

BT GROUP PLC
Form 6-K
May 27, 2009

Table of Contents

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 27, 2009

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 o

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 o

No X

Enclosure: BT Group plc Annual Report and Form 20-F 2009 as sent to shareholders

Table of Contents

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/ Alan

Name: Scott

Alan Scott

Title: Deputy
Secretary

Date: May 27, 2009

Table of Contents

BT GROUP PLC ANNUAL REPORT & FORM 20-F

BT GROUP PLC ANNUAL REPORT & FORM 20-F

BT Group plc
Annual Report
& Form 20-F
2009

BT Group plc is a public limited company registered in England and Wales and listed on the London and New York stock exchanges. It was incorporated in England and Wales on 30 March 2001 as Newgate Telecommunications Limited with the registered number 4190816. Its registered office address is 81 Newgate Street, London EC1A 7AJ. The company changed its name to BT Group plc on 11 September 2001. Following the demerger of O2 in November 2001, the continuing activities of BT were transferred to BT Group plc.

British Telecommunications plc is a wholly owned subsidiary of BT Group plc and encompasses virtually all the businesses and assets of the BT group. The successor to the statutory corporation British Telecommunications, it was incorporated in England and Wales as a public limited company, wholly owned by the UK Government, as a result of the Telecommunications Act 1984. Between November 1984 and July 1993, the UK Government sold all of its shareholding in British Telecommunications plc in three public offerings.

This is the Annual Report for the year ended 31 March 2009. It complies with UK regulations and is 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. A separate Summary financial statement & notice of meeting 2009 has been issued to all shareholders.

In this Annual Report, references to BT Group, BT, the group, the company, we or our are to BT Group plc (which includes the continuing activities of British Telecommunications plc) and its subsidiaries and lines of business, or any of them as the context may require.

References to a year are to the financial year ended 31 March of that year, eg 2009 refers to the year ended 31 March 2009. Unless otherwise stated, all non-financial statistics are at 31 March 2009. Please see cautionary statement regarding forward-looking statements on page 148.

A number of measures quoted in this Annual Report are non-GAAP measures. The Directors believe these measures provide a more meaningful analysis of the trading results of the group and are consistent with the way financial performance is measured by management. These include EBITDA, adjusted EBITDA, adjusted operating profit, adjusted profit before taxation, adjusted earnings per share, net debt and free cash flow. The rationale for using non-GAAP measures and reconciliations to the most directly comparable IFRS indicator are provided on pages 33 to 35, 39, 41, 47 and 48.

<u>2</u>	<u>Financial summary</u>
<u>3</u>	<u>Chairman's message</u>
<u>4</u>	<u>Chief Executive's statement</u>
<u>5</u>	<u>This is BT</u>
<u>6</u>	<u>How we are structured</u>

<u>8</u>	<u>Business review</u>
<u>26</u>	<u>Other matters</u>
<u>32</u>	<u>Financial review</u>

<u>50</u>	<u>Board of Directors and Operating Committee</u>
<u>52</u>	<u>The Board</u>
<u>54</u>	<u>Report of the Audit Committee</u>
<u>56</u>	<u>Report of the Nominating Committee</u>
<u>56</u>	<u>Report of the Committee for Responsible and Sustainable Business</u>
<u>57</u>	<u>Report on directors' remuneration</u>
<u>70</u>	<u>Directors' information</u>
<u>71</u>	<u>Business policies</u>
<u>74</u>	<u>Shareholders and Annual General Meeting</u>
<u>76</u>	<u>Statement of directors' responsibilities</u>
<u>77</u>	<u>Report of the independent auditors' consolidated financial statements</u>
<u>79</u>	<u>Consolidated financial statements</u>
<u>136</u>	<u>Glossary of terms and US equivalents</u>
<u>137</u>	<u>Report of the independent auditors' parent company</u>
<u>138</u>	<u>Financial statements of BT Group plc</u>
<u>141</u>	<u>Subsidiary undertakings and associate</u>
<u>142</u>	<u>Quarterly analysis of revenue and profit</u>
<u>143</u>	<u>Selected financial data</u>
<u>145</u>	<u>Financial statistics</u>
<u>146</u>	<u>Operational statistics</u>
<u>148</u>	<u>Information for shareholders</u>
<u>160</u>	<u>Cross reference to Form 20-F</u>
<u>163</u>	<u>Glossary of terms</u>
<u>166</u>	<u>Index</u>

