue due to the merger or acquisition of customers, business failure or contract termination and contracts may become loss-making. Failure to replace the revenue and earnings lost from such customers could lead to an overall reduction in group revenue, profitability and cash flow.

Risk mitigation

We have in place business processes that support each stage of a major contract s lifecycle: bid; in-life; renewal; and termination. Our programme of in-life reviews is designed to validate financial and non-financial controls over delivery of the contract. It incorporates tiered levels of defined reviews according to the scale and complexity of the contract. Controls are applied and regularly for intrusion and anomalies, through to rapid modification of firewalls and automated blocking of malicious data traffic. Together, these measures increase the likelihood that any potential incidents can be contained and dealt with as quickly as possible.

monitored across our major contracts. All our major contracts are subject to regular management review and many are subject to independent review (both internal and external) as part of that governance. Our independent review programme helps us apply lessons learned and to promote best practice through the business.

Pensions

We have a significant funding obligation in relation to our defined benefit pension schemes. Low investment returns, high inflation, longer life expectancy and regulatory changes may result in the cost of funding BT s main defined benefit pension scheme, the BT Pension Scheme (BTPS), becoming a significant burden on our financial resources.

Changes over the last year

Following the conclusion of the 30 June 2011 triennial funding valuation of the BTPS in May 2012, the valuation documentation was submitted to the Pensions Regulator for their review. The final Court decision in the Crown Guarantee case, after any appeals, will give greater clarity as to the extent to which the liabilities of the BTPS are covered by a Crown Guarantee. This will inform the Pensions Regulator s next steps with regard to the valuation of the Scheme. Accordingly, as matters stand, it is uncertain as to when they will conclude their review.

Government bond yields have fallen since the valuation at 30 June 2011, with real yields being negative at times. This has been caused by a number of factors, including the Bank of England s Quantitative Easing programme. If the fall in yields is maintained and reflected in the next funding valuation, due as at 30 June 2014, this would increase the value of the BTPS liabilities.

Growth in a competitive market

We operate in markets which are characterised by: high levels of change; strong competition; declining prices; technology substitution; market and service convergence; customer churn; declining revenues; new competitors; and regulatory intervention to promote competition and reduce wholesale prices.

A significant proportion of our revenue and profit is generated in the UK where the overall telecoms market has been in decline in real terms, despite strong volume growth in new services. Revenue from our calls and lines services to consumers and businesses has historically been in decline but new broadband and connectivity markets are growing. Our ability to deliver profitable revenue growth in a responsible and sustainable manner depends on us delivering on our strategic priorities (see page 14).

Changes over the last year

The level of risk facing our business increased as the economic situation in the UK and other key markets deteriorated in the year. Depressed business activity together with lower disposable incomes continues to be a major barrier to growing revenues, particularly among business customers.

Regulatory decisions made during the year also contributed adversely to our risk profile, revenue and profits. These decisions failed to address imbalances in the competitive playing field. This means that

The European Commission is reviewing the current Directive for pensions and we responded to a relevant consultation during the year. The Commission s aim is to issue new draft legislation in summer 2013. Depending on its scope, there is potential for any legislative change to have an impact on BT s funding liabilities in the future. We will continue to monitor developments in this area.

Impact

An increase in the pension deficit and associated funding requirements may have an impact on the level of deficit payments we are required to make into the scheme. Indirectly it may also have an adverse impact on our share price and credit rating. Any deterioration in our credit rating would increase our cost of borrowing and may limit the availability or flexibility of future funding, thereby affecting our ability to invest, pay dividends or repay debt as it matures.

Risk mitigation

The investment performance and liability experience, as well as the associated risks and any mitigation, are regularly reviewed and monitored by both us and the BTPS Trustee.

The BTPS has a well-diversified investment strategy, which reduces the risk of adverse movements in the value of individual asset classes and helps ensure that an efficient balance of risk and return is maintained.

Our financial strength and cash generation provide a level of protection that enables variations in the funding position of the BTPS to be managed without having a material impact on the ongoing performance of our business.

some of our competitors in the consumer space benefit from limited regulation on their core business combined with extensive sector-specific regulation being applied to our UK fixed-line business.

A number of competitor-related developments have contributed to the risk increasing. These include, but are not limited to: the acquisition of Cable & Wireless Worldwide by Vodafone; the decision by Vodafone and O2 to establish a joint venture to consolidate existing network infrastructure and local transmission; the agreement which brought forward the timetable for 4G mobile services being launched in the UK; and increased competitive activity around over-the-top video-on-demand services in the UK.

Impact

Failure to achieve profitable revenue growth from our strategic priorities may lead to a continued decline in revenue, erosion of our competitive position and might also lead to a reduction in profitability and cash flow in the future.

Risk mitigation

Our mitigation of this risk centres on successfully executing our strategy. We believe that delivering this strategy, with its focus on Customer service delivery, Cost transformation and Investing for the future, as well as investing in our existing business and offering new services in adjacent markets, will together help us drive profitable revenue growth.

We have a well-developed cost transformation programme in place which should provide future savings to support profitability trends. We also believe risks can be mitigated by seeking changes in regulation to level the playing field so that we can compete effectively, and for the benefit of our customers.

Communications industry regulation

Our activities across all the jurisdictions in which we operate can be impacted by regulation. Regulatory requirements and constraints can directly impact our ability to compete effectively and earn revenues.

In the UK where, following detailed market analysis, we are found to have significant market power, Ofcom requires us to provide wholesale services at regulated prices. It can also require us to make retrospective repayments to other CPs where we are found to have set prices outside regulatory requirements, and can impose fines on us for non-compliance with the regulatory rules, including competition law.

Outside the UK, general licensing requirements can restrict the extent to which we can enter markets and compete. Regulation will also define the terms on which we can purchase key wholesale services from others.

In the UK, risks can come from, for example, periodic market reviews which might introduce tighter regulatory constraints from new charge controls or from CPs disputing or complaining about our pricing, products or services. Outside the UK, regulators can investigate our licensing requirements and whether our services comply with their rules.

Business integrity and ethics

We are committed to maintaining high standards of ethical behaviour, and have a zero tolerance approach to bribery and corruption. We have to comply with a wide range of local and international anti-corruption and bribery laws. In particular the UK Bribery Act and US Foreign and Corrupt Practices Act (FCPA) provide comprehensive anti-bribery legislation. Both have extraterritorial reach and thereby cover our global operations. As we expand internationally, we are increasingly operating in countries identified as having a higher risk of bribery and corruption.

We also have to ensure compliance with trade sanctions, and import and export controls.

Changes over the last year

The Serious Fraud Office (SFO) has produced revised guidance on the UK Bribery Act. The SFO has indicated it will now focus on its role as an investigator and prosecutor of serious and/or complex fraud and where there is sufficient evidence and it is in the public interest, prosecutions rather than civil settlements will now be pursued, even where companies have self-reported. This represents a change to its previous stance where self-reporting may have led to more lenient treatment. It has further confirmed that it considers facilitation payments to be bribes.

Changes over the last year

Over the last year, we have seen regulatory activity in a number of areas which are summarised in **Regulation** on page 38. A number of these rulings have resulted in a negative impact either through retrospective price reductions or on our future pricing.

Impact

Risks from regulation are most significant in the UK.

Around £5.8bn of our revenue (of which £3.3bn is to downstream parts of BT) is from wholesale markets where we have been found to hold significant market power and which are currently subject to regulatory charge controls. Most of these controls require us to reduce our prices annually to reflect expected reductions in unit costs through efficiency savings. Controls are usually set for three years and will therefore constrain revenues during that period.

Other CPs can ask Ofcom to resolve disputes with us about current or historic prices. Where Ofcom finds that these prices are, or have been, set at levels above those required under the regulatory framework, we may need to make retrospective payments to CPs.

We may from time-to-time be required to provide new services, or existing services on improved terms, to wholesale customers on a non-discriminatory basis. This could increase our costs.

The US Department of Justice and Securities and Exchange Commission have also produced guidance on the FCPA giving information about the US government s approach to FCPA enforcement.

In addition, sanctions regulations in Europe and the US have been extended.

Impact

Failure by our employees, suppliers or agents to comply with anti-corruption and bribery and sanctions legislation could result in substantial penalties, criminal prosecution and significant damage to our reputation. This could in turn impact our future revenue and cash flow, the extent of which would depend on the nature of the breach, the legislation concerned and any associated penalties. Allegations of corruption or bribery or violation of sanctions regulations could also lead to reputation and brand damage with investors, regulators and customers.

Risk mitigation

We have in place a number of controls to address risk in this area. These include a comprehensive anti-corruption and bribery programme, The Way We Work , which is our statement of business practice and is being refreshed to give greater guidance to our people. We ask all BT employees to sign up to its principles and our anti-corruption and bribery policy. We have specific policies covering gifts and hospitality and charitable donations and sponsorship. We run a training programme with a particular focus on roles such as procurement and sales.

We regularly assess our business integrity risks to make sure that the appropriate mitigation is in place. We operate a confidential hotline. Our internal audit team regularly runs checks on our business. We also use external providers to carry out assessments in

Regulation outside the UK can impact our revenue by restricting our ability to compete through overly-restrictive licensing requirements or ineffective regulation of access to other CP networks.

Risk mitigation

We employ a team of regulatory specialists (including accountants and economists) who, together with legal experts and external advisors, continuously monitor and review the scope for regulatory changes and potential future disputes. This team maintains a dialogue with regulators and with other key influencers to ensure our positions are understood and to drive for fair and proportionate regulation. We are also able to appeal any regulatory decisions where we believe errors have been made.

areas we believe to be higher risk, to ensure our policies are understood and the controls are functioning.

We conduct due diligence checks on third parties including suppliers and agents. Procurement contracts include anti-corruption and bribery clauses. A trade sanctions policy and sign-off procedure are also in place.

Supply chain

The integrity and continuity of our supply chain is critical to our operations. Our aim is to harness the capability, diversity and innovation of the global supply market to add value to our business and customers. We are committed to ensuring that all dealings with suppliers, from selection and consultation to contracting and payment, are conducted in accordance with our trading and ethical policies. See **Suppliers** on page 22.

The failure of a critical third-party supplier to meet its obligations could cause significant harm to our business and the BT brand, as well as potentially impact our cost transformation and efficiency plans.

Changes over the last year

Many suppliers continue to be impacted by the global economic downturn and as a result we have seen an increase in the number of suppliers suffering from financial distress. The downturn has also increased the risk of suppliers applying less focus on key areas such as business continuity management or corporate and social responsibility in an effort to reduce their costs.

Impact

Whilst the size of the impact from a supplier failure can vary, all supplier failures typically result in an increased cost to our business and have the potential to negatively impact the service we provide to customers. In many cases the cost associated with supplier failure is significant, particularly if it then results in us having to change technology. If we are unable to contract with an alternative supplier, our customer commitments could also be compromised, possibly leading to contractual breach, loss of revenue, penalties or increased costs.

A failure in our supply chain to meet legal obligations or ethical expectations could adversely impact our reputation or possibly lead to censure, legal action and financial loss.

Risk mitigation

We conduct supplier risk analysis as part of our sourcing strategy, and where possible, take actions to reduce risk, such as through dual-sourcing where appropriate. We operate a comprehensive in-life risk mitigation programme that classifies our suppliers into appropriate risk categories and then aims proactively to build risk mitigation plans and detect potential supplier failures before they happen. For our critical suppliers this mitigation strategy considers a range of risks including: financial failure; supplier capability and capacity; sole sourcing; corporate and social responsibility; business continuity; security; location; and the overall supplier relationship.

This approach has been complemented by a programme specifically looking at our low spend suppliers, to ensure we achieve maximum business benefit but at the same time do not contract with too many suppliers, exposing us to unnecessary risk.

By adopting this approach, we seek to minimise the risk of not being able to meet our customer and legal commitments or comply with our ethical policies. This helps to minimise our exposure to loss of revenue, financial penalty and any adverse impact on our brand and reputation.

We work closely with our suppliers to ensure that the goods and services that we buy are made, delivered and disposed of in a socially and environmentally responsible manner.

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Business

In this section we explain how we are organised to deliver our strategy. We provide information on the products and services we sell. We explain the different customers and markets we serve and the trends we are seeing in our markets. We also explain the regulatory environment that affects us.

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Operating Committee

The key management committee is the *Operating Committee*, which meets weekly and is chaired by the Chief Executive. Its members are set out below.

The *Operating Committee* has responsibility for running our business and delivering our strategy. It monitors the group s financial, operational and customer service performance and has cross-business oversight of the lines of business. It also reviews the group s key risks and considers the potential threats and opportunities for the business. You can read more about the *Operating Committee* on page 67.

1. Ian Livingston[a]

Chief Executive

Appointed Chief Executive in June 2008. Ian was formerly CEO, BT Retail and prior to that, Group Finance Director.

2. Tony Chanmugam[a]

Group Finance Director

Appointed Group Finance Director in December 2008. Tony was formerly CFO, BT Retail and Managing Director, BT Enterprises.

3. Gavin Patterson[a]

CEO, BT Retail

Appointed CEO, BT Retail in May 2008. Gavin was formerly Managing Director, Consumer Division, BT Retail.

4. Luis Alvarez

CEO, BT Global Services

Appointed CEO, BT Global Services in October 2012. Luis was formerly president of the Europe, Middle East, Africa and Latin America operations of BT Global Services.

5. Clare Chapman

Group People Director

Appointed Group People Director in October 2011. Before joining BT, Clare was director general of workforce for the NHS and Social Care at the Department of Health. Clare was also previously group personnel director at Tesco.

6. Clive Selley

CEO, BT Technology,

Service & Operations & Group CIO

Appointed CEO, BT Technology, Service & Operations in January 2013. Clive was formerly CEO, BT Innovate & Design and prior to that President of Portfolio & Service Design.

7. Nigel Stagg

CEO, BT Wholesale

Appointed CEO, BT Wholesale in September 2011. Nigel was formerly BT Business Managing Director, BT Retail and prior to that Managing Director, Customer Service, BT Retail.

8. Olivia Garfield

Invitee

CEO, Openreach

Appointed CEO, Openreach in April 2011. Olivia was formerly Group Director, Strategy, Policy and Portfolio and prior to that held roles in BT Global Services. The CEO of Openreach cannot be a member of the *Operating Committee* under the provisions of the Undertakings.[b]

Members

[a] Directors of BT Group plc. You will find their full biographies on pages 65 and 66.
[b] You will find more information on the Undertakings on page 39.

How we deliver our strategy

Our business is built around our customers serving their needs and delivering value to them.

How we are organised

We have four customer-facing Iines of business: BT Global Services, BT Retail, BT Wholesale and Openreach. They are supported by our internal service unit, BT Technology, Service & Operations.

BT Global Services

We are a global leader in managed networked IT services. We work for around 7,000 large corporate and public sector customers in more than 170 countries worldwide. We focus on serving the following key industries and regions.

Our customers benefit from our global reach and our ability to deliver services locally in the countries they are in. They also gain from our ability to tailor products and services to their industry. During the year we increased the number of industries we focus on to include global systems integrators, logistics and mining, oil & gas.

The UK is our largest region by revenue. We have a large base of customers in the corporate sector and serve public sector bodies such as central government and local councils.

In continental Europe, we run large businesses in key countries such as Belgium, France, Germany, Italy, the Netherlands and Spain. Current Analysis ranked us second in the German market for pan-European and global IP and data services.[a] In Italy, we are the main country-wide operator exclusively focused on business-to-business services.[b] In Spain, the telecoms regulator ranked BT as the leading alternative to the incumbent operator in the enterprise data market.[c] We also support customers in Central and Eastern Europe, the Nordics and Russia.

In the United States and Canada, we serve customers from offices in more than 25 key cities.

We have an increasing presence in the high-growth regions of Asia Pacific, Latin America, Turkey, the Middle East and Africa. We operate in 85 countries in these markets, helping multinationals expand into these regions and supporting local companies as they grow internationally. We continue to invest in these markets, hiring more people, improving our products and services and building network and IT infrastructure.

[a] Current Analysis, *BT Germany: company assessment* (August 2012), page 2.
[b] AGCOM, *Relazione annuale 2012: sull attività svolta e sui programmi di lavoro* (July 2012), page 98.
[c] CMT, *Industry Sector Report 2011* (June 2012), page 60.

Products and services

We combine our products and services with industry expertise and consulting services. We have simplified our products categorising them around what our customers need and making them more straightforward to buy and link together. Those categories are:

BT Assure Security that protects

People and businesses are using more mobile devices, social media and cloud services. Together with the growth in cyber-attacks, this means that customers are prioritising security. We provide a range of security products and services including firewalls, web security, intrusion prevention and threat monitoring.