Table of Contents**OVERVIEW
FINANCIAL SUMMARY**

	2009	2008
	£m	£m
Revenue	£21,390	£20,704
EBITDA ^a		
adjusted ^{b,c}	£5,348	£5,784
reported	£3,301	£5,245
Profit (loss) before taxation		
adjusted ^{b,c}	£1,877	£2,506
reported	£(134)	£1,976
Earnings (loss) per share		
adjusted ^{b,c}	18.4p	23.9p
reported	(1.1)p	21.5p
Full year proposed dividend	6.5p	15.8p

Key performance indicators**Key points**

- 4 Revenue growth of 3%
- 4 EBITDA decline due to the unacceptable performance of BT Global Services
- 4 The rest of the business delivered a good performance in spite of the economic downturn
- 4 BT Global Services contract and financial review charges of £1.6bn and a specific item restructuring charge of £280m
- 4 Pension deficit payments of £525m per annum for the next three years

4 Full year proposed dividend of 6.5p per share

a EBITDA:

Earnings before
interest,
taxation,
depreciation and
amortisation.

b Items presented
as adjusted are
stated before
contract and
financial review
charges recorded
within BT
Global Services
and specific
items.

c Adjusted
EBITDA,
adjusted profit
before taxation,
adjusted
earnings per
share and free
cash flow are
non-GAAP
measures. The
rationale for
using
non-GAAP
measures and
reconciliations
to the most
directly
comparable
IFRS indicators
are provided in
the Financial
review on pages
33-35, 39, 41, 47
and 48.

2 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents

OVERVIEW

CHAIRMAN'S MESSAGE

The world looks a very different place than it did a year ago. Global trade has contracted for the first time in many decades. Financial markets have been in turmoil and trading conditions worldwide remain extremely challenging. Against this background, the importance of defending free trade and fighting for regulation that promotes investment and encourages competition has never been greater.

Our management team not only understands the challenges, but also sees the opportunities that lie ahead. Three out of our four principal divisions (BT Retail, BT Wholesale and Openreach) are delivering well. Management's highest attention is now directed towards returning BT Global Services, our one under performing division, to profitable growth.

We have agreed with the Trustee of the BT Pension Scheme the pension contributions for the next three years, enabling the Board to announce a sustainable dividend policy.

The proposed final dividend of 1.1p gives a full year dividend of 6.5p which rebases dividend payments to a level which we are confident is sustainable. The Board is committed to delivering attractive returns for shareholders and believes that the operational improvements in the business will generate sufficient cash flow to allow the dividend to grow at the same time as investing in the business, reducing debt and supporting the pension scheme.

Regulation

It is clear how important the 2005 Telecommunications Strategic Review by Ofcom has been in establishing the UK as the most competitive telecommunications market in the world. While the price of other utilities has soared, the price of communications has fallen sharply. New market entrants have flourished, encouraged by low wholesale prices and incentives to invest in unbundled local loops. Britain has more companies competing in the same space than any comparator country.

Now a healthy debate is underway about the investment needed to deliver the next generation of broadband services. These will be carried largely over fibre optic cables able to deliver speeds of up to 100Mb compared with a typical speed of 4-5Mb today. This investment will provide the UK with the world class IT infrastructure it will need to thrive as a knowledge-based society.

It is essential that the regulatory environment encourages investment. This means that BT and others must have the potential to make a return for shareholders that is commensurate with the risk involved. We need a level playing field in the UK's fast moving market which allows every company to compete on equal terms and makes sure that new monopolies are not allowed to emerge. We also need regulation to move at the same speed as the market is evolving.

In our overseas markets, particularly in the rest of Europe and in North America, regulators must do more to encourage fair competition. BT should be able to invest and compete in any other country, in the same unrestricted manner that overseas companies can invest and compete in the UK.

A sustainable business

BT has a proud record of contributing to the communities in which we work and of building a sustainable business. We believe our services are an important part of the solution to climate change.

Thousands of our people are involved in voluntary work and I am keen to build on this heritage and make sure that as a global business BT's Better World Campaign takes a genuinely global view.

Your Board

In December 2008, we welcomed Tony Chanmugam to the Board as Group Finance Director in succession to Hanif Lalani who had become Chief Executive, BT Global Services.

Since joining BT I have been extremely fortunate to have as my Deputy Chairman, Maarten van den Bergh who is stepping down from the Board at the conclusion of this year's AGM in July. Maarten has been a tremendous asset to the Board having served as senior independent director since 2006 and as Chairman of both the Board's Pension Scheme Performance Review Group and Remuneration Committee. I would like to thank him for almost nine years of distinguished service.

I would also like to express my gratitude to Matti Alahuhta who has decided to step down at the end of May having served as a non executive director for just over three years. His telecommunications industry and international

experience have been of great value to the Board and we wish him well.

I am working with the Nominating Committee to strengthen your Board following these departures and we will announce new appointments shortly.

My thanks also go to the rest of the Board for their extremely hard work during the last challenging months. I would also like to pay tribute to the BT staff. Everywhere I go I have been struck by their passion and commitment. I am confident in their ability to build on BT's many strengths in the future.

The future

BT is in business for the long-term. We invest billions of pounds into the UK's IT infrastructure for the long-term. We are seeking the regulatory certainty which will support long-term business decisions. And we want long-term relationships with our customers that are based on excellent service, and on our enduring commitment to helping them thrive in this fast changing world.

Sir Michael Rake

Chairman

13 May 2009

Table of Contents

OVERVIEW

CHIEF EXECUTIVE'S STATEMENT

The actions we have taken will enable BT to come out of this recession a stronger and better business.

There's no doubt about it, this has been a tough year. A tough year for BT Group, a tough year for the economy and a tough year for our shareholders.

But there are good reasons to look forward with optimism. Taken together, BT Retail, BT Wholesale and Openreach have delivered a resilient performance. That despite the economic downturn. However this success was overshadowed by the performance at BT Global Services. Because of this we have had to take a number of very substantial charges. These have not been comfortable, but were necessary to establish the solid foundations from which we can now build a profitable business.

Meeting our customers' needs

The markets in which we operate are changing fast and we need to move with them. In the UK we have the most competitive communications market in the world. Thanks largely to BT's investment, the UK now has some of the highest broadband availability and take up in the world as well as some of the lowest prices. Speeds are improving all the time, and our new fibre based services will deliver a next generation of super-fast broadband, bringing speeds of up to 100Mb to people's homes.

We have made real improvements in customer service, and we are going to do much more. Let me give you a couple of examples. Three years ago you could expect a fault on your telephone line once every nine years. That's now improved to once every 13 years. By the end of the financial year, 97% of our customers were getting through on their first call, complaints were down and customer satisfaction had improved significantly. And on Christmas Day 2008 we recorded our lowest ever number of outstanding network faults.

When our service improves, our customers are happy, more people want to do business with us, and also we can reduce our costs. That's because when we get our services right first time, the number of people phoning our call centres falls and the number of engineers we need to send out to fix things declines. That's just as true for the biggest customer of BT Global Services or BT Wholesale as it is for a family buying a broadband service from us. We have made significant progress, but this is most definitely not the end of our journey to make BT a leader in customer service.

New opportunities

Even in the most difficult economic circumstances a diverse and agile business will find opportunities to grow and improve the service it delivers to its customers. A really good example is BT Conferencing which is strongly growing both revenues and profits and is now the world's biggest provider of videoconferencing. Using the latest technology we are meeting the needs of companies all around the world. Helping customers save money by cutting travel costs and reducing their carbon footprint.