BT Compute Services that adapt

Businesses want reliable but flexible IT platforms and services for their applications, data storage and security. We provide IT services in our worldwide data centres and deliver them over our global network.

BT Connect Networks that think

Our network services connect our customers to their people, their own customers and to the world. We offer a range of IP, Ethernet and web-based network services. We deliver these in more than 170 countries over a range of access technologies including DSL, VPN and satellite.

BT Contact Relationships that grow

We provide a range of contact centre services to help our customers build stronger relationships with their customers. Our services provide the option of using email, web chat, social media and the phone either via automated systems or dedicated advisors. Our cloud solution gives customers more flexibility and control over their costs by allowing capacity to change in response to demand.

BT One Communications that unify

Businesses communicate in a number of different ways by phone, SMS, voicemail, instant messaging, email, video conferencing and data-sharing solutions. They want these channels to be integrated and work together. Our collaboration services help customers simplify their communications and transform the way they interact with their customers, colleagues, partners and suppliers.

BT Advise Knowledge that delivers

Our experts around the world provide consulting, integration and managed services to our customers. They help solve business problems. They have a range of specialisms, certifications and accreditations to make sure customers get the best out of our products and services.

Industry-specific solutions

As every industry has its unique needs and challenges, we provide a range of industry-specific solutions. For example, BT Radianz links financial institutions from around the world, giving them access to hundreds of critical applications. BT for Life Sciences R&D lets research scientists collaborate on a secure platform. BT Trace helps organisations manage increasingly complex global supply chains by giving them a single real-time view of their operations.

BT Retail

BT Retail has four customer-facing divisions: BT Consumer, BT Business, BT Ireland and BT Enterprises.

BT Consumer

We are the leading consumer voice and broadband provider in Great Britain and have a growing pay-TV service. We sell our services under the BT and Plusnet brands.

We help our BT-branded services stand out from the competition by offering a range of extra features. Plusnet provides voice and broadband services for more cost-conscious customers who value our highly-regarded customer service. We are a member of the YouView TV consortium and during the year secured a wide range of sports content to show on our BT Sport channels.

BT Business

We supply SMEs in Great Britain with fixed calls and lines, broadband, mobility and IT services as well as data and voice networks. We also have specialist arms within BT Business including:

BT iNet	A Cisco centre of excellence specialising in infrastructure, security and unified communications
BT Engage IT	A leading provider of business-to-business IT equipment and services
BT Business Direct	An online store providing IT, computing and networking equipment plus associated installation and support services

BT Ireland

In Northern Ireland, we are the leading communications services provider for consumers, SMEs and the public sector. We run the copper access network and our fibre rollout has reached over 90% coverage, making Northern Ireland one of the best connected regions in Europe.

In the Republic of Ireland, we serve corporate and public sector customers and are one of the country s largest providers of wholesale network services.

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BT Enterprises

BT Enterprises consists of seven separate divisions, each one operating as a standalone business. BT Fleet was moved into BT Enterprises in April 2013.

BT Conferencing	Audio, video and web conferencing and collaboration services for business customers in the UK and around the world
BT Directories	Directory Enquiries (118500), operator and emergency services. Marketing services including The Phone Book, website design and web-based promotion (to help customers advertise online)
BT Expedite & Fresca	Services for the retail sector including store point of sale systems, back-office applications like merchandising and sales analytics, and software and platforms for web commerce
BT Redcare	Fire and intruder alarm signalling services, CCTV and surveillance networks, and control room services. Mobile-to-mobile services for vending machines, cash machines and payment terminals, taxis and fleet management
BT Payphones	Public payphones and managed prison, card and private payphones

BT Wi-fi	More than five million UK hotspots offering broadband on the move to consumers and small businesses and to wholesale customers like mobile network operators
BT Tikit	IT products and services for legal and accountancy firms

Products and services for Consumers

We mainly sell three things to consumers: fixed-voice, broadband and TV. To win and keep customers we must offer all three in flexible bundles. We offer a wide choice of good-value packages that encourage customers to take extra services. Most of our sales are through our call centres or online, with some through our customer service team.

Voice services

We provide customers with fixed-lines and a choice of calling plans, including unlimited options for evening, weekend and peak-time calling. All our plans include features such as call waiting and free calls to 0845/0870 numbers.

We offer different ways to pay. Line Rental Saver gives a large discount on line rental to customers who pay for a year upfront.

We offer BT Basic, a simple, low-cost phone service for people on low incomes. We are the only company to offer such a service.

This year we launched the SmartTalk app. Customers can use it to make calls on their smartphones over wi-fi (in the UK and abroad) which are billed as part of their home calling plan.

We also launched a new phone which lets customers reduce nuisance calls by allowing them to block international, withheld, or specific numbers.

Broadband

BT Broadband is our standard service delivered over copper lines. BT Infinity is fibre-based using FTTC and FTTP technology. BT Broadband and BT Infinity come in a range of options with different usage limits and bundles of call plans. They also include our free BT Home Hub, free BT Cloud online storage, BT NetProtect Plus security software and free access to our wi-fi hotspots.

TV services

We have two on-demand subscription packages: TV Essential and TV Unlimited. Customers can also get linear channels and extra features depending on which set-top box they choose and whether or not they have BT Infinity.

We started offering customers our YouView set-top box in October 2012. It gives them standard definition (SD) and HD Freeview channels and the ability to pause, record and rewind live TV and on-demand content. YouView s programme guide scrolls back seven days to give customers easy access to catch-up TV from BBC iPlayer, ITV Player, 4oD and Demand 5. Customers with our Vision 2.0 set-top box get advanced search and recommendation facilities in addition to the same basic features.

BT Infinity customers with a Vision 2.0 set-top box can buy our Extra TV service, giving them 18 extra SD channels and four HD channels, including popular channels such as National Geographic and Comedy Central. We will be bringing these channels to YouView boxes in the summer.

Products and services for UK SMEs

We sell fixed-voice, broadband, networking, IT and mobility products and services. These range from simple standalone products to managed services and complex customised solutions. Our bigger customers buy from us through desk-based and field-based account managers. Smaller customers use four channels: call centres; 40 Local Businesses partners (not part of BT but exclusively selling our products and services); non-exclusive relationships with indirect partners; and bt.com.

Voice services

Our fixed-voice services range from standard calls and lines to fully-managed office phone systems and contact centre solutions. As well as traditional voice, we are increasingly selling VoIP services.

Broadband and internet

We provide a range of internet access options including BT Business Broadband over copper, BT Infinity for business (over FTTC and FTTP) and BTnet dedicated internet access. We also sell email, hosted Microsoft collaboration services and web-hosting.

Networking services

Our voice and data networking services support customers who need to connect different sites. We design, install and manage leased lines, Ethernet services, IP virtual private network (IPVPN) services, SIP trunking, structured cabling and local area networking solutions.

IT services

We offer IT services through five businesses.

BT iNet and BT Engage IT sell cloud and data centre services, unified communications, security solutions, end-user support services, hardware, software and consultancy services. They partner with most leading vendors companies like Cisco, Microsoft, Citrix, HP, EMC, VMware, Oracle, NetApp, Apple and Symantec. BT Business Direct sells hardware and software from a wide range of suppliers. BT Expedite & Fresca specialises in the retail sector. BT Tikit combines its specialist legal and accountancy software products with the best technologies from multiple partners to give customers a fully-integrated solution, supported by a single supplier.

Mobility

We sell mobile voice and broadband data services through a mobile virtual network operator (MVNO) agreement with Vodafone. Our 4G mobile spectrum licence will help us build on our existing proposition and offer an even better range of mobile services.

BT Wholesale

BT Wholesale sells voice, broadband and data communications products to fixed and mobile network operators (MNOs), internet service providers (ISPs) and telecoms resellers in Great Britain. Our managed network services combine BT products with third-party components and our own professional services, which include network solution design, field services, network migration, programme management and risk management. We also offer industry-specific services to media companies and broadcasters.

Products and services

Wholesale broadband

CPs buy wholesale fibre and copper broadband services from us. Our WBC portfolio includes three FTTC options, eight FTTP options and our ADSL2+ copper broadband service.

The rollout of ADSL2+ and fibre broadband is well advanced in the UK. This means that from autumn 2013 we will be retiring our legacy wholesale broadband services within the WBC footprint. We are working closely with CPs to help them migrate their customers smoothly.

Wholesale Ethernet

We design high-bandwidth Ethernet services to help CPs extend their networks and give their own customers high-quality services. With speeds of 2Mbps to 10Gbps, we have the widest range of Ethernet access options on offer.

Partial private circuits

We are a major provider of partial private data circuits which enable our customers to complete their own networks and help them extend the reach of their services.

Voice services

We offer managed voice solutions for CPs who do not want to invest in their own PSTN or IP voice networks. Our Wholesale Calls product is an end-to-end PSTN voice service and in 2013/14 we will be launching new IP hosted communications services including SIP trunking, IP Centrex and hosted contact centre solutions.

IP Exchange (IPX)

We offer voice interconnect services so that a phone call will reach its destination at an agreed level of quality. The migration of voice calls to IP requires new interconnect arrangements which are made simple by IPX. It enables fixed and mobile operators with differing VoIP networks to connect VoIP-to-VoIP and VoIP-to-traditional voice calls by seamlessly translating them in an electronic clearing house and it supports emerging services such as HD voice.

We sell IPX through BT Wholesale in Great Britain and internationally through BT Global Services.

Transit

We route voice services between CPs across our network, both in the UK and internationally, but this is a low-margin product with declining demand.

Managed Network Services (MNS)

Our managed network services give CPs access to our expertise and economies of scale and help them reduce their operational and future capital spending.

We design, build, manage and transform networks for them, while our white-label managed services help them offer products like voice and broadband without the need to make large investments. Our solutions can be either dedicated to one customer or shared amongst several. We can offer a complete service, from accepting and processing new orders through to customer service and billing the end-user.

Media and broadcast services

Our global media network links all the main locations around the world where producers create or distribute broadcast content. We have a number of strategic alliances which extend our portfolio and customer reach. In the UK, digital terrestrial TV delivery is underpinned by our media-specific MPLS network and we deliver TV outside broadcast services over our network connecting 155 sports and news locations.

In addition, BT Agilemedia offers high-quality solutions to enable mass viewer participation in TV voting and competitions.

Openreach

At Openreach we want to improve access to broadband across Britain. We believe this will support economic growth.

We are responsible for providing services over the local loop (sometimes known as the local access network and the last mile). This is made up of the copper and fibre connections between our exchanges, and homes and businesses. We are in charge of BT s fibre broadband rollout. We also offer backhaul products to connect exchanges to CPs networks.

BT s Undertakings (more on page 39) commit us to selling our main products and services to all CPs openly and equally and on the same terms as we do to our own lines of business. To make this work properly, Openreach s operational, engineering and systems capabilities are separate from those of the rest of BT. Around 96% of Openreach revenue is subject to this regulation.

Products and services

Openreach sells three main products: fibre broadband, copper-based services and Ethernet.

Fibre broadband

This is either FTTC, which offers speeds of up to 80Mbps, or FTTP, which offers faster speeds of up to 330Mbps when fibre is connected all the way to the customer premises.

In April 2013 we launched FTTP-on-Demand, which will initially be available within a subset of the FTTC footprint. It will let end-users in FTTC areas get a FTTP connection if they need one we think SMEs will be especially interested in the faster speeds.

With our Fibre Voice Access product, CPs can offer voice services over fibre which offer similar functionality to copper voice services.

Our fibre broadband network can also carry broadcast Internet Protocol television (IPTV) services. We have launched a multicast capability which cuts the costs of delivering broadcast TV over our network and means CPs (generally triple play providers) can prioritise broadcast TV over other web traffic.

Passive Infrastructure Access (PIA)

PIA products allow CPs to rent space in Openreach s ducts or on telegraph poles. CPs can use this space for their own fibre instead of buying fibre-based broadband from us.

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Wholesale Line Rental (WLR)

WLR lets CPs offer own-branded phone services (with their own pricing and billing) using our equipment and network. They pay to use the copper line between our exchanges and customer premises but can avoid investing in extra network equipment or infrastructure.

Local Loop Unbundling (LLU)

LLU allows CPs to offer DSL-broadband services by installing their own equipment in our exchanges and renting the copper line. CPs can use our shared metallic path facility (SMPF) product to offer broadband over a WLR line or our metallic path facility (MPF) product to offer both phone and broadband services using their own equipment.

Ethernet

Our Ethernet products offer dedicated, symmetric, fibre-connectivity. CPs use them in their own networks and to provide high-quality, high-bandwidth services to businesses and the public sector.

You can read more about these services at
www.openreach.co.uk

BT Technology, Service & Operations

During the year we brought together BT Innovate & Design and BT Operate, our two internal service units, to form BT Technology, Service & Operations (BT TSO). There were around 17,000 people in BT TSO at 31 March 2013, supporting our customer-facing lines of business.

We created it to simplify the way we work, help us further transform our cost base and speed up and improve delivery to BT customers. It is a simpler organisation with more efficient processes and fewer hand-offs. This means our design and development teams can react more quickly to operational changes and events.

Products and services

BT TSO is responsible for the whole lifecycle of our global networks and systems from innovation, design, test and build through to operational management. We manage BT s voice, data and TV networks and IT applications which make up the core infrastructure for BT s products and services. Our people also design and deliver the networks and platforms which are used by our customer-facing lines of business, and the large-scale global managed network services which are sold to customers in the UK and internationally.

We manage and deliver BT s long-term technology strategy and research and innovation programmes, including managing BT s worldwide patent portfolio (see page 21).

We are also responsible for managing the group s energy consumption and for putting strategies in place to cut our future carbon footprint.

Reducing our energy use

In the UK, we spent £274m on energy this year. Even though business volumes have increased, we have achieved our fourth consecutive year of worldwide energy reduction, using 3.3% less energy this year against our target of 1.5%. The energy saving programmes we ran in 2012/13 are expected to generate £33m in annualised cost benefits.

Climate stabilising intensity

We track how we are doing on climate change with a climate stabilising intensity performance indicator.

We want to cut BT s CO_2e intensity by 80% by December 2020 (compared with 1996/97). This year we achieved a 77% cumulative reduction.

Security

Our physical and cyber security operations were previously managed by BT Operate. We now manage these through a separate security enterprise, BT Security, which is supported by BT TSO engineers. This business is in charge of protecting our own and customers data and assets. We believe that it differentiates the services we can offer and will help us win in the market.

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Our customers and markets

We serve a number of different types of customers in the UK and around the world. In this section we explain who our customers are and the trends we see in the markets where we operate.

UK consumers

We serve UK consumers through BT Consumer and BT Ireland (both parts of BT Retail).

There are around 26m households in the UK and our consumer products and services can reach almost all of them.

The market for fixed calls and lines, broadband and TV is very competitive. There are around 114 companies offering voice and/or broadband services. The market has concentrated over the last few years with several strong players emerging. The four largest providers are BT, Virgin Media, Sky and TalkTalk.

Fixed calls and lines

Around 22m, or 84% of homes in the UK have a fixed phone line. That proportion has stayed steady for the past three years. Around 15% of UK homes only have a mobile phone with around 1% having no phone at all.

There were 24.4m home phone lines in the UK as at December 2012 (including some homes which have more than one phone line and some SMEs who buy consumer services). That is up 2% compared with last year. An overall rise in the total number of homes in the UK coupled with more demand for fixed broadband connections played a part in that growth.

At 31 March 2013 we had a total of 10.2m consumer fixed-lines in the UK, with around 9.8m active voice lines (where a customer buys calls from us as well as paying for the line).

We have the largest share of fixed-lines to homes in the UK at 42%, compared with 47% last year. Our share has been declining over the last few years as competitors have taken advantage of the favourable regulatory regime in the UK.

The number of minutes spent on calls from fixed-lines has been falling for some time. Customers are increasingly using mobiles, email, social networking and other kinds of communication instead. Our total call volumes declined 9% in the year, compared with an 11% decline last year.

Broadband

The UK has one of the highest levels of broadband availability in Europe. Almost all homes can get a fixed broadband connection and around three-quarters do so.

The UK also compares favourably on broadband pricing. Ofcom research ranks the UK the seventh cheapest out of 25 European countries for standalone broadband and sixth cheapest out of 23 countries for broadband and voice bundles.

At 31 March 2013 there were around 21.9m DSL, fibre and cable broadband connections to homes and businesses in the UK, up by 5% over last year.

Fibre penetration has grown significantly during the year. There are more connected devices and people are using more bandwidth-intensive applications such as watching video, streaming music and playing online games. More than half of households now own web-connected games consoles, over 40% of individuals connect their TV to the internet, and 15% of households own a tablet device.