Another example is our Business One Plan service, which is the UK's first triple play of landline, mobile and broadband for small and medium-sized businesses. It launched three years ago and in 2009 added free calls within an organisation – even between offices and mobile workers – a significant saving. Over a million business lines are now using this service and more than 2,500 new customers sign up each week. In our consumer business the new BT Home Hub has been ordered by over 800,000 customers since its launch last June. It has the best wireless range on offer, and allows customers to save power by programming it to switch off when it's not being used.

These are just a few examples of BT seizing opportunities and delivering great service in the UK and around the globe. I was particularly pleased that Telemark Services, an industry analyst, has just rated BT Global Services the best operator in the world in its Customer Satisfaction Index with the highest score ever awarded.

A better business, a better future

In order to transform the company, we need to drive significant cost saving. Regrettably this has meant a reduction in our workforce. However, we have sought to retrain and redeploy permanent staff whenever we can. That has meant that in the past year only a third of the reduction came from our permanent staff, with the rest made up of contractors and third-party resource.

Edgar Filing: BT GROUP PLC - Form 6-K

So in the past year we have taken some tough decisions and we have taken some bold decisions too. Like investing £1.5bn in fibre based super-fast broadband. There are certainly plenty of challenges, but I believe that the actions we have taken will enable BT to come out of this recession a stronger and better business.

Ian Livingston

Chief Executive

13 May 2009

4 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents

OVERVIEW

THIS IS BT

BT is one of the world's leading communications services companies. In the UK, we are the largest communications service provider to the residential and business markets. The BT brand is one of the most trusted in the UK. Around the world, we are a major supplier of networked IT services to government departments and multinational companies.

BT GROUP PLC ANNUAL REPORT & FORM 20-F 5

Table of Contents

OVERVIEW

HOW WE ARE STRUCTURED

We meet the needs of our different customer groups through four customer-facing lines of business, supported by two internal functional units. BT Retail, BT Wholesale and Openreach operate mainly in the UK. BT Global Services provides services in more than 170 countries around the world.

We believe that the way we are structured brings us closer to our customers, helps us get it right first time and enhances the customer experience, at the same time as helping us reduce our costs and drive value for our shareholders.

6 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents

BUSINESS AND FINANCIAL REVIEWS

BUSINESS REVIEW

<u>8</u>	<u>Introduction</u>
<u>8</u>	<u>Our 2009 performance</u>
<u>8</u>	<u>Our focus</u>
<u>9</u>	<u>Maintaining a sustainable business</u>
<u>9</u>	<u>Measuring our performance</u>
<u>9</u>	<u>Outlook</u>
<u>10</u>	<u>How we are structured</u>
<u>10</u>	<u>BT Global Services</u>
<u>13</u>	<u>BT Retail</u>
<u>16</u>	<u>BT Wholesale</u>
<u>17</u>	<u>Openreach</u>
<u>19</u>	<u>BT Design</u>
<u>20</u>	<u>BT Operate</u>
<u>20</u>	<u>Our resources</u>
<u>23</u>	<u>Corporate responsibility</u>

OTHER MATTERS

<u>26</u>	<u>Regulation</u>
------------------	--------------------------

- 27** **Competition**
- 28** **Branches outside the UK**
- 28** **Our relationship with HM Government**
- 28** **Legal proceedings**
- 28** **Acquisitions and disposals**
- 29** **Our property portfolio**
- 29** **Principal risks and uncertainties**

FINANCIAL REVIEW

- 32** **Summarised group income statement**
- 33** **Introduction to the Financial review**
- 33** **Group results**
- 36** **Other group items**
- 40** **Cash flow**
- 41** **Balance sheet**
- 44** **Taxation**
- 45** **Financial risk management**
- 47** **Critical accounting policies**
- 47** **Alternative performance measures**

Table of Contents

BUSINESS AND FINANCIAL REVIEWS

BUSINESS REVIEW

Falling prices, rising data speeds and constant innovation continue to make the communications marketplace dynamic and intensely competitive. In 2009, we faced the additional challenges of the economic downturn and an unacceptable performance from BT Global Services.