According to Ofcom research, the average broadband download speed for the UK was 12.0Mbps in November 2012. That is up from 7.6Mbps a year earlier. Plusnet was ranked highest for average download speeds over copper. BT Infinity offers the most consistent speeds over a 24-hour period, with the lowest network congestion at peak times, and the fastest upload speeds in the country.

We have around 6.7m retail broadband customers (including business customers). We are the UK s biggest broadband provider with a 31% share of the total broadband market at 31 March 2013. Excluding cable, we have a 38% share. As with fixed calls and lines, Sky, Virgin Media and TalkTalk are the other big players. Mobile operator O2 left the fixed broadband market during the year.

We now have around 1.3m retail fibre broadband customers representing 19% of our retail broadband customer base.

TV services

Broadcast TV is currently the most common way for people to watch television. There are three main platforms satellite, cable and digital terrestrial.

But broadband is revolutionising the way people watch, especially with interactivity and on-demand TV. The public sector broadcasters offer free on-demand content services such as BBC iPlayer, ITV Player, 4oD and Demand 5. All the UK s main pay-TV providers also offer on-demand services. These are either free as part of a monthly subscription for broadcast channels, covered by an extra subscription or are on a pay-per-view basis.

There are other subscription-based providers such as Netflix and LOVEFiLM and pay-per-view providers such as Blinkbox. These over-the-top providers stream content over the web without owning any of the distribution infrastructure.

There are 14.8m UK pay-TV subscribers, making up 54% of TV households. The rest typically receive free digital terrestrial channels via Freeview or Freesat.

Sky has the largest market share of pay-TV subscriptions at 66%. We have a 5% share. During the year we grew our TV customer base by 15% compared with 1% for Sky and 0% for Virgin Media.

UK SMEs

We serve the UK SME market through BT Business and BT Ireland, which both sit within BT Retail. We also deliver specialist services to SMEs (as well as larger corporates) through BT Conferencing, BT Expedite & Fresca, and other divisions in BT Enterprises.

There are an estimated 4.8m UK SMEs, from sole traders to businesses with up to 1,000 people. Their communications and IT needs vary widely, depending on factors such as size, number of sites, industry and maturity.

At the smaller end of the market, customers needs are simple and they sometimes buy services from consumer-orientated providers. Larger customers have more complex needs, typically buying a range of voice, data, IT and mobile services.

We have around 1m SME customers in the UK. Small businesses with fewer than 50 people make up more than 90% of these.

The SME market for fixed and mobile communications and IT services in Great Britain is fragmented and highly competitive. It is worth around £30bn of which we have a 7% share.

Fixed calls and lines

The SME market for fixed-voice is declining, with call volumes falling due to substitution by mobile, email and VoIP.

There are 8.8m business lines in the UK many SMEs take more than one line. We have a 47% market share of business lines, down two percentage points in the year. Our share of access and calls revenue was flat in the year. We compete against more than 300 resellers and fixed network operators. Daisy, TalkTalk, Virgin Media, XLN, Alternative Networks, Cable & Wireless Worldwide (now owned by Vodafone), Colt Group and KCOM Group are our main competitors.

IT services

The IT services market stayed broadly flat this year. There has been more interest in both cloud-based services (like managed hosting of IT applications and data) and unified communications services, which give businesses better flexibility over their costs. Our biggest competitors in IT services are SCC, Computacenter, Phoenix IT, Kelway, Dimension Data and Logicalis.

Mobile

Revenue in the UK mobile market has fallen, impacted by mobile termination rate reductions and price erosion. Call volumes have fallen slightly but data volumes are increasing strongly due to the growth in smartphones and tablets. We have focused on a few specific mobile

opportunities. We have a small market share but our subscriber base is growing. The main operators in the UK mobile market are Vodafone, O2 and EE.

Conferencing

Demand for conferencing services is growing, particularly as companies seek to reduce their travel costs. We sell conferencing services both in the UK and overseas. The global audio conferencing market has continued to expand, with volume growth more than offsetting declining prices. In video conferencing, growth is particularly strong in the personal (desktop) market.

Large corporate and public sector customers

Large corporate and public sector customers are served by BT Global Services. They are our biggest segment by external revenue.

Gartner, a leading information technology research and advisory company, estimates that the global business ICT market is worth around £647bn.

The market consists of a wide range of products and services. Suppliers range from large network-based vendors like us through to niche technology players. Vendors specialise in different services such as systems integration, software development, IT hardware and telecoms solutions.

Gartner expects the global business ICT market to grow at a compound annual growth rate of 3.1% over the next three years.

Demand for network-based services, such as data, mobility, social networking, cloud and security is driving that growth as businesses seek to tap into key technology trends and global opportunities. Demand for more traditional services is declining as customers switch to newer technologies.

[a] The Gartner Report described herein, Gartner, Forecast: Enterprise IT Spending by Vertical Industry Market, Worldwide, 2011-2017, 1Q13 Update represents data, research opinion or viewpoints published, as part of a syndicated subscription service, by Gartner, Inc. (Gartner), and are not representations of fact. Each Gartner Report speaks as of its original publication date (and not as of the date of this Report) and the opinions expressed in the Gartner Report(s) are subject to change without notice.

Gartner expects the market to grow in all the regions we operate in albeit at different rates. Continental Europe is expected to experience the lowest rate of growth at 2.0% a year over the next three years. In contrast, Asia Pacific, Latin America, Turkey, the Middle East and Africa should grow at 3.3% a year.

In the global business ICT market, we are focused on delivering major managed networked IT services securely, efficiently and globally.

According to ISG Research, BT has the highest standalone managed network services (MNS) market share globally, is the only provider with double-digit share for standalone MNS services in each of the three major regions (Americas, Asia Pacific and EMEA), and is the standalone MNS market share leader in EMEA.

We experienced tough conditions in Europe and the financial services sector during the year. But we are increasing our market share in the high-growth regions.

The public sector generated 26% of our revenue. In the UK, we are one of the Government s largest suppliers of networked IT services as a whole, they are our biggest customer. Except as described on page 39, we have a normal customer and supplier relationship with them. Of our corporate customers, financial institutions are our largest customer segment, generating 19% of our revenue in the year. We also supply a range of services to other telecoms companies.

We serve:

- 94% of the FTSE 100 companies
- 74% of the Fortune 500 companies
- 100% of Interbrand s top 50 annual ranking of the world s most valuable brands
- the world s top stock exchanges, leading broker-dealers and biggest banks
- national and local government organisations and other public sector bodies in 26 countries around the world.

As well as pursuing new customers, we aim to grow our share of existing customers spending through increasing the number of products and services we sell to them.

Wholesale customers

We serve the wholesale telecoms customer segment in Great Britain through Openreach and BT Wholesale. In Northern Ireland and the Republic of Ireland, we serve wholesale customers through BT Ireland. Everywhere else in the world, we serve the wholesale market through the wholesale arm of BT Global Services.

Openreach sells local loop and backhaul services to around 500 CPs the largest being Sky, TalkTalk and BT lines of business.

BT Wholesale works with more than 1,400 CPs, including all the big fixed and mobile operators, ISPs and broadcasters. We manage and support the network and services needs of many UK operators including EE, KCOM Group, MBNL, O2, Virgin Media and Vodafone. Our biggest competitors are Cable & Wireless Worldwide, Colt Group, TalkTalk and Virgin Media, as well as Ericsson for managed services.

Outside the UK, we offer wholesale telecoms services to more than 1,200 CPs around the world. We compete with the wholesale divisions of local incumbents, alternative network operators and global wholesale telecoms companies like BICS and Level3.

We are Europe s largest telecoms services wholesaler by revenue.

Regulation

Communications services are vital in a modern world. This means the industry sometimes needs to be controlled and monitored. In nearly all our markets, these services are subject to regulation by governmental and non-governmental bodies. In this section we explain some of the recent and upcoming decisions taken by regulators and how they affect us.

European Union (EU) regulation

In EU countries, electronic communications services are governed by a number of European directives and regulations. These create a Europe-wide framework covering services including fixed and mobile voice, broadband, cable and satellite TV.

Different countries have implemented the existing directives in different ways. The directives include rules covering access and interconnection, universal service obligations, and how often national regulators should review markets for significant market power (SMP). They also cover how regulators set price controls. They require regulators to consult with the European Commission (EC) on any price control decisions before they are finalised to make sure they are consistent with the European regulations.

During 2013/14 the EC is expected to issue guidance on regulating next generation fibre access networks. We expect this to align the rest of Europe more closely with the existing UK approach. The EC is also expected to review the scope of the relevant market segments covered by telecoms regulation.

UK regulation

The telecoms industry is regulated through various European directives, the Communications Act 2003 (the Communications Act) and Ofcom (the UK s independent regulator) as well as other regulations and recommendations.

The Communications Act

The Communications Act gives Ofcom legal powers and sets out the legal requirements for how electronic communications services should be regulated in the UK. It includes the conditions imposed by the European directives. The Government is currently reviewing our sector s regulatory regime, with a new framework planned for 2015. The review is looking into how to encourage growth and innovation and how to remove unnecessary regulation.

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Ofcom

Ofcom is the independent regulator and competition authority for the whole UK communications market. Its main duties are:

- to further the interests of citizens in relation to communications matters
- to further the interests of consumers in relevant markets, where appropriate by promoting competition.

Under the powers of the Communications Act, Ofcom sets conditions that CPs must comply with and can issue directions under these conditions. Some conditions, known as General Conditions, apply to all CPs. Others apply to certain individual companies that Ofcom has decided are universal service providers or have SMP in a particular market. Anyone can appeal against Ofcom s decisions through a number of routes, including to the Competition Appeal Tribunal (CAT) or to the High Court.

The General Conditions that apply to all CPs are mainly about protecting consumers general access and interconnection, planning for emergencies, providing information to Ofcom, and allocating and transferring phone numbers.

We are the designated universal service provider for the UK (except for the Hull area where it is KCOM Group) and so we have certain universal service obligations. This is an important responsibility and we take it seriously. Our main obligation is to make sure that basic fixed-line services are available at an affordable price to all consumers in the UK. We are also obliged to provide public payphones.

The European directives require Ofcom to review relevant communications markets regularly, usually every three years, and to decide whether any CP has SMP in those markets. If Ofcom decides that a CP has SMP, it could put controls in place, typically on the prices which the CP can charge. Ofcom will generally try to set charges that are reasonably based on costs and an appropriate return on the capital invested.

Impact of regulation

There are a number of regulatory decisions and outcomes of appeals that affected us during the year and will impact us in the future.

- Ofcom finished its review of the business connectivity markets, which cover products such as Ethernet and private circuits. It renewed price controls for another three years. The main changes were an increase in the size of the deregulated London area and deregulation of long distance wholesale private circuits and some retail leased lines. We also now have SMP in high bandwidth Ethernet services outside the deregulated London area which will be subject to a charge control. We expect the charge controls to have a net negative year-on-year impact of around £50m-£100m on group revenue and EBITDA in 2013/14 with a further similar impact in 2014/15

In December 2012 Ofcom issued its final determinations on disputes over historic Ethernet pricing. Ofcom concluded that between April 2006 and March 2011 the prices we set for certain Ethernet services were too high resulting in an overcharge of £151m over this period. We disagree with the determinations and have submitted an appeal to the CAT

In July 2012 the Court of Appeal overturned the CAT s favourable August 2011 decision in relation to wholesale ladder pricing. Ladder pricing links the amounts that BT charges mobile operators for mobile calls to 0800, 0845 and 0870 numbers terminating on our network to the retail price charged by mobile operators to their customers. We have been granted permission to appeal this decision to the Supreme Court and the hearing is expected in early 2014. In 2011/12 we recognised revenue of £56m and EBITDA of £29m from ladder pricing. We did not recognise any revenue or profit from ladder pricing this year. One-off charges of £85m against revenue and £58m against EBITDA have been recognised in the year relating to ladder pricing in the 2010/11 and 2011/12 years.

In March 2011 we lost an appeal to the CAT relating to Ofcom s decision in a dispute over our charges to other CPs for trunk components of wholesale partial private circuits. In July 2012 the Court of Appeal issued its judgment on our appeal against the CAT s decision. The appeal failed to set aside Ofcom s determination or the CAT judgment, but provided helpful clarification of Ofcom s powers.

Sky appealed in June 2010 against Ofcom s decision to regulate Sky Sports 1 and 2. In August 2012 the CAT decided in Sky s favour, and in April 2013 we received permission to appeal the CAT s decision to the Court of Appeal.

The charge controls for WLR, LLU and ISDN30 products which became effective in April 2012 had a negative impact of around £120m on group revenue and EBITDA in the year. We expect a further impact of around £120m in 2013/14.

During 2013/14, Ofcom is expected to complete its reviews of:

the Fixed Access market (including WLR, LLU, GEA, ISDN 2 and ISDN 30 products)

the Wholesale Broadband Access market (including IPstream, Datastream and WBC)

the Wholesale narrowband market (comprising calls and interconnection services).

Where we are found to have SMP, Ofcom will carry out consultations on setting controls. These could change the prices we charge for these products.

Ofcom has recently opened a compliance investigation following a complaint which alleges that BT has acted anti-competitively, contrary to UK and EU law. The complaint alleges that BT has abused its dominant position, claiming that the margin between the prices BT Retail charges for some of its superfast broadband products, and the price paid to Openreach for the relevant network inputs, is insufficient to allow other CPs to compete profitably with BT Retail. Ofcom has stated that the initial information gathering phase of the investigation will take place during spring/summer 2013 which will inform consideration during autumn/winter 2013, of whether, and if so how, to proceed further with the investigation.

See Ofcom s website at www.ofcom.org.uk

for more details on regulation

BT s Undertakings

In response to Ofcom s 2005 strategic review of telecommunications, we put forward some legally binding undertakings under the Enterprise Act 2002. These Undertakings (which include the creation of Openreach) began in September 2005.

They aim to give clarity and certainty to the UK telecoms industry about the way we provide upstream regulated products. This in turn supports effective and fair competition in related downstream markets.

Most of the commitments in the Undertakings have been delivered, but we were unable to move a small percentage of certain customer records to separated computer systems by the target date of 31 December 2012. Ofcom has issued a Direction, which we have accepted, that gives us until 30 November 2013 to meet this commitment.

Our relationship with HM Government

We can be required by law to do certain things and provide certain services to government. For example, under the Communications Act, we (and others) can be required to provide or restore services during disasters. The Civil Contingencies Act 2004 also says that the Government can impose obligations on us (and others) at times of emergency or in connection with civil contingency planning. The Secretary of State can also require us to take certain actions in the interests of national security and international relations.

Overseas regulation

The degree of regulation in international markets varies widely. This can hinder our ability to compete. We are pressing incumbent operators and their national regulatory authorities around the world for fairer, cost-related wholesale access to their networks.

In particular, we are working with the industry and the regulator in the US to encourage early completion of the regulator s review of the Business Access market and to put remedies in place to address any dominance found.

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Performance

In this section we discuss the financial performance of the group as well as the operating and financial performance of our customer-facing lines of business.

We assess and explain the performance of the group using a variety of alternative performance measures. These include underlying revenue and operating costs excluding transit, adjusted and reported EBITDA, adjusted earnings per share, normalised and reported free cash flow and net debt. These are not defined under IFRS and are therefore termed non-GAAP measures. Each of these measures is defined and discussed in more detail on pages 170 to 172.

We assess the performance of our customer-facing lines of business on an adjusted basis, being before specific items which are not allocated to the customer-facing lines of business. A definition of specific items is set out on page 170 and specific items for this year and the two prior years are disclosed in note 9 to the consolidated financial statements.

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Group Finance Director s introduction

We have delivered a strong financial performance by focusing on efficiency. This has enabled us to make some key investments for the future.

Our performance this year

Underlying revenue excluding transit was down 3%, reflecting regulatory headwinds and the challenging conditions in Europe and the financial services sector. However, it showed an improved trend in the second half of the year, which benefited from stronger performances in BT Global Services, BT Retail s Business and Consumer divisions and in BT Wholesale.

We reduced our underlying operating costs excluding transit by 6% in the year. Some of this reflects the decline in revenue, but the majority is the result of our cost transformation activities. Over the last four years we have reduced our operating costs and capital expenditure before purchases of telecommunications licences by £4.7bn in aggregate.

But there is still much more to do, and plenty of opportunity. Through forensic analysis of our end-to-end processes across our lines of business, we can continue to improve our efficiency and reduce the cost of failure.

Adjusted EBITDA was £6.2bn, an increase of 2% and adjusted profit before tax was up 11% at £2.5bn. Adjusted EPS, at 26.6p, was up 12%.