Introduction

BT is a communications services company which operates in more than 170 countries worldwide. We are proud to serve customers that range from some of the largest multinational corporations and public sector organisations in the world, through the small business sector to millions of families and residential customers in the UK.

We are at the heart of a communications revolution which is continuing to improve the quality of people's lives and the effectiveness of their businesses. It is our job to bring together the best technology to create services that our customers need while offering them the very best value.

Our 2009 performance

In 2009, in spite of the economic downturn, three of our lines of business – BT Retail, BT Wholesale and Openreach have each performed well. Both BT Retail and Openreach delivered EBITDA growth while in BT Wholesale the rate of decline in revenue has slowed. This good performance was primarily due to the effective delivery of cost savings. However, these achievements were overshadowed by the unacceptable performance in BT Global Services.

The issues in BT Global Services

During the 2009 financial year, the level of profitability in BT Global Services fell significantly. This was caused by a combination of higher costs, the slow delivery of cost reduction initiatives and worsening economic conditions. This led the Board to conclude that previous estimates of profitability for some of our major contracts were no longer likely to be achieved.

On page 10 we explain what actions the Board took as a result of these issues and how BT Global Services is being restructured to streamline and refocus the business.

Our focus

We aim to make BT a better business and drive shareholder value by delivering on our current strategic priorities better, faster and cheaper.

These are:

4 providing excellent customer service

4 building future networks

4 becoming more agile.

Providing excellent customer service

Our goal is to provide excellent service in every market in which we operate by putting our customers at the heart of everything we do.

Every part of BT is taking action to make substantial improvements to the delivery of our services. That means getting things right first time every time, keeping our promises to our customers and meeting or exceeding their expectations.

We continually track improvements that reflect the real experience of our customers from start to finish. We have made significant progress in the last 12 months across the whole range of our customers and we are determined to make further improvements. In the highly competitive markets in which we operate we believe that being recognised for outstanding customer service is a key differentiator for BT.

As an example of the progress we are making in the consumer market, the time taken to get through to an adviser fell by 65% in the past year. Our customers experienced a reduction of more than 20% in the number of line faults,

which means that a line will go wrong on average just once every 13 years. In the small business market, there was a 20% improvement in the average time to clear telephony network faults, while the average time to provide international multi-protocol label switching (MPLS) services to large business customers reduced by over 40%.

Building future networks

The digital revolution is opening up a world of new possibilities for all our customers. It means people can work together and collaborate more effectively than ever before. They can be entertained and informed in ways that would have been hard to imagine just a few years ago. We think this revolution has only just begun, and we are investing in our networks, systems and services to ensure that they are fit for the future.

In July 2008, we announced plans to make Britain's biggest ever investment in a fibre-based super-fast broadband network. We will spend £1.5bn making fibre based services available to around 40% of the UK's homes and businesses by 2012. This will deliver a range of services with top speeds of up to 100Mb, allowing customers simultaneously to run multiple bandwidth-hungry applications, such as high-definition movies, gaming, complex graphics and videos; all with greatly improved upload as well as download speeds.

These plans are conditional on our ability to make a proper return on our investment, and we have seen encouraging progress in establishing the right regulatory basis for this investment.

Super-fast broadband will run on BT's 21CN infrastructure. 21CN is our next generation global platform and has been at the heart of BT's transformation for some years.

We have now completed the new 21CN core network which is a unified software driven platform. It will help us meet our customers' needs faster and more efficiently whether they are delivered over copper or fibre. It will reduce the time it takes to get new services to market, eliminating duplication and reducing costs.

Our flagship MPLS network service provides coverage and support around the world from 875 BT managed points of presence and around 2,600 in partnership.

8 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

Becoming more agile

Our goal is to combine the strengths of being a large company with the speed and flexibility of a small company. Our people are becoming more agile in the way they work together to serve customers. We are making our company more agile as well, cutting out any bureaucracy that can slow us down. As a result we will be more responsive to customer needs.

We are continuing to simplify our business to give people more authority and to allow them to do their jobs more effectively.

As we become a more agile organisation, we reduce our costs as well as the number of people we need to employ. In the past year we have reduced the number of full-time employees by around 5,000. In addition to this, the number of indirect employees working through agencies or third party contractors was reduced by around 10,000, giving a reduction in our total labour resource of some 15,000. We expect further reductions of a similar level in 2010. We have sought to retain our permanent workforce through redeployment and retraining, and will continue to do so. We continue our drive to reduce costs across the business, and made further progress in 2009 towards transforming our cost base.

Three out of four of our lines of business have made a strong contribution towards the delivery of cost savings, although BT Global Services still has to control costs more tightly and deliver greater savings.

Maintaining a sustainable business

BT is committed to contributing positively to the communities in which it works and to operating in a socially responsible way. We are using communications technology to help create a better, more sustainable world. Our goal is to help meet the challenge of climate change, to promote a more inclusive society and to enable sustainable economic growth.

We believe that being a recognised leader in the field of corporate responsibility contributes to shareholder value. It builds our brand and is central to the way we do business. It encourages the best people to want to work for BT. It is a powerful reason for customers to do business with us and stay loyal to us.

We commit a minimum of 1% of our pre-tax profits to activities that support society. We invested a total of £25m, comprising time, cash and in-kind contributions, in the community in 2009. Of this amount, £2.3m was in the form of charitable donations.

Measuring our performance

For 2009, the key performance indicators (KPI) against which we measured the delivery of our strategy were:

4 customer service

4 earnings per share

4 free cash flow.

Our customer service results were encouraging and we delivered significant improvements during the year. However, the unacceptable performance in BT Global Services impacted free cash flow and earnings per share, which were well below target.

Customer service

We set ourselves a group-wide stretching target in 2009 of improving right first time by 24%. We achieved an increase of 17%, compared with 9% in 2008 and we are targeting further improvements in 2010. We are now delivering excellent customer service levels in many areas.

Earnings per share

Adjusted basic earnings per share^{a,b} were 18.4p in 2009, compared with 23.9p in 2008 and 22.7p in 2007 (see **Financial review** page 39). The reported basic loss per share was 1.1p in 2009, compared with basic earnings per share of 21.5p and 34.4p in 2008 and 2007, respectively.

Free cash flow

Free cash flow^b in 2009 was £737m, compared with £1,503m in 2008 and £1,354m in 2007 (see **Financial review** page 41).

Outlook

We expect revenue to decline by 4% to 5% in the 2010 financial year, reflecting a continuation of the trends seen towards the end of the 2009 financial year, the impact of lower mobile termination rates, together with the impact of refocusing BT Global Services.

We expect to deliver a net reduction in group capital expenditure and operating costs of well over £1bn in 2010. Included within this is a reduction in group capital expenditure to around £2.7bn. As a result, we expect group free cash flow, before any pension deficit payments, but after the cash costs of the BT Global Services restructuring charges, to reach over £1bn in 2010 and beyond.

Earnings per share will be impacted by the movement of the net finance expense on the pension obligations which moves from a credit of £313m in the 2009 financial year to a charge of about £275m in 2010.

The proposed final dividend of 1.1p gives a full year dividend of 6.5p which rebases dividend payments to a level we are confident is sustainable. The Board is committed to delivering attractive returns for shareholders and believes that the operational improvements in the business will generate sufficient cash flow to allow the dividend to grow at the same time as investing in the business, reducing debt and supporting the pension scheme.

^a Items presented as adjusted are stated before contract and financial review charges and specific items.

^b Adjusted basic earnings per share and free cash flow are non-GAAP measures provided in addition to disclosure requirements defined under IFRS. The rationale for using non-GAAP measures is explained on pages 33, 47 and 48, and a reconciliation of adjusted basic earnings per share and free cash flow, to the most directly comparable

IFRS indicator,
is provided on
pages 39 and 41
respectively.