We invested £2.4bn in capital expenditure which included the accelerated investment in our fibre rollout. This has now reached more than half the UK. Efficiencies within our capital investment programmes mean we are doing more for less. In addition we secured a 4G spectrum licence for £0.2bn, which will enable us to provide enhanced services and build on our existing strength in wi-fi.

We generated normalised free cash flow of £2.3bn in the year, in line with our expectations.

Outlook

We expect an improved trend in underlying revenue excluding transit next year.

We expect adjusted EBITDA to be £6.0bn-£6.1bn in 2013/14. The small decline compared with this year is despite underlying improvements in our business performance and is more than accounted for by our investment in BT Sport and the higher pension operating charge. The EBITDA performance in the first half of the year will be impacted by our upfront investment in BT Sport. We expect adjusted EBITDA to increase to £6.2bn-£6.3bn in 2014/15 and to grow further in 2015/16.

We expect higher levels of normalised free cash flow than previously, at around £2.3bn in 2013/14, around £2.6bn in 2014/15 and with further growth in 2015/16.

Tony Chanmugam

Group Finance Director

9 May 2013

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Overview

We operate in an environment characterised by changing customer expectations and developments in technology. The UK telecommunications sector is one of the most competitive markets in the world and there has been continued regulatory pressure to reduce the prices of some of our products. There has been an ongoing shift by customers towards interactive broadband, data and IP services as well as mobile. Fixed-line voice services, which have historically been high margin products, have been in decline. Large multinational customers want complex managed network services across their footprint and SMEs often want a single supplier for their communications needs.

We have responded to these external developments. Growing demand for broadband and data services has meant that we have been enhancing our product offering to meet future customer requirements. We make our networks and expertise available to other CPs, many of whom we compete with, to benefit from our economies of scale. We are also strengthening our position in the high-growth regions of the world. But the economic conditions and regulatory challenges have hampered our growth ambitions over recent years.

Our focus on improving customer service and efficiency has generated substantial cost savings, enabling us to grow our profits and cash flow despite the revenue pressures. We also started a group-wide restructuring programme in the second half of this year which will further improve our cost base and enhance customer service.

Our cost savings have allowed us to make strategically important investments for the future of BT, whether that be in rolling out our fibre broadband network, TV or in 4G spectrum. These are long-term investments which will help in achieving our aim to generate profitable revenue growth in the future.

Outlook

Our outlook is set out below.

	2013/14	2014/15	2015/16
Underlying revenue excluding transit[a]	Improved trend		
Adjusted EBITDA[a]	£6.0-£6.1bn	£6.2-£6.3bn	Growth
Capital expenditure[b]	Broadly level with 2012/13	Broadly level with 2012/13	
Normalised free cash flow[a]	c.£2.3bn	c.£2.6bn	Growth
Dividend per share	Up 10%-15%	Up 10%-15%	
Share buyback programme	c.£300m	c.£300m	

[a] Underlying revenue excluding transit is defined on page 170. Adjusted EBITDA and normalised free cash flow are defined on page 171.
[b] Before purchases of telecommunications licences.

Our normalised free cash flow outlook is above our previous expectations, reflecting the benefits of our restructuring programme and capital expenditure efficiencies. We expect our restructuring programme to reduce our cost base by around £200m per year with this run-rate largely achieved in 2014/15, contributing to an improvement in EBITDA and capital expenditure efficiency. We expect around £400m of further specific restructuring costs, most of which will be incurred in 2013/14.

Income statement

Summarised income statement

Year ended 31 March	2013	2012	2011
Before specific items	£m	£m	£m
Revenue	**18,253**	**19,307**	**20,076**
Other operating income	392	387	373
Operating costs[a]	(12,464)	(13,630)	(14,563)
EBITDA	**6,181**	**6,064**	**5,886**
Depreciation and amortisation	(2,843)	(2,972)	(2,979)
Operating profit	**3,338**	**3,092**	**2,907**
Net finance expense	(653)	(681)	(845)
Associates and joint ventures	9	10	21
Profit before taxation	**2,694**	**2,421**	**2,083**
Taxation	(606)	(584)	(452)
Profit for the year	**2,088**	**1,837**	**1,631**

[a] Excluding depreciation and amortisation.

Revenue

Underlying revenue excluding transit was down 3%, and showed an improved trend for the second half of the year compared with the first half.

The decline in underlying revenue excluding transit in the year reflects lower revenue from calls and lines, the tough conditions in Europe and the financial services sector and regulatory price reductions.

Calls and lines revenue was down 8% (2011/12: 9%). The continuing decline is due to customers switching from fixed-line calls to mobile, broadband, data and IP services.

These declines were partly offset by a 7% increase (2011/12: 7%) in broadband and convergence revenue. This was due to growth in our broadband base, particularly BT Infinity, and our Ethernet portfolio.

Adjusted revenue was down 5%, with transit revenue down by £293m (including mobile termination rate reductions of £187m), a £168m negative impact from foreign exchange movements and a £36m negative net impact from acquisitions and disposals. This compares with a 4% decline in 2011/12, principally due to a 9% reduction in calls and lines revenue and a 26% reduction in transit revenue.

A full breakdown of our revenue by major product and service category is provided in note 4 to the consolidated financial statements.

Operating costs

We reduced operating costs before depreciation and amortisation by £1,166m in the year by focusing on efficiency. In aggregate operating costs and capital expenditure (excluding purchases of telecommunications licences) have reduced by £4.7bn over the last four years despite greater investment in new areas of the business.

Underlying operating costs before depreciation and amortisation and excluding transit were down 6% (2011/12: 4%) reflecting the benefit of transforming our cost base and reduced cost of sales due to the decline in revenue. Our total operating costs before depreciation and amortisation and specific items were £12,464m, down 9% (2011/12: 6%). There are more details on our group-wide cost transformation programmes on page 13.

Labour costs, both direct and indirect, make up the largest category within our cost base. Net labour costs decreased by 4% (2011/12: broadly flat) to £4,626m, as improved productivity and better systems and processes offset our investment programmes, the recruitment of around 1,600 engineers and the insourcing of around 4,000 jobs. Leaver costs were £58m (2011/12: £97m).

Payments to telecommunications operators (POLOs) were down 15% (2011/12: 16%) reflecting lower mobile termination rates and reduced transit and wholesale call volumes. We spent 4% less on property and energy (2011/12: 7% less) as we drove better space utilisation but lower energy usage was more than offset by higher energy prices. Network operating and IT costs were down 7% (2011/12: 11%) as we rationalise our networks and systems. Other operating costs, which include cost of sales, marketing and transport costs, decreased by 11% (2011/12: 3%) due to the decline in revenue and the benefit of our cost transformation programmes.

A detailed breakdown of our operating costs is set out in note 6 to the consolidated financial statements.

EBITDA

Adjusted EBITDA increased by 2% (2011/12: 3%) to £6,181m, reflecting further progress in transforming our cost base.

Underlying EBITDA, which excludes a £10m negative impact from foreign exchange movements and an £11m negative net impact from acquisitions and disposals, also increased by 2% (2011/12: 3%).

An analysis of EBITDA by line of business is set out in note 4 to the consolidated financial statements. Commentary on line of business results is provided in the line of business performance section on page 53.

Depreciation and amortisation

Depreciation and amortisation of £2,843m decreased by 4% (2011/12: flat). This is due to more efficient delivery of our capital investment programmes over the last four years.

Net finance expense

Net finance expense before specific items of £653m decreased by £28m (2011/12: £164m) due to the lower average cost of net debt.

Year ended 31 March	2013 £m	2012 £m	2011 £m
Interest on borrowings	660	672	852
Capitalised interest	(5)	(9)	(6)
Fair value movements on derivatives	11	29	34
Total finance expense	666	692	880
Total finance income	(13)	(11)	(35)
Net finance expense	**653**	**681**	**845**

The table below provides an overview of average gross debt, investments and cash balances, net debt and the related weighted average interest rates over the past three years.

Year ended 31 March	2013 £m	2012 £m	2011 £m
Average gross debt	10,599	9,295	10,808
Weighted average interest rate on gross debt	6.1%	7.3%	7.8%
Average investments and cash balances	1,611	1,148	2,192
Weighted average interest rate on investments	0.5%	0.6%	0.6%
Average net debt	8,988	8,147	8,616
Weighted average interest rate on net debt	7.3%	8.3%	9.8%

Interest on our borrowings decreased by £12m (2011/12: £180m). Although the weighted average interest rate has reduced, its effect was largely offset by an increase in our average gross debt due to the £2bn pension deficit payment in March 2012. Fair value movements on derivatives include £5m (2011/12: £16m, 2010/11: £28m) of swap restructuring costs on certain derivatives. They also include £6m (2011/12: £13m, 2010/11: £6m) of fair value movements on derivatives not in a designated hedge relationship.

Finance income increased by £2m (2011/12: £24m decrease) mainly due to higher average cash and investment balances.

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Reconciliation of net finance expense and net interest cash outflow

Net interest cash outflow of £692m (2011/12: £685m, 2010/11: £944m) is £39m higher (2011/12: £4m, 2010/11: £99m) than the net finance expense in the income statement. This is mostly due to certain interest cash outflows and inflows being spread over a number of years in the income statement.

	2013	2012	2011
Year ended 31 March	£m	£m	£m
Net finance expense	653	681	845
Timing differences:			
Derivative restructuring costs	16	(4)	(18)
Annual coupon payment on maturing bonds	15		73
Deferred income	8	8	38
Impact of fair value accounting			6
Net interest cash outflow	**692**	**685**	**944**

Earnings per share

Adjusted earnings per share increased by 12% to 26.6p principally reflecting the growth in profit before tax. Adjusted profit before tax was £2,694m, up 11% reflecting the higher EBITDA, lower depreciation and amortisation and lower net finance expense.

Adjusted earnings per share, which is defined on page 171, is one of our key performance indicators. It is an important measure of the overall profitability of our business, as detailed in **Key performance indicators** on page 4.

The graph below shows the drivers of the rise in adjusted earnings per share over the last two years.

Our earnings per share in future years will be impacted by share options maturing and share awards vesting under our employee share plans. See page 19 for more details.

Dividends

The Board is proposing a final dividend of 6.5p, up 14%. This gives a full year dividend of 9.5p, also up 14%, and compares with an increase in the full year dividend of 12% in 2011/12.

This will be paid, subject to shareholder approval, on 2 September 2013 to shareholders on the register on 9 August 2013.

Our future dividend expectations are set out in our **Outlook** on page 44.

Cash flow

Our cash generation is strong, with normalised free cash flow of £2.3bn and net debt of £7.8bn, down £1.3bn. The cash generation of our business has put us in a good liquidity and funding position.

Free cash flow

We measure our performance using normalised free cash flow. This is one of our three key performance indicators as detailed on page 4.

Normalised free cash flow, which is defined on page 171, is an important measure of our financial performance. It represents the cash we generate from our operations after capital expenditure and finance costs. It excludes the impact of specific items, purchases of telecommunications licences, pension deficit payments and the related cash tax benefits. This is consistent with how management measures our financial performance and gives us a meaningful way to analyse the free cash flow generated by the group.

We have set out a reconciliation from net cash inflow from operating activities, the most directly comparable IFRS measure, to normalised free cash flow, on page 172.

Summarised cash flow statement

	2013	2012	2011
Year ended 31 March	£m	£m	£m
EBITDA	6,181	6,064	5,886
Capital expenditure[a]	(2,438)	(2,560)	(2,630)
Interest	(692)	(685)	(944)
Taxation[b]	(624)	(615)	(356)
Working capital movements	(81)	(3)	(11)

Other non-cash and non-current liabilities movements	(46)	106	131
Normalised free cash flow	**2,300**	**2,307**	**2,076**
Purchases of telecommunications licences	(202)		
Cash tax benefit of pension deficit payments	560	215	147
Specific items	(366)	(204)	(212)
Reported free cash flow	**2,292**	**2,318**	**2,011**
Pension deficit payments	(325)	(2,000)	(1,030)
Dividends	(683)	(590)	(543)
Disposals and acquisitions	222	15	64
Share buyback programme	(302)		
Proceeds from issue of own shares	109	21	8
Reduction (increase) in net debt from cash flows	1,313	(236)	510
Net debt at 1 April	(9,082)	(8,816)	(9,283)
Reduction (increase) in net debt from cash flows	1,313	(236)	510
Non-cash movements	(28)	(30)	(43)
Net debt at 31 March	**(7,797)**	**(9,082)**	**(8,816)**

[a] Excluding purchases of telecommunications licences.
[b] Excluding cash tax benefit of pension deficit payments.

We generated normalised free cash flow of £2,300m which was in line with our expectation for the year and level with the prior year.

Growth in our profits and efficiencies in our capital expenditure programmes helped generate strong cash flows although these improvements were largely offset by working capital movements, some of which reflected the timing of contract-related receipts and supplier payments.

Our cash generation and financial strength have enabled us to progress our financial objectives. We have reduced our net debt by £1,285m whilst supporting our pension fund, paying progressive dividends to our shareholders and making strategic investments for the future of our business. We have also spent £302m (2011/12 and 2010/11: £nil) on our share buyback programme to counteract the dilutive effect of our all-employee share option plans. Exercises of share options generated proceeds of £109m (2011/12: £21m, 2010/11: £8m).

The net cash outflow from specific items was £366m (2011/12: £204m, 2010/11: £212m) which principally comprised restructuring costs of £147m (2011/12: £120m, 2010/11: £165m), a £95m outflow following the regulatory decision on historic Ethernet pricing, cash payments of £67m from the ladder pricing decision relating to 2010/11 and 2011/12, and property rationalisation costs of £55m (2011/12: £68m, 2010/11: £47m).

Disposals and acquisitions included proceeds of £270m relating to the sale of our remaining interest in Tech Mahindra which were partially offset by a net £54m outflow, including £10m cash acquired, in relation to our acquisition of Tikit Group plc.

Capital management and funding policy

The objective of our capital management and funding policy is to reduce net debt while investing in the business, supporting the pension fund and paying progressive dividends.

To meet this objective we may issue or repay debt, issue new shares, repurchase shares or adjust the amount of dividends we pay to shareholders.

We manage the capital structure based on economic conditions and the risk characteristics of the group. The Board reviews the capital structure regularly. No changes were made to our objectives and processes during 2012/13 or 2011/12.

Our general funding policy is to raise and invest funds centrally to meet anticipated requirements using a combination of capital market bond issuance, commercial paper borrowing, committed borrowing facilities and investments. These financial instruments will mature at different stages in order to meet short, medium and long-term requirements.

Details of our treasury management policies are included in note 26 to the consolidated financial statements.

The major source of our cash inflow for 2012/13, 2011/12 and 2010/11 was the cash generated from our operations. We also issued short-term commercial paper and raised long-term debt in the capital markets. These, as well as committed bank facilities of £1.5bn, are expected to remain the key sources of liquidity for the foreseeable future. The committed borrowing facility is available until March 2016; none of it has been drawn down at 31 March 2013.

We expect to spend around £300m per year for the next two years on our share buyback programme, which will partly counteract the dilutive effect of all-employee share option plans maturing over this period. We will undertake the buyback through a combination of direct market purchases and purchases by our Employee Benefit Trust.

Net debt

Net debt was £7,797m at 31 March 2013, down £1,285m.

We intend to continue our policy of reducing net debt and are targeting a BBB+/Baa1 credit rating.

Our net debt calculation is based on the expected future undiscounted cash flows due to arise on the maturity of financial instruments. This is adjusted for the re-measurement of hedged risks under fair value hedges and the use of the effective interest method. Currency denominated balances are retranslated to Sterling at swap rates where hedged.

The movement in our net debt position in the year was as follows:

£m	At 1 April 2012	Cash flow	Fair value move-ments	Foreign exchange	Other	At 31 March 2013
Debt due within one year[a]	2,887	(1,488)		23	314	1,736
Debt due after one year	7,599	791	31	172	(316)	8,277
Impact of cross-currency swaps[b]	(228)			(189)		(417)
Removal of accrued interest and fair value adjustments[c]	(333)		(31)		19	(345)
Gross debt	**9,925**	**(697)**		**6**	**17**	**9,251**
Cash and cash equivalents	(331)	(597)		1	3	(924)
Current assets investments	(513)	(19)			1	(531)
Removal of accrued interest[c]	1					1
Net debt	**9,082**	**(1,313)**		**7**	**21**	**7,797**

[a] Including accrued interest and bank overdrafts.

[b] Retranslation of debt balances at swap rates where hedged by cross-currency swaps.

[c] Removal of accrued interest applied to reflect the effective interest rate method and fair value adjustments.

The adjustment to retranslate our debt balances to Sterling at swap rates to reflect the impact of hedging increased by £189m in 2012/13, principally due to the strengthening in the year of both the Euro and US Dollar against Sterling. The adjustment to net debt to remove the impact of fair value hedge accounting and the use of the effective interest method increased by £12m in 2012/13, principally due to lower Sterling interest rates.

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Debt maturity analysis

During 2012/13 the group repaid three significant term debt balances that matured in the year, totalling £1.7bn. In August 2012 we repaid a 6.375% bank loan, with a principal of £300m. In January 2013 a 5.15% US$850m bond and a 5.25% 1,000m bond (£512m and £842m respectively after the impact of hedging) also matured and so were repaid.

Gross debt, translated at swap rates, at 31 March 2013 is £9.3bn comprising term debt of £7.8bn, finance leases of £0.3bn, commercial paper of £0.8bn and other loans of £0.4bn. The maturity profile of our term debt and the applicable average coupon rate is shown in the graph on page 48. Debt due within one year of £1.7bn comprises term debt of £0.3bn, commercial paper of £0.8bn, other loans of £0.4bn and accrued interest of £0.2bn.

A detailed breakdown of our loans and other borrowings is provided in note 24 to the consolidated financial statements.

Credit risk management

Credit exposures arising from financial instruments transacted by the treasury operation and from the group s trading-related receivables are continually reviewed. We take proactive steps to ensure that the impact of adverse market conditions on these financial instruments is minimised. Management within the lines of business actively reviews exposures arising from trading balances. In managing investments and derivative financial instruments, the treasury operation monitors the credit quality across treasury counterparties and actively manages exposures which arise.

Taxation

The effective corporation tax rate was 22.5% this year compared with 24.1% in 2011/12. This is close to the UK statutory rate of 24% (2011/12: 26%) and reflects the utilisation of tax losses and prior year adjustments.

This year we contributed £1.6bn of VAT (2011/12: £1.6bn) and £1.2bn of PAYE and NI (2011/12: £1.1bn) to the UK Exchequer, and we also contributed £0.4bn in our significant non-UK jurisdictions. This ranked us the eighth highest UK contributor, according to the Hundred Group Total Tax Contribution Survey for 2012.

Tax strategy

Our aim is to comply with relevant regulations. We try to structure our affairs in a tax efficient manner where this is a consequence of our operating activities and has underlying commercial substance, with the aim of supporting our capital or operational expenditure programmes and customer service initiatives. The Board sets the parameters which govern our approach and regularly reviews our tax strategy.

We operate in more than 170 countries and this comes with additional complexities in the taxation arena. The majority of our tax liabilities arise in the UK. In terms of our UK corporation tax position, all years up to 2010 are substantially agreed.

We have an open, honest and positive working relationship with HMRC and are committed to prompt full disclosure and transparency in all tax matters. We recognise that there may be areas of differing legal interpretations between ourselves and tax authorities. Where this occurs we will engage in proactive discussion to bring matters to as rapid a conclusion as possible.

Tax expense

Our total tax expense before specific items was £606m (2011/12: £584m, 2010/11: £452m).

Our effective tax rate on profit before taxation and specific items is slightly lower than the UK statutory rate. As shown below, this is due to the utilisation of non-UK losses and the impact of prior year adjustments being in excess of normal disallowable costs as well as other tax adjustments.

	2013	2012	2011
Year ended 31 March	£m	£m	£m
Profit before taxation and specific items	2,694	2,421	2,083
Tax at UK statutory rate of 24% (2011/12: 26%, 2010/11: 28%)	647	629	583
Non-UK losses utilised	(14)	(75)	(53)
Prior year adjustments	(57)	(74)	(36)
Non-deductible items	30	37	28
Other tax adjustments		67	(70)
Effective tax charge before specific items	606	584	452
Effective tax rate	**22.5%**	**24.1%**	**21.7%**

A reconciliation of reported profit before taxation to total tax expense is shown in note 10 to the consolidated financial statements.

The UK corporation tax rate changed from 26% to 24% on 1 April 2012 and from 24% to 23% on 1 April 2013. The Government has indicated that it intends to enact further reductions in the UK corporation tax rate to 21% to take effect from 1 April 2014 and to 20% from 1 April 2015. For 2013/14 we expect our effective tax rate to be around 23%.

Our UK corporation tax liabilities arising in the year were covered by a reallocation of overpayments made in prior years, following the tax deductible pension deficit payment made in March 2012 and the use of capital allowances that we had not previously claimed. We paid non-UK corporate income taxes of £63m (2011/12: £47m, 2010/11: £34m).

Tax losses

We have unrecognised tax losses of £21.4bn (2011/12: £21.2bn) of which £17.2bn are capital losses arising in the UK. More details are set out in note 10 to the consolidated financial statements.

The majority of the remaining losses of £4.2bn arose in our non-UK entities in prior periods. The timeframe in which we can use these losses to offset against future taxable profits, and our ability to do so, is determined by the locations of the subsidiaries in which the losses arose.

Capital expenditure

We are making significant investments in the future of our business. The efficiencies we have delivered in our capital programmes mean that our capital expenditure has reduced, even though we have accelerated our fibre rollout. We are doing more for less.

Our capital expenditure before purchases of telecommunications licences totalled £2,438m (2011/12: £2,594m, 2010/11: £2,590m). This is shown below.

Our capital expenditure this year reflects our continuing strategy to improve customer service and invest for the future of the business. Our investments included:

- increasing the footprint of our fibre broadband network which now passes more than 15m homes and businesses, over half of UK premises
- extending our WBC copper broadband network which now covers more than 90% of premises, with more than 5m active customers
- providing additional capacity in support of our Ethernet portfolio for BT Wholesale and BT Global Services customers
- migrating our customers onto next generation networks (both in the UK and overseas) while simplifying and decommissioning legacy platforms.

We also purchased a 4G licence in the UK for a cost of £202m. This will enable us to provide our business and consumer customers with an enhanced range of mobile broadband services, building on our existing strength in wi-fi.

Of the capital expenditure, £248m (2011/12: £235m) arose outside the UK. Capital expenditure contracted but not yet incurred totalled £355m at 31 March 2013 (2011/12: £433m).

Balance sheet

Summarised balance sheet

Our balance sheet primarily reflects the significant investments in infrastructure that are the foundations of our business, and our capital management and funding strategy with which we underpin that investment.

At 31 March	2013 £m	2012 £m	Movement £m
Property, plant & equipment, software and telecoms licences	15,934	16,121	(187)
Goodwill & other acquisition related intangible assets	1,477	1,394	83
Other non-current & current assets	1,586	1,538	48
Trade & other receivables	3,061	3,476	(415)
Investments, cash & cash equivalents	1,455	844	611
Loans & other borrowings	(10,013)	(10,486)	473
Trade & other payables	(5,521)	(5,962)	441
Other current & non-current liabilities	(1,859)	(1,787)	(72)
Provisions	(630)	(857)	227
Deferred tax liability	(1,209)	(1,100)	(109)
Pensions, net of deferred tax	(4,543)	(1,873)	(2,670)
Total (deficit) equity	**(262)**	**1,308**	**(1,570)**

The carrying value of property, plant & equipment, software and telecommunications licences reduced by £187m. This reflects the related depreciation and amortisation charge of £2,825m exceeding the capital expenditure of £2,438m and £202m for the purchases of telecommunications licences. Goodwill and other acquisition related intangible assets have increased by £83m, mainly relating to the acquisition of Tikit Group plc.

Other non-current and current assets increased by £48m, principally reflecting an increase in derivative financial instruments of £227m, partially offset by a decrease in current and deferred tax assets of £49m and by a £125m decrease in our investments in associates and joint ventures due to the disposal of Tech Mahindra. Deferred tax movements are shown in note 10 to the consolidated financial statements. Trade and other receivables and trade and other payables reduced by £415m and £441m, respectively, principally reflecting lower revenue and costs.

Investments, cash and cash equivalents and loans and other borrowings totalling £8,558m decreased by £1,084m, as shown on page 48.

Provisions reduced by £227m mainly due to the utilisation of regulatory provisions in the year. Pensions, net of deferred tax, increased by £2,670m to £4,543m, as explained in **Pensions** below.

The reduction in equity in 2012/13 is principally due to the recognition of actuarial losses on retirement benefit obligations, which more than offset the profit for the year. The deficit at 31 March 2013 does not impact the distributable reserves and dividend paying capacity of the parent company, BT Group plc, which had a profit and loss reserve of £9,667m at 31 March 2013.

Pensions

Overview

We provide retirement plans for employees. The largest of these plans is the BT Pension Scheme (BTPS), a defined benefit plan in the UK. Although closed to new members, the BTPS still has around 44,000 contributing members, 193,000 pensioners and 80,500 deferred members. The BT Retirement Saving Scheme (BTRSS) is the current arrangement for UK employees who joined the group after 1 April 2001. It has around 22,000 active members.

The BTPS and BTRSS are not controlled by the Board. The BTPS is managed by a separate and independent corporate trustee. The BTRSS is a contract-based, defined contribution arrangement provided by Standard Life under which members choose their own investments and receive benefits at retirement that are linked to the performance of those investments.

We maintain similar arrangements in most other countries with a focus on these being appropriate for the local market and culture.

More information on our pension arrangements and on funding and accounting valuations is given in note 19 to the consolidated financial statements. The funding of the BTPS is also discussed further under **Our risks** on page 25.

BTPS funding valuation and future funding obligations

The funding of our main defined benefit pension plan, the BTPS, is subject to legal agreement between BT and the Trustee of the BTPS which is determined at the conclusion of each triennial funding valuation. The most recent triennial funding valuation at 30 June 2011 and the associated recovery plan was agreed with the BTPS Trustee in May 2012.

Under this prudent funding basis, at 30 June 2011 the market value of the assets was £36.9bn and the funding deficit was £3.9bn. If the valuation had used our median estimate approach, we estimate that the scheme had a surplus of £2.5bn at 30 June 2011. This approach reflects how investments might on average be expected to perform over time and the use of other assumptions with no allowance for prudence.

Under the recovery plan, we made deficit payments of £2.0bn in March 2012 and £325m in March 2013. The plan also includes payments of £325m in March 2014, followed by seven annual payments of £295m through to March 2021. Further details on the funding are included in note 19 to the consolidated financial statements. The next funding valuation is due to be carried out as at 30 June 2014.

IAS 19 accounting position

The accounting deficit, net of tax, has increased from £1.9bn to £4.5bn. The movements in the deficit are shown below.

Actuarial gains on plan assets reflect the strong investment returns in the year of around 12%, which was more than double the expected return, and BTPS plan assets reached a record high of £41.3bn.

Actuarial losses on plan liabilities have arisen primarily as a result of a lower discount rate assumption, driven by low real corporate bond yields, partly reflecting the impact of quantitative easing and higher expectations for future inflation. As a result the real discount rate, relative to RPI, is exceptionally low at 0.87%.

The International Accounting Standards Board has published a revision to IAS 19 which will be mandatory in 2013/14. Details of this and its impact are set out on page 115 of the consolidated financial statements.

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Other information

Contractual obligations and commitments

A summary of our principal contractual financial obligations and commitments at 31 March 2013 is shown below. Further details on the items can be found in the notes to the consolidated financial statements. Details of our financial commitments and contingent liabilities are included in note 29 to the consolidated financial statements.

		Payments due by period			
£m	Total	Less than 1 year	Between 1 and 3 years	Between 3 and 5 years	More than 5 years
Loans and other borrowings[a]	9,633	1,729[b]	2,483	1,905	3,516
Finance lease obligations	272	7	24	23	218
Operating lease obligations	7,182	412	760	723	5,287
Capital commitments	355	342	13		
Programme rights commitments	888	279	558	51	
Pension deficit obligations	2,390	325	590	590	885
Total	**20,720**	**3,094**	**4,428**	**3,292**	**9,906**

[a] Excludes fair value adjustments for hedged risks.
[b] Includes £236m of accrued interest due within less than one year.

At 31 March 2013, our cash, cash equivalents and current asset investments were £1,455m. We also have an unused committed borrowing facility amounting to £1.5bn. These resources and our future cash generation are expected to allow us to settle our obligations as they fall due.

Off-balance sheet arrangements

Other than the financial commitments and contingent liabilities disclosed in note 29 to the consolidated financial statements, there are no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditure or capital resources.

Legal proceedings

We do not believe that there is any single current court action that would have a material adverse effect on our financial position or operations. During 2012/13 the aggregate volume and value of legal actions to which we are party remained broadly the same as at the end of 2011/12.

Line of business performance

BT Global Services

We further consolidated our position as a global leader in managed networked IT services. We have focused on improving customer service and made investments to extend our global capabilities. But we have more to do to improve our financial performance and have accelerated our cost transformation activities.

Operating performance

Our investments to support our customers and improve our services have resulted in contract wins around the world with an order intake of £6.3bn (2011/12: £6.7bn). This was lower than last year reflecting the tough conditions in Europe and the financial services sector.

Contracts we won in the year include:

Customer	Contract
British American Tobacco	Global wide area network infrastructure across nearly 1,000 sites in 119 countries, which means BAT can prioritise different types of traffic according to the needs of its business
Caixa Econômica	Connecting more branches of the state- owned development bank in Brazil to support its expansion

Federal	across the country
Cornwall Council and its health partners	Support services to the public, the integration of telehealth and telecare services and the creation of a Centre of Excellence supporting growth and trade across the UK
Department for Work and Pensions	Communication services and network, telephony, conferencing and contact centre infrastructure
European Commission	Network and consultancy services, including remote access, teleworking, and internet fallback to all major European Union institutions
Media-Saturn	Network services connecting around 750 sites of Europe s largest consumer electronics retailer
Novartis	Adding new collaboration services and connecting more locations worldwide
Rolls-Royce	Network infrastructure in 55 sites to help enhance operational flexibility, encourage co-operation with suppliers, and improve efficiency; and BT Connect network services to link 160 locations globally
Tesco	Cloud-based contact centre services covering up to 1,800 agents to improve customer service at busiest times

Visa Europe	Managed solutions for payments processing and corporate services

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Customer service delivery

We made improvements in customer service this year. Through our Right First Time programme we have improved our ability to meet customer-agreed milestones for our complex contracts by 14%.

We gather feedback from our customers in lots of different ways: surveys; our global account management teams; and through events where we talk to our customers about our strategy and how they feel about working with us.

We use this feedback to identify further opportunities to improve our service and increase customer satisfaction. Customer experience and feedback are an important part of how we recognise and reward our people.

This year we:

- rolled out better systems and industry standard processes
- consolidated and invested in regional service centres to serve our global customers better
- improved our customer portals to speed up and simplify online ordering
- invested in customer experience dashboards to give account managers better insight
- improved our proactive service diagnostics to help us anticipate and prevent customer service issues.

Our customers can use our products and services to reduce their impact on the environment. For example, we are helping Greater Manchester Police to reduce its carbon footprint through a flexible working solution that decreases the office space it requires.

We are also becoming a greener business ourselves. Our Frankfurt data centre is 60% more energy efficient than the average, thanks to intelligent climate control.

In all the societies where we do business, we try to make a positive difference. In Brazil, for example, we are helping Caixa Econômica Federal to bring banking services to people living in remote places.

Cost transformation

We reduced our net operating costs by 9%, reflecting the impact of lower revenue and our cost transformation programmes. We made savings in our network, procurement and processes.

- **Network.** We have closed legacy platforms and migrated customers to new and improved services. We have reviewed end-to-end processes for managing overseas access circuits to lower cost of delivery. We are optimising our network, adding new points of presence in key locations to reduce third-party network costs

Procurement. We have negotiated better commercial terms with many suppliers to cut contract delivery costs. We are working with suppliers to leverage best practice and improve pricing across some of our major contracts
Processes. We are transforming our end-to-end customer service processes. By moving contract management back-office functions into shared service centres, we are boosting efficiency, cutting costs and improving customer service.

Investing for the future

We continued to invest in the high-growth regions. For example, we opened a GIPX hub in Singapore for the Asia Pacific region, a customer showcase in Argentina, and a data centre in Colombia.

We have further developed our industry-specific solutions. We added a new cloud platform for financial markets to our BT Radianz network, and connected new customers in Hong Kong, Moscow, Singapore and the UAE to the BT Radianz community. We introduced a new cloud solution to BT Trace, giving customers more insight into their supply chains in near real-time. In the UK, we became a leading supplier to the UK Government s Public Services Network (PSN).

We have improved our core products and services, launching new features and upgrades. For example, we introduced BT Assure Analytics which shows security threats in real-time. Our new BT One Voice smartphone app cuts mobile costs for people who travel around the world. And our BT One Cloud Video now offers HD video conferencing with 25,000 points of access.