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

BT Global Services order intake (£m)

How we are structured

We have four customer-facing lines of business: BT Global Services, BT Retail, BT Wholesale and Openreach. These are supported by two internal functional units: BT Design and BT Operate.

BT Retail, BT Wholesale and Openreach operate mainly in the UK, where we are the largest communications services provider to the residential and business markets. BT Global Services operates in the UK and globally.

BT is one of Europe's largest and most successful communications wholesalers to other communications providers (CPs). In the UK we support CPs through BT Wholesale and Openreach, and internationally through Global Telecoms Markets, an operating unit of BT Global Services.

We have integrated our networks, IT and testing facilities which are managed by BT Design and BT Operate. Specifically, BT Design deploys platforms, IT systems and processes that support our products and services, while BT Operate is responsible for making sure they run smoothly. Neither generates external revenue.

Line of business financial performance

The financial performance of each of the lines of business for 2009, 2008 and 2007 is discussed in this **Business review**. We measure the financial performance of BT Retail, BT Wholesale and Openreach based on EBITDA and operating profit before specific items. For 2009, we measure the results of BT Global Services on an adjusted basis, being before the impact of contract and financial review charges and specific items. For further discussion of these items see pages 33 and 47 to 48. A reconciliation of adjusted EBITDA to group operating profit (loss) by line of business, and for the group, is provided in the table at the foot of pages 34 to 35.

BT Global Services

Business overview

BT Global Services is a provider of networked IT products, services and solutions. We aim to be the partner of choice for large enterprise and government customers in the UK and globally.

We have created a powerful combination of networked IT and professional services capabilities together with strong customer partnerships, investing and innovating together to build long-term value.

The Gartner Group's research organisation recognises BT as a global leader in Gartner's Magic Quadrant for Network Service Providers, and industry analyst Telemark Services has given BT its platinum award, reflecting customer satisfaction with our delivery of global data virtual private network services, regarded as best in class.

Customer service improvements in 2009 included a reduction of more than 40% in the average time to provide international MPLS services and a 6% improvement in the delivery of international repairs within the target time. We have more than 3,400 points of presence in more than 170 countries. We are the largest supplier of networked IT services to -UK national and local government.

Despite these strengths, during 2009 the level of profitability in BT Global Services fell significantly.

As explained in the **Principal risks and uncertainties** section in this year's and previous years' annual reports, our pricing, cost and profitability estimates for major contracts generally include long-term cost savings that we expect to make over the life of the contract. In 2009, a failure to achieve these anticipated savings made a number of these contracts less profitable or even loss making, adversely impacting our profits.

Actions taken

The Board changed the senior management team within BT Global Services, with a new Chief Executive for the division appointed in October 2008. The new team's brief was to address the cost base, to bring greater focus to the profitability of new contract wins and to reduce shortfalls in delivery performance on existing contracts. The new management team undertook an extensive review of BT Global Services' financial position, contracts and operations. The financial review covered the financial performance of BT Global Services and its balance sheet position. The contract reviews covered the largest and most complex contracts and were conducted jointly with external advisors. Having completed the contract and financial reviews, a charge of £1.6bn was recognised, which includes £1.2bn relating to the two major contracts that are the subject of ongoing commercial negotiations. These charges reflect a more cautious view of the recognition of future cost efficiencies and other changes in underlying assumptions and

estimates, particularly in the light of the current economic outlook. £1.3bn of the total charge relates to contract costs which had been previously capitalised on the balance sheet.

BT Global Services management team is implementing a number of process improvements. Some of these were in place by the end of 2009, the rest are being implemented in 2010. These include undertaking more regular contract reviews to assess commercial risks and opportunities as part of a strengthened contract governance process that combines operational, financial and risk reporting. Additional scrutiny of contracts and cost transformation plans have been put in place and will continue to be conducted on a rigorous and regular basis involving strong independent oversight of assumptions and estimates for new and existing contracts. We are also placing greater focus on profitable sectors, setting stringent win criteria and enhancing due diligence around our ability and readiness to meet our delivery requirements on all major contracts.

Immediate