We have invested in our BT Advise team of consultants by launching the BT Advise Academy to make sure our training and accreditation is consistent across the world. We have brought in new tools, like QuickStarts and eValuators, which let our customers assess the opportunities and risks within their business and come up with network IT services strategies to address them.

London 2012 the most connected Olympic and Paralympic Games ever

BT was the official communications services partner for London 2012. We connected 94 locations (including 34 competition venues) with a single communications network. Our London 2012 network carried every official photograph and sports report and millions of calls, emails, texts and tweets.

It also carried all the broadcast pictures and video for every single sporting moment outside the Olympic Park. We provided 80,000 access points connecting 16,500 telephones, 14,000 mobiles, 14,000 cable TV outlets and 1,500 wireless access points. To do all this, we had to install several thousand kilometres of internal cabling, the equivalent of more than 100 marathons.

Our single, integrated communications network was a first for a summer Games. We achieved a critical core network service availability of 99.999%. It was the best possible showcase on a global stage of our ability to manage and deliver large and complex projects.

Financial performance

Year ended 31 March	2013 £m	2012 £m	2011 £m
Revenue	7,166	7,809	8,059
Underlying revenue excluding transit	(6%)	(1%)	(4%)
Net operating costs[a]	6,540	7,182	7,466
EBITDA	626	627	593
Depreciation and amortisation	623	712	734
Operating profit (loss)	3	(85)	(141)
Capital expenditure	525	560	498
Operating cash flow	6	183	119

[a] Net of other operating income.

Underlying revenue excluding transit decreased by 6% (2011/12: 1%) reflecting the tough conditions in Europe and the financial services sector. Revenue decreased by 8% (2011/12: 3%) including a £151m negative impact from foreign exchange movements, a £43m impact from disposals and a £16m decline in transit revenue.

Revenue from managed networked IT services decreased by 10% (2011/12: 1%). Whilst we increased our market share in Asia Pacific, Latin America, Turkey, the Middle East and Africa, this was more than offset by the impact of the tough European economic conditions, foreign exchange movements and disposals. Calls and lines revenue decreased by 10% (2011/12: 9%) reflecting the continued trend of customers migrating to alternative IP-based services. Transit revenue decreased by 7% (2011/12: 27%) largely due to the impact of mobile termination rate reductions in Europe.

Underlying net operating costs excluding transit costs decreased by 7% (2011/12: 1%) reflecting the impact of lower revenue and our cost transformation programmes. Net operating costs decreased by 9% (2011/12: 4%).

EBITDA was flat (2011/12: 6% increase) and increased by 4% (2011/12: 7%) excluding foreign exchange movements and disposals. Depreciation and amortisation decreased by 13% (2011/12: 3%) as a result of lower capital expenditure in recent years. Operating profit increased by £88m (2011/12: £56m) resulting in a positive operating profit for the first time in five years.

Capital expenditure decreased by 6% (2011/12: 12% increase). EBITDA less capital expenditure increased by £34m to £101m compared with a £28m decrease to £67m in 2011/12.

Operating cashflow was an inflow of £6m (2011/12: £183m, 2010/11: £119m). As expected this was lower than the prior year reflecting the phasing of working capital.

BT Retail

Despite the challenge of highly competitive markets, we have increased our profits for the eighth year running. By simplifying, standardising and automating our processes, we have cut costs. We have grown our broadband market share and our fibre customer base. We have made good progress on TV, launching YouView from BT and securing great content for BT Sport. BT Business improved its revenue trend with good growth in IT services.

[a] DSL and fibre, excluding cable.

Operating performance

BT Consumer

Consumers want to buy bundles of services. So to attract new customers and keep hold of existing ones, we have continued to focus on selling dual play (calls and broadband) and triple play (calls, broadband and TV) bundles.

Around 99% of our new broadband sales are now bundles and 82% of our retail broadband customers take a bundle of services.

The market is tough with some of our competitors offering big incentives to customers to switch to their products or services. We have therefore continued to lose consumer lines. Net active line losses have risen 4% but net total line losses have declined by 19%.

Our targeted promotions, seasonal deals and the improvement in our bundled propositions are helping us fight back. We have also launched new features like BT SmartTalk, BT Cloud and our new home phone with call blocking.

Plusnet performed well with good broadband and voice customer additions.

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We won 424,000 net additional retail broadband customers. That represents 51% of the DSL and fibre broadband market net additions and takes our retail customer base to around 6.7m, up 7%. Our net additions declined compared with the prior year largely due to slower market growth.

We have made a big push to promote BT Infinity. We now have around 1.3m retail fibre customers, including business customers (31 March 2012: 0.5m). Overall, 19% of our broadband customers are now on fibre.

On top of encouraging people to take up broadband we have launched initiatives to help people use the web safely. We are running a pilot project in schools where BT volunteers offer parents practical advice on how to keep their families safe online.

We launched Vision 2.0, YouView from BT and Extra TV. We had 810,000 customers on our TV service at 31 March 2013, up 15%.

Our consumer ARPU has increased to £365 (2011/12: £343). This is largely driven by broadband sales especially fibre.

BT Business

The decline in the fixed-voice market continued to impact our calls and lines business. Despite this, net line losses have improved slightly with a decrease of 2% in the year.

Our call volumes have continued to decline due to the lower number of lines, but call minutes per line have declined much more slowly. Call revenue has been impacted by customers choosing our newer packages with attractive tariffs and buying prepaid call bundles.

Broadband performed well, boosted by strong sales of BT Infinity for business thanks to targeted advertising campaigns.

We have launched a range of new mobile handsets and tablets this year and continued to gain mobile subscribers.

In 2011/12 we decided to withdraw from low-margin IT hardware trade sales. This meant that in the first half of this year, our IT services revenue trend was impacted by lower hardware sales in BT Business Direct. However, good growth in BT iNet and BT Engage IT meant that IT services grew by 2% overall for the year, or 9% excluding low-margin IT hardware trade sales.

BT Engage IT launched BT Managed Compute a fully-managed infrastructure-as-a-service cloud solution. It provides customers with a scalable, flexible path to migrate to cloud services. We won a deal with Anchor (a provider of housing and care for older people), our first big customer for this service.

BT iNet has focused on improving its most profitable areas. For example, we have invested in a Converged Infrastructure Practice to expand our data centre skills and capabilities.

BT Ireland

Despite the challenging economy, we have seen good growth in government and business contracts in the Republic of Ireland. We signed a wholesale deal to provide BSkyB with managed voice and broadband services to support their launch in the Republic of Ireland. We were also selected as the NI Direct strategic partner to develop and improve access to Northern Ireland government services.

Our fibre rollout in Northern Ireland has reached over 90% coverage with 52% of our consumer broadband customers now taking fibre-based services.

BT Enterprises

For **BT Conferencing**, the US market has been particularly tough, but our expansion into Latin America and Asia Pacific has gone well. We have achieved major wins in all regions, including Reckitt Benckiser, Message Stick and a major international bank. We have signed a partnership with Dolby to develop new services using innovative technology that makes audio conference calls feel more like face-to-face meetings.

In June 2012 we combined all our wi-fi activities into one identity: **BT Wi-fi**. We have won a number of major deals, including contracts with Barclays bank and Game (a videogames retailer) for in-branch and in-store wi-fi. Wi-fi minutes trebled for the year and reached 4.7bn minutes in the fourth quarter and over 13bn minutes for the year.

BT Redcare grew its ATM machines communications business by 50%, thanks to a contract with a major bank for 4,300 sites. We have invested in new fibre sensing technology, expanded our Fire and Security business in Northern Ireland and the Republic of Ireland, and launched broadband-based public CCTV.

The Adopt a Kiosk programme in **BT Payphones** has helped us save on removal costs, as well as letting local communities use their much-loved red kiosk in a number of different ways.

In **BT Expedite & Fresca**, we have finished rolling out self-checkouts for WH Smith and a cloud-based store solution for Fat Face. We have also won an e-commerce contract with Claire s, a new customer.

We are building a pipeline of propositions to integrate **BT Tikit** s capabilities with our core portfolio.

Customer service delivery

The year started well with a good performance on customer service delivery in the first quarter. But this was followed by some of the wettest weather on record in the UK which affected our lead times on provisioning and repairs for much of the year.

We have invested in making things simpler for our customers. For example, streamlining our processes to save them time and cut down the number of times they need to deal with us. Our Net Easy score (which tracks how easy it is for customers to get issues fixed), has increased by two percentage points.

We are helping customers to help themselves more through improved capabilities on bt.com, a desktop help app and our automated self-help functions when they call us. We now handle 75% of all service contact over self-service channels.

Customer service in BT Business has improved further. Complaints are down 24%. We have achieved this by fixing things before customers get in touch and by focusing on getting things right first time.

We have also managed to cut cancelled orders by 35% and unnecessary visits to customers by 16,000.

The 75th anniversary of the 999 service has helped to showcase our long history of managing high-volume call centres. Of the 31m 999 calls received by BT operators each year, 98% are answered within five seconds.

Cost transformation

We made good progress on reducing our costs, benefiting from our actions last year, and from new ones this year.

Net operating costs decreased by 5% (2011/12: 6%) reflecting our cost transformation initiatives, partly offset by additional costs associated with the improved revenue trend, and our investment in BT Sport.

We have generated savings in each of our main divisions from these initiatives. We have redesigned processes to reduce labour and failure costs. We have renegotiated supplier contracts. We have also reduced the levels of bad debt.

Investing for the future

BT Retail s biggest investments this year have been in TV.

We will launch our BT Sport channels in summer 2013. These will offer premium content at great value. In football, we have secured the broadcast rights to 38 live games in the Premier League plus Italy s Serie A, Ligue 1 in France, MLS in the US and Brasileiro in Brazil. We have won rights for Premiership rugby, the Women s Tennis Association and Moto GP.

We have agreed to buy ESPN s UK and Ireland TV channels business (including the ESPN and ESPN America channels), with rights to the FA Cup, UEFA Europa League, Scottish Premier League and other live sports.

We have hired some of the UK s top sports presenters Jake Humphrey, Clare Balding, Lawrence Dallaglio and Rio Ferdinand and we have secured our own prime production space in the former Olympic Park.

In the business market we have invested in building our conferencing service overseas, specialist IT services (like BT Tikit) and cloud services.

The 2.6GHz spectrum licence we acquired will enable us to provide businesses and consumers with enhanced 4G mobile broadband services, building on our existing strength in wi-fi.

Financial performance

Year ended 31 March	2013 £m	2012 £m	2011 £m
Revenue	7,228	7,393	7,700
Net operating costs[a]	5,293	5,563	5,916
EBITDA	1,935	1,830	1,784
Depreciation and amortisation	390	410	443
Operating profit	1,545	1,420	1,341
Capital expenditure	375	434	434
Operating cash flow	1,508	1,362	1,382

[a] Net of other operating income.

Revenue decreased by 2% (2011/12: 4%) with declines in calls and lines partly offset by growth in IT services and broadband.

BT consumer revenue declined by 2% (2011/12: 5%). The reduced rate of decline was driven by growth in our broadband base, growth in Plusnet and a lower rate of decline in calls and lines revenue.

BT Business revenue declined by 3% (2011/12: 5%). The reduced rate of decline was due to growth in IT services and a slower decline in voice revenue.

BT Enterprises underlying revenue declined by 1% (2011/12: 1% increase). Growth in BT Expedite, BT Conferencing and BT Wi-fi were more than offset by declines in BT Directories, BT Payphones and BT Redcare.

BT Ireland underlying revenue increased by 4% (2011/12: flat) with growth in both Northern Ireland and the Republic of Ireland.

EBITDA increased by 6% (2011/12: 3%) and with depreciation and amortisation decreasing by 5% (2011/12: 7%) due to the lower level of capital expenditure in recent years, operating profit increased by 9% (2011/12: 6%).

Capital expenditure was down 14% (2011/12: flat). Operating cash flow increased by 11% (2011/12: 1% decrease) reflecting the growth in EBITDA and lower capital expenditure.

BT Wholesale

Customers switching from wholesale broadband to LLU, the shift to IP services and regulation were our biggest challenges this year. Despite this, a combination of managed service re-signs and growth in Ethernet and IP Exchange drove an improved trend in underlying revenue excluding transit during the year. Hard work on costs delivered an improved EBITDA trend as well.

Operating performance

Our Mobile Ethernet Access Service (MEAS) is now available at around 15,000 mobile base station sites, an increase of around 2,000 in the year.

IP Exchange has more than 150 customers in the UK alone and is growing fast. BT Wholesale and BT Global Services together generated more than £100m of IP Exchange revenue this year. Total voice minutes reached 7.75bn, a 90% increase in the year.

We have also seen strong demand for Ethernet with the number of circuits installed growing by 63%.

During the year, we signed contracts with a total order value of over £2bn, more than double the intake of around £750m achieved in the prior year.

Contracts won include:

Customer	Contract
Telefonica UK	A 10-year contract to support the introduction of 4G services to its O2 customers. Provision of a sizeable increase in backhaul capacity to new and existing sites, and also a dedicated high capacity transmission network
BSkyB	A new five-year contract to continue to provide wholesale voice services for BSkyB off-network fixed-line customers
MBNL	An increase in the scope of our MEAS contract to provide more backhaul capacity at key base stations across the UK

Customer service delivery

More reliable next generation broadband services led to a 9% reduction in broadband faults reported in the year. We are also better at fixing reported faults, with our diagnostic tools automatically fixing 79% in the fourth quarter of 2012/13, up from 67% in the same period of the prior year. This gave our advisors more time to focus on providing better customer service, for example by sorting out problems before they affected end-users. We also improved our broadband order handling, with our systems automatically processing half a million orders, and we achieved an 84% efficiency improvement in our Ethernet order handling.

We introduced a digital content exchange service in London and Manchester. Through our International Media Centre at the BT Tower, we broadcast the TV content for the London 2012 Olympic and Paralympic Games across the world.

Cost transformation

Net operating costs reduced by 11% (2011/12: 6%) or by 1% excluding transit costs (2011/12: 3% increase). This was achieved by reducing labour costs, which fell by 15% (2011/12: 8%), lower third-party costs and rationalising our networks. These reductions have been partially offset by higher cost of sales due to the change in product mix.

Investing for the future

This year we invested both in creating new products and services and in improving the resilience and footprint of our existing growth products. Our key investments included:

- a new suite of hosted communications services for launch in 2013/14
- new solutions based on small cell technology for mobile operators to boost their coverage
- extending our national broadband, Ethernet and MEAS footprints
- new management information and routing systems to support growth in international voice calls
- a new online portal that will offer better tools for pricing, ordering and support.

We also invested in our customer service operations, to help cut costs and make it easier for customers to do business with us.

We will continue with this investment strategy in 2013/14.

Financial performance

Year ended 31 March	**2013** £m	2012 £m	2011 £m
Revenue	3,588	3,923	4,201
Underlying revenue excluding transit	(2%)	(2%)	(3%)
Net operating costs[a]	2,420	2,715	2,885
EBITDA	1,168	1,208	1,316
Depreciation and amortisation	593	604	619
Operating profit	575	604	697
Capital expenditure	233	336	329
Operating cash flow	896	800	911

[a] Net of other operating income.

Underlying revenue excluding transit declined by 2% (2011/12: 2%), or by 1% excluding ladder pricing[a], with growth in managed network services, Ethernet and IP Exchange offset by the ongoing migration of broadband lines to LLU and by declines in other traditional services.

Total revenue declined by 9% (2011/12: 7%), or 7% excluding ladder pricing, mainly due to a £277m (2011/12: £224m) reduction in transit revenue including mobile termination rate reductions of £132m and lower volumes. Revenue from MNS contracts continued to grow and accounted for 32% of external revenue in the year, up from 27% in the prior year.

EBITDA decreased by 3% (2011/12: 8%), or 1% excluding ladder pricing. Depreciation and amortisation reduced by 2% (2011/12: 2%) and operating profit declined by 5% (2011/12: 13%), but was flat (2011/12: 14% decrease) excluding ladder pricing.

Capital expenditure decreased by 31% (2011/12: 2% increase) primarily due to lower spend on Ethernet as a result of improvements in capacity management and lower spend on our WBC copper broadband product which is now in exchanges serving more than 90% of UK premises. Operating cash flow increased by 12% (2011/12: 12% decrease) principally due to the reduction in capital expenditure.

[a] For a definition of ladder pricing, see page 195. For more details on ladder pricing, see page 39.

Openreach

We have now increased fibre broadband coverage to more than 15m premises and achieved 873,000 net connections in the year. Our physical line base grew by 54,000. But our service performance was not good enough, affected by the poor weather conditions.

Operating performance

We brought fibre broadband to a further 6.2m homes and businesses in the year, equivalent to around 120,000 per week.

Take-up is growing strongly, with more than 1.5m homes and businesses now connected.

We won 19 Broadband Delivery UK (BDUK) bids to deploy fibre broadband in areas outside our commercial fibre broadband footprint. In December 2012 we connected the first BDUK customers in North Yorkshire, less than six months after signing the contract.

There are 17.6m broadband users on our network, an increase of 834,000 in the year.

Demand for our Ethernet services continues to grow the number of Ethernet circuits rose by 15%. This growth reflects higher demand for connections for CPs business customers as well as CPs requiring greater speeds and capacity within their own networks.

Lastly, despite the problems caused by the poor weather, we still managed to grow our physical line base by 54,000 in the year.

Customer service delivery

Our service delivery was strong in the first quarter but deteriorated for the next two quarters following some of the wettest weather on record. This meant we had to spend more time than expected on repair work. There were more faults to fix and it took longer to put them right. This additional work stopped us from delivering new services as quickly as we had planned.

To meet higher levels of demand and improve customer service, we recruited around 1,600 new engineers. We also made a big investment in the tools used by our engineers, making them more productive.

Thanks to these changes, we were able to carry out 8% more engineer visits in the second half of the year than in the second half of 2011/12. This meant that by February 2013, our provision lead times were back at the levels we have committed to.

Cost transformation

Net operating costs decreased by 3% (2011/12: 1% increase) despite the additional engineering resource we took on which increased our labour costs.

We achieved this reduction through efficiency improvements, for example in our back-office functions and call centres. We also improved the productivity of our field engineers by reducing the number of administrative tasks they have to do and by making better use of their time.

Investing for the future

On top of investing in our fibre broadband rollout we spent around £190m on our copper network to improve performance and enhance resilience.

We upgraded the IT systems that support our interactions with customers and our internal processes. We also added more hoists to our fleet to support heavy-duty engineering work.

Financial performance

Year ended 31 March	**2013** £m	2012 £m	2011 £m
External revenue	1,747	1,623	1,504
Internal revenue	3,320	3,513	3,426
Revenue	5,067	5,136	4,930
Net operating costs[a]	2,753	2,837	2,798
EBITDA	2,314	2,299	2,132
Depreciation and amortisation	972	939	877
Operating profit	1,342	1,360	1,255
Capital expenditure	1,144	1,075	1,087
Operating cash flow	1,147	1,195	1,078

[a] Net of other operating income.

External revenue increased by 8% (2011/12: 8%), while internal revenue decreased by 5% (2011/12: 3% increase), bringing total revenue down by 1% (2011/12: 4% increase).

The revenue decline was due to regulation-driven price changes, impacting revenue and EBITDA by around £180m, representing 4% of total revenue and 8% of total EBITDA. This was partially offset by revenue growth from Ethernet, LLU and fibre broadband.

EBITDA increased by 1% (2011/12: 8%), with the decline in revenue offset by a 3% reduction in net operating costs (2011/12: 1% increase).

Depreciation and amortisation increased by 4% (2011/12: 7%) reflecting the accelerated investment in fibre broadband, which also led to capital expenditure increasing by 6% (2011/12: 1% decrease). Operating profit decreased by 1% (2011/12: 8% increase).

Operating cash flow decreased by 4% (2011/12: 11% increase) primarily due to the higher capital expenditure and timing of debtor receipts.

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Our performance as a responsible and sustainable business

We are a company that does business responsibly and sustainably. We track our sustainability performance using seven indicators. We made progress against five of these but failed to meet our customer service and sickness absence targets. Read more on page 13 for RFT and page 19 for sickness absence.

To find out more, take a look at our

Better Future report at www.bt.com/betterfuture

[a] CO_2e emissions figures restated based on 2012 DEFRA reporting guidelines.

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Governance

In this Report of the Directors we set out who sits on the Board, our governance structure and how it operates, and our areas of focus in the year.

Corporate governance statement

We are committed to operating in accordance with best practice in business integrity and ethics and maintaining the highest standards of financial reporting and corporate governance. The directors consider that BT has, throughout the year, complied with the provisions of the UK Corporate Governance Code (the Code) as currently in effect and applied the main principles of the Code as described on pages 63 to 97 of this Report of the Directors.

The Code and associated guidance is available on the Financial Reporting Council website at
www.frc.org.uk

The directors submit their report and the audited financial statements of the company, BT Group plc, and the group, which includes its subsidiary undertakings, for 2012/13. BT Group plc is the listed holding company for the BT group of companies: its shares are listed on the London Stock Exchange, and on the New York Stock Exchange in the form of American Depositary Shares.

The Strategy, Business and Performance sections on pages 11 to 61 and Governance on pages 63 to 97 form the Report of the Directors.

We present the audited financial statements on pages 102 to 162 and 167.

Chairman s governance report

I am personally committed to ensuring that our Board is strong, working effectively and able to respond to the opportunities and challenges we face.

As a Board, we provide strong leadership in setting standards and values for our company. We keep our corporate governance framework under continual review and our Board committees play a vital role in ensuring its effectiveness. Our governance structure is shown in the diagram below. Each committee chair has provided a report on the committee s role and what it has done during the year. You can read about this on pages 71 to 92. As a Board we have focused on a range of matters from our future strategy for TV, mobility and wireless, BT Global Services, a review of cyber defence and the development of our Better Future strategy, together with a regular review of the key risks to our business.

I continue to keep the membership of our Board under review, looking for exceptional candidates to join us and ensuring we have the right mix of skills, experience and background. Currently 30% of our Board members are women, and our aim is to continue to have at least 25% female representation.

We promote an inclusive working environment throughout our company and we aim to mirror the diversity, in its widest sense, of the societies in which we operate. At 31 March 2013, 21% of our people were women, in a sector that has traditionally been male dominated.

At our executive and senior management level 20% are women, a proportion which we are aiming to increase.

We continue to engage in the wider governance debate and consultation exercises that have taken place during the year. We have responded to the Department of Business, Innovation and Skills on the future of narrative reporting and executive pay disclosures as well as participating in a Financial Reporting Lab project issued by the Financial Reporting Council.

Sir Michael Rake

Chairman

9 May 2013

Our governance structure

The Board has ultimate responsibility for the management of the group, and has structured its committees as set out below.

The *Equality of Access Board* (EAB) monitors, reports and advises BT on its compliance with the Undertakings given by BT to Ofcom (the Undertakings). The EAB reports regularly to the Board and publishes an annual report to Ofcom. You can find full details of the committee members and its remit in the EAB report at www.bt.com/eab.

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Board of Directors

Chairman

Appointed to the Board as Chairman in September 2007. A British national, age 65.

Skills and experience

Sir Michael has financial, risk, and international business and professional services expertise gained during his time as chairman of KPMG International from 2002 to 2007. He previously held other roles in KPMG from 1974. A Chartered Accountant, he was knighted in 2007 for his services to the accountancy profession.

Other appointments include

Deputy chairman of Barclays and a non-executive director of McGraw-Hill. Sir Michael is vice-president of the RNIB, a member of the board of the Transatlantic Business Council, and is also to be appointed President of the Confederation of British Industry in June 2013.

Chief Executive

Appointed as Chief Executive in June 2008 and on the Board since 2002. A British national, age 48.

Skills and experience

Ian has financial, risk, operational, sales and marketing and international business experience. He was formerly CEO, BT Retail and prior to that, Group Finance Director. He joined Dixons Group in 1991 after working for 3i and Bank of America International. His positions at Dixons spanned operational and financial roles in the UK and overseas. He is a Chartered Accountant.

Other appointments include

Non-executive director and chairman of the audit committee of Celtic.

Group Finance Director

Appointed to the Board as Group Finance Director in December 2008. A British national, age 59.

Skills and experience

Tony has experience in finance, risk and the management and delivery of large contracts. He was formerly CFO, BT Retail, and Managing Director, BT Enterprises and, from 1997 to 2004, he was CFO and then Chief Operating Officer of BT Global Solutions. He qualified as a Chartered Management Accountant.

Other appointments

None outside BT.

CEO, BT Retail

Appointed to the Board as CEO, BT Retail in June 2008. A British national, age 45.

Skills and experience

Gavin has experience in sales, marketing and operations. He was formerly Managing Director, Consumer Division, BT Retail and before joining BT was managing director of the consumer division of Telewest. Prior to this, he spent nine years at Procter and Gamble, rising to become European marketing director.

Other appointments include

Non-executive director of British Airways.

Non-executive director

Appointed to the Board in July 2009. A British national, age 57.

Skills and experience

Tony brings international business expertise in addition to financial, operational, sales and marketing experience. From 1999 to 2003 Tony was chief executive of BSkyB. He has also held a number of senior executive positions in broadcasting and telecoms businesses in the UK, US and Continental Europe.

Other appointments include

Chairman of the supervisory board of Kabel Deutschland, and on the board of the Spanish cable company ONO.

Non-executive director

Appointed to the Board in March 2008 and became Senior Independent Director in July 2009. A British and Australian dual national, age 64.

Skills and experience

Patricia brings experience of running large complex organisations, government affairs, public policy and international business. Patricia stepped down as an MP at the 2010 election. She was Secretary of State for Health from 2005 to 2007, and Trade and Industry and Cabinet Minister for Women from 2001 to 2005.

Other appointments include

Independent director of Groupe Eurotunnel SA and chair of the UK India Business Council and Katha Children s Trust.

Non-executive director

Appointed to the Board in February 2006. A British national, age 55.

Skills and experience

Phil has experience in the financial sector as well as risk, control, governance and sustainable business. Phil s previous roles included group finance director of HBOS, chairman of Insight Investment and Clerical Medical and chief executive of Zurich Life and Eagle Star Life.

Other appointments include

Non-executive director of Friends Life Group, Business in the Community and Travelex. Also a trustee of Action Medical Research and BBC Children in Need.

Non-executive director

Appointed to the Board in November 2011. A US national, age 50.

Skills and experience

With a 25 year career in the technology and software industry, Karen brings experience in technology to the Board. Karen was previously a board member of i2Group and from 1998 to 2005 Karen was with the NASDAQ- listed software company Epiphany Inc, latterly as chief executive officer.

Other appointments include

Director of Convercent, and an advisory board member of the Mita Institute and at Stanford University.

Non-executive director

Appointed to the Board in January 2011. A British national, age 55.

Skills and experience Nick brings experience in finance, risk, control, governance and international business expertise. He was chief financial officer of Diageo prior to his retirement in December 2010, having joined the board in 1999.

Other appointments include

Chairman of Williams Grand Prix Holdings, senior independent director of BAE Systems, and chairman of Edwards Group.

Non-executive director

Appointed to the Board in January 2011. A British and Swiss dual national, age 49.

Skills and experience

Jasmine has experience in UK and global businesses and corporate social responsibility and sustainable business. She was appointed chief executive of Save the Children International in 2010, having joined Save the Children in 2005.

Other appointments include

Governor of Dragon School Trust.

Dan Fitz

Company Secretary

Dan is the Group General Counsel and Company Secretary of BT Group plc. He joined BT in April 2010 as its Group General Counsel and was appointed Company Secretary in November 2012. Dan previously spent six years at Misys plc and twelve years at Cable & Wireless plc. Age 53.

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How we govern the company

Role of the Board

Who we are

You can read about the **Board of Directors**, who they are, and the skills and experience they each bring to the Board on pages 65 and 66. The Board comprised a majority of independent non-executive directors throughout the year.

Director election and re-election

We will propose all directors for re-election this year. We include in the **Report on Directors Remuneration** details of all directors contracts/ letters of appointment.

The Board viewed the Chairman as independent at the time of his appointment. All the non-executive directors met, and continue to meet, the criteria for independence set out in the Code and the Board therefore considers them to be independent.

Attendance at Board meetings

We normally meet nine times each year. When necessary, we hold additional Board meetings, and this year we held two additional meetings to discuss time-critical matters. The Chairman meets privately with the non-executive directors before each scheduled Board meeting. If unable to attend a meeting, directors are encouraged to give their views and comments on matters to be discussed to the Chairman in advance. Meeting attendance by each of the directors is shown below.

Board members	Meetings	
Member	Eligible to attend	Attended
Sir Michael Rake (Chairman)	11	11
Ian Livingston	11	11

Tony Chanmugam	11	11
Gavin Patterson	11	11
Tony Ball	11	9
Eric Daniels[a]	4	4
Rt Hon Patricia Hewitt	11	10
Phil Hodkinson	11	9
Karen Richardson	11	10
Nick Rose	11	11
Jasmine Whitbread	11	9

[a] Eric Daniels retired from the Board on 13 June 2012.

The Chairman keeps under review the level of attendance and contribution by directors at Board meetings, as well as their performance. During the year he met with each director on an individual basis and considers that each of them makes an effective contribution to the Board debate across a wide range of issues and continues to demonstrate commitment to the role. The Chairman also reviews with each director any training or development they need to assist them in doing their role. Patricia Hewitt is the Senior Independent Director. She reviewed the Chairman s performance during the year, taking into account the feedback from the other Board members including the internal evaluation exercise. Patricia was consulted on the proposal for the Chairman to be appointed President of the Confederation of British Industry in June 2013. She concluded that his commitments would enable him to continue to dedicate sufficient time to the group, taking into account his decision to stand down as chairman of easyJet, effective on 1 May 2013 following easyJet s entry into the FTSE 100 in March 2013.

Our role

We are ultimately responsible for the group s strategy and for overseeing the group s performance, in addition to discharging certain legal responsibilities.

We set the direction for the group s values, ethics and business policies and practices. We also oversee: operating and financial performance; risk management and internal controls; compliance and major public policy issues; and review the Group Risk Register.

We agree the corporate governance framework. For example we give authority to the key management committee, the *Operating Committee*, to make decisions on operational and other matters. The *Operating Committee* develops BT s strategy and budget for our approval; recommends to us capital expenditure and investment budgets; allocates resources across BT within plans agreed by us; plans and delivers major programmes; and reviews the senior talent base and succession plans. The *Operating Committee* can approve, up to limits which we set, capital expenditure, disposals of fixed assets, investments and divestments. It can, and has, delegated some of these approvals, up to its own limits, to sub-committees, such as the Design Council and to senior executives. The Company Secretary attends all meetings of the *Operating Committee*.

You can view a formal statement of our role at www.bt.com/board

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The Chairman and the Chief Executive

The roles of the Chairman and the Chief Executive are separate. They are set out in written job descriptions, agreed by the *Nominating & Governance Committee*. These provide clarity on the different responsibilities of each role. A summary of these is set out below.

The Chairman and the Chief Executive meet regularly and keep in close contact as they recognise that their working relationship is a critical link between the Board and senior management.

Role of the Chairman

The Chairman s role is to lead a well-informed and effective Board, ensure sound governance of the group and represent the group in key relationships.

His key responsibilities include:

- chairing the Board, *Nominating & Governance Committee*, and the *Committee for Sustainable and Responsible Business*; being a member of the *BT Pensions Committee*
- ensuring that the Board determines the nature, and extent, of the significant risks BT is willing to embrace in implementing its strategy
- consulting with the non-executive directors, particularly the Senior Independent Director, on corporate governance matters
- monitoring the contributions and performance of the non-executive directors and the Chief Executive and acting on performance evaluations undertaken by the Board
- promoting a culture of openness, debate and appropriate challenge, and ensuring constructive relations between executive and non-executive directors

ensuring, with the Chief Executive and the Company Secretary, that the Board is kept properly informed, is consulted on all matters important to it, receives accurate, timely and clear information and has adequate time to discuss all items

ensuring that new directors participate in a full, formal and tailored induction, and regularly reviewing and agreeing with each director their training and development needs

being a key contact and escalation point for important stakeholders, and ensuring that BT maintains effective communication with shareholders and that their views, and any concerns, are communicated to the Board

with the Chief Executive and Senior Independent Director, representing BT in key strategic and government relationships.

Role of the Chief Executive

The Chief Executive is responsible for the performance and management of the group s business and success in achieving its goals and targets while managing the risks.

His key responsibilities include:

proposing strategies, business plans and policies for Board approval, and implementing those consistently with BT s purpose, values, business principles and standards

implementing Board decisions

leading the *Operating Committee* in the day-to-day running of the business

with the *Operating Committee*, developing and implementing appropriate strategies and monitoring the financial, operational and customer service performance of the group

maintaining shareholder relations including ongoing communication with major shareholders

fostering key relationships including those with governments, regulators, major customers and suppliers, industry players and opinion formers

monitoring the performance of, and succession planning for, BT s senior management team, with due regard to diversity

maintaining an effective framework for internal controls and risk management

engaging and communicating with BT people, including communicating the expectations of the Board.

The Non-Executive Directors and Company Secretary

The roles of the non-executive directors and the Company Secretary are set out below.

Role of the Non-Executive Directors

The non-executive directors:

- provide a strong, independent element on the Board and are well placed to challenge constructively and help develop proposals on strategy
- collectively bring experience and independent judgement, gained at the most senior levels of international business operations and strategy, finance, marketing, technology, communications, political and international affairs and responsible and sustainable business leadership.

In her capacity as the Senior Independent Director, and as the chair of the *Remuneration Committee*, Patricia Hewitt may meet with BT s major institutional shareholders and shareholder representative bodies, and she is able, if necessary, to discuss matters with them where it would be inappropriate for those discussions to take place with either the Chairman or the Chief Executive. You can find further details on page 97. Patricia also acts as a sounding board for the Chairman and an intermediary for the other directors when necessary.

Each non-executive director has an appointment letter setting out the terms of his or her appointment. This includes membership of any Board committees, the fees to be paid and the time commitment expected. We ask each non-executive director to allow a minimum commitment of 22 days each year, subject to committee commitments, and to allow slightly more in the first year in order to take part in the induction programme. We highlight that additional time may be required if the company is going through increased activity. The appointment letter also covers matters such as confidentiality of information and BT s share dealing code.

Role of the Company Secretary

The Company Secretary:

manages the provision of timely, accurate and considered information to the Board

recommends to the Chairman and the Chief Executive, for Board consideration where appropriate, corporate governance policies and practices and is responsible for communicating and implementing them across the group

advises the Board on appropriate procedures for the management of its meetings and duties (and those of the main Board committees), as well as corporate governance and compliance within the group.

The appointment and removal of the Company Secretary is a matter for the whole Board.

What we have done

The chart below shows how we allocated our time. A number of these areas are also considered by the Board committees. This is broadly in line with last year. A number of strategy reviews took place throughout the year and more time was spent on key business discussions such as TV and wireless and mobility.

During the year we carefully considered and agreed the strategic direction in relation to launching BT Sport and the 4G auction. We also endorsed the refreshed BT values, which came into effect in April 2013.

In addition to the regular monthly reports from the Chief Executive, Group Finance Director and Company Secretary, each of the lines of business presented during the year on their business. This included opportunities and challenges. During the year, we reviewed the company s strategy, our approach to tax, investor relations and communications. In relation to people, we received updates on health, safety and wellbeing and a report on organisational health. We visited the US west coast to look at some of the trends impacting our industry, explore emerging technologies and meet with some of our longstanding partners.

We have procedures in place for managing potential conflicts of interest, and directors have a duty to update us on any changes to these potential conflicts. Phil Hodkinson declared that he was on the board of HMRC prior to any discussion on tax. We were comfortable there was no conflict in relation to the matters being discussed.

Board evaluation

The Chairman and Company Secretary carried out a Board evaluation in March and April 2012 through a questionnaire and discussion. The resulting report, which we discussed in May, described a number of areas where we were effective and functioning well. We also identified a number of improvements. We highlight our progress in the key areas in the table opposite.

We have distributed an internal questionnaire for the next annual Board evaluation. This covers the following areas: our composition and effectiveness and that of our Board committees; strategy; management performance; risk; the processes supporting us; and our performance. We will discuss the results of the questionnaire at a future Board meeting.

In addition, the *Audit & Risk Committee*, and *Nominating & Governance Committee* have undertaken an evaluation of their effectiveness.

Key areas	Actions
Board Effectiveness	
More blue sky style discussion on key strategic choices	We have received regular strategy updates during the year. We also held our annual Board strategy session in March 2013.
Opportunities for the Board members to have greater visibility of senior executives	Senior executives below the *Operating Committee* have presented to us on items including TV, 4G spectrum, IT services and cyber defence. They have also attended networking breakfasts and dinners with the Chairman and non-executive directors. Separate reviews have taken place outside Board meetings with individual non-executive directors and management teams in key business areas such as TV, fibre and customer service.
Board Process	
Enhance the feedback from the *Remuneration Committee* to the Board	The *Remuneration Committee* chair updates the Chairman and non-executive directors during the private session ahead of our Board meetings.
Access to additional information and resource in certain areas	We have received updates from external equity analysts and brokers.
Performance	

Continuing interest in a range of training areas	Specific training has included: updates on anti-corruption and bribery; geopolitical risk; developments in financial reporting; an Openreach working session covering a range of topics including innovations and technology; and sessions with key suppliers.
Extend the time spent on review of talent and succession planning	We have been engaged on the effectiveness of talent processes during the year and the Chairman and non-executive directors have attended talent breakfasts. We reviewed the succession plan at our April 2013 meeting.

Board induction

On appointment, directors take part in an induction programme to increase their knowledge and understanding of the business. We provide them with information about BT, our role as a Board and the matters reserved for our decision. We include: the terms of reference and membership of the main Board committees; the powers delegated to those committees; corporate governance policies and procedures, including the powers reserved to our most senior executives; and the latest financial information. We organise meetings with each of the executive and non-executive directors, members of the *Operating Committee* and senior executives across the business as part of the induction programme.

Training and information

In addition to the induction programme, we have an ongoing programme of director development and company awareness. This gives the non-executive directors an appreciation of the different elements of the business. We highlight the key features of the programme below.

Key areas	Programme
Our business, the competitive and regulatory environment, and other changes affecting us and the communications industry as a whole	We provide directors with written briefings and monthly Investor Relations and Analyst Relations reports. Directors also have meetings with senior executives.
Legal and other duties and obligations as a director of a listed company	The Company Secretary briefs directors on appointment and provides them with updates both in writing and in face-to-face meetings. During the year we provide reminders of certain obligations, and updates in changes to legal, accounting and governance requirements.

Updates from the Chairman	The Chairman sends a weekly email to non-executive directors. This includes updates on key business activities and topical sector highlights.

Reports of the Board Committees

Audit & Risk Committee Chairman s report

Who we are

I chair the *Audit & Risk Committee*, and our membership and meeting attendance are set out opposite.

Although not members of the committee, the Group Finance Director, Group Controller, Company Secretary, Director Internal Audit and Director Group Financial Control attend each meeting, as does the lead audit partner and other representatives from our external auditors. The external auditors are not present when we discuss their performance and/or remuneration.

The Board considers that our members have broad commercial knowledge and extensive business leadership experience. We have held between us various roles in major business, Government, financial management, and financial function supervision, and the Board considers that this constitutes a broad and suitable mix of business and financial experience.

The Board has agreed that I have recent and relevant financial experience as required by the provisions of the Code and that I constitute an audit committee financial expert for the purposes of the Sarbanes-Oxley Act.

After each meeting I report to the Board on the main issues that we discuss.

Committee members

Member	Meetings Eligible to attend	Attended
Nick Rose (Chairman)	6	6
Rt Hon Patricia Hewitt	6	5
Phil Hodkinson[a]	2	2
Karen Richardson[b]	4	4

Jasmine Whitbread	6	6

[a] Phil Hodkinson retired from the committee on 30 June 2012.
[b] Karen Richardson joined the committee on 13 June 2012.

Our role

You can view our terms of reference on our website at www.bt.com/committees
We have clear terms of reference which set out our authorities and duties. We review these annually and they are approved by the Board.

External audit

We recommend the appointment and re-appointment of the external auditors and consider their resignation or dismissal, recommending to the Board appropriate action to appoint new auditors.

We assess the performance of the external auditors annually. The evaluation focuses on: audit scope and planning; performance of the lead audit partner and the audit team; audit reporting and communications; added value; and the audit fee. PricewaterhouseCoopers LLP and its predecessor firms have been BT s auditors since BT listed on the London Stock Exchange in 1984. The external auditors are required to rotate the lead partner every five years and other partners that are responsible for the group and subsidiary audits change at least every seven years. Such changes are carefully planned to ensure business continuity without undue risk or inefficiency. The partner responsible for BT s audit is completing his fourth year within the group audit team and his first year as lead partner, which is a role he can continue for a further three years.

No contractual obligations exist that restrict the group s choice of external audit firm. We discuss with the auditors the scope of their audits before they start. We review the results and consider the auditors formal reports, and we report the results of those reviews to the Board.

Independence of the external auditors

As a result of regulatory or similar requirements, we may need to employ the external auditors for certain non-audit services. The Board has agreed policies (in line with the relevant provisions of the Sarbanes-Oxley Act) on what non-audit services can be provided by the external auditors and the relevant approval process. This safeguards the independence and objectivity of the external auditors. Work of a consultancy nature is not to be offered to the external auditors unless there are clear efficiencies and value-added benefits for the company.

Internal audit

We monitor internal audit and its relationship with the external auditors, as well as internal audit s plans, performance and effectiveness.

Internal controls and risk management

On behalf of the Board, we review the group s risk profile, endorse a programme for testing of the risk mitigation and controls that underpin the group s assessment of residual risk and review the group s current risk exposure and capability to identify new risks. Our role supports the Board s responsibilities in respect of the monitoring, review and reporting on internal control and risk management.

We review the disclosures made by the Chief Executive and Group Finance Director during the certification process for the Annual Report & Form 20-F. You can read more about this process on page 95. The Board takes responsibility for all disclosures in the Annual Report & Form 20-F. We also consider any whistleblowing reports (including the confidential, anonymous submission by employees) regarding accounting, internal accounting controls or auditing matters, ensuring arrangements are in place for the proportionate, independent investigation and appropriate follow-up of such matters.

Financial reporting

We review BT s published financial results, the Annual Report & Form 20-F and other published information for statutory and regulatory compliance. We report our views to the Board to assist in its review and approval of the results announcements and the Annual Report & Form 20-F.

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What we have done

We met six times during the year and the chart below shows how we allocated our time. We covered the same key areas as last year with a slightly increased focus on internal controls and risk management.

We are keen to interact with senior management below executive level and representatives from finance and internal audit have attended meetings at our invitation.

We set time aside at each meeting to seek the views of the internal and external auditors in the absence of management.

Our principal activities during the year were:

External audit

We carried out the annual review of the auditors performance by gathering feedback from our members and senior management. We considered reports on the audit firm s own internal quality control procedures and assessment of independence. We agreed on a number of areas of progress and identified with the auditors some further improvements. Having assessed the responses we did not consider it necessary to require them to tender for the audit. The appointment of PricewaterhouseCoopers LLP as auditors of the group is subject to shareholder approval at the AGM.

We are considering, in the light of the recent changes to the Code to put the external audit contract out to tender at least every ten years, how and when a tender process might be implemented. We will make a recommendation to the Board during 2013/14.

We reviewed and approved the auditors group audit plan after discussion with them. The auditors explained to us the programme of work they planned to undertake to ensure that the identified audit risks did not lead to a material misstatement of the financial statements.

The key risks identified included revenue recognition, major contracts, fraud, pensions, regulatory and other provisions, capitalisation and asset lives, tax and goodwill. We agreed it was appropriate for the auditors to focus on these areas. Where they thought it would be effective to do so, this work included the evaluation and testing of the group s own internal controls.

We discussed these issues with them again at the time of their review of the half-year results and again at the conclusion of their audit of the financial statements for the year. As they concluded the audit, they explained:

- the work they had done to test management s assumptions and estimates, in particular in relation to major contracts, the carrying value of goodwill, pensions, regulatory and other provisions, and how they had satisfied themselves that these were reasonable
- they had reviewed the appropriateness and application of the group s accounting policies
- the results of their testing of the controls and other procedures carried out in the major overseas locations and any issues they had found there.

The auditors also reported to us the misstatements that they had found in the course of their work and we have confirmed that there were no such material items remaining unadjusted in the financial statements.

Independence of the external auditors

We monitored compliance with the agreed policies on what non-audit services can be provided by the external auditors, and we reviewed the extent of non-audit services being performed and approved any non pre-approved services, before the work was undertaken. We also monitored the level of non-audit fees paid to the auditors. You can see details of non-audit services carried out by the external auditors in note 8 to the consolidated financial statements.

Internal audit

We endorsed in May 2012 the internal audit plan of work. This integrates the assurance requirements for the internal financial controls testing programme, the company s overseas footprint, and the group s risk assurance mapping. It includes coverage of significant static and dynamic risks.

We reviewed promptly all material reports from the internal auditors and ensured that management took appropriate action on issues arising from such reports. We monitored management s responsiveness to the findings and recommendations of the internal auditors. Examples included physical access security and global IT governance. At the end of the year we received a report on the performance of internal audit.

Internal controls and risk management

We give risk management special attention and during the year we heard from each line of business CEO on the key risks in their part of the business, as well as the actions they are taking to address them. We aim to cover all significant risks to the group not just the financial risks. One of our meetings focused solely on risk at which the Chief Executive discussed the group s enterprise-wide risk management processes, and the key risks facing the group as a whole. We reviewed the internal control requirements under the Code including the risk management processes. You can find details of the Board and our review of the group s systems of internal control and risk management on page 95.

We received updates on security and resilience, cyber security, BT s networks, major contracts, BT s operations in Italy, customer data handling, litigation trends, as well as updates on major litigation and competition and regulation.

Financial reporting

We reviewed the Annual Report & Form 20-F 2012, together with annual, half-year and quarterly results announcements for recommendation to the Board.

We considered the appropriateness of the group s accounting policies, critical accounting estimates and key judgements. We reviewed accounting papers prepared by management on areas of financial reporting judgement including the treatment of specific items, the estimation of the group s tax charge, and the assumptions underlying the pension liability valuation. We also considered the judgements made of the carrying value of goodwill and confirmed, based on management s expectations of future performance, that no goodwill impairment charges were required in

2012/13.

We considered and are satisfied that, taken as a whole, the Annual Report 2013 is fair, balanced and understandable and provides the information necessary for shareholders to assess the group s performance, business model and strategy.

Governance

Our performance is reviewed annually by inviting members, key executives and the external auditors to complete questionnaires. The results showed that we continue to be effective in terms of both behaviours and processes. Areas of focus over the next twelve months include connectivity with other BT Board committees, enterprise risk management/risk appetite, cyber security, data privacy and BT Global Services operations.

Nick Rose

Chairman of the Audit & Risk Committee

9 May 2013

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Nominating & Governance Committee Chairman s report

Who we are

At the request of the Board, I chair the *Nominating & Governance Committee* although I would not participate in any discussion concerning the selection and appointment of my successor.

Our membership and meeting attendance are set out below.

The Company Secretary and, where appropriate at my invitation, the Chief Executive attend our meetings.

Committee members

	Meetings	
Member	Eligible to attend	Attended
Sir Michael Rake (Chairman)	4	4
Tony Ball	4	3
Eric Daniels[a]	1	1
Rt Hon Patricia Hewitt	4	4
Phil Hodkinson	4	4
Nick Rose[b]	2	2

[a] Eric Daniels retired from the committee on 13 June 2012.

[b] Nick Rose joined the committee on 30 October 2012.

Our role

You can view our terms of reference on our website at www.bt.com/committees
Our role is to make sure there is an appropriate balance of experience and abilities on the Board. We also oversee BT s governance framework and key compliance programmes, with a focus on non-financial assurance.

Nominating

We keep under review the size and composition of the Board and the need to refresh the membership so that we have the appropriate balance of skills, experience, independence and knowledge of the group. This includes keeping under review our policy on Board diversity including gender and any measurable objectives set for implementing the policy. We agree the specific experience and skills that we are looking for and consider candidates that are identified by the Board and external consultants. We ensure that diversity is considered as part of the shortlist process drawn up by our external consultants. Having met potential candidates, we make a recommendation to the Board.

We advise the Board on succession planning for all Board appointments and the Company Secretary. We also make recommendations to the Board on the reappointment of non-executive directors at the end of their terms of office. We keep under review the time required of the non-executive directors to carry out their duties and commitments and the number of external directorships and other interests held by the Board and the members of the *Operating Committee*.

Governance and compliance

In line with our revised terms of reference, we oversee and monitor BT s governance framework (including our regional approach to governance) so that it continues to be fit for purpose to meet BT s business and organisational goals and is consistent with our approach to risk. We have oversight of our key compliance programmes. These include: ethics and business practices; sanctions and international trade; regulatory compliance; and data preservation and protection in the UK and around the world. We review the process for, and effectiveness of, our whistleblowing procedures, and we have a code of ethics for the Chief Executive, Group Finance Director and senior finance managers as required by the Sarbanes-Oxley Act. We keep under review that the Board and its committees are appropriately receiving assurances on all major governance and compliance matters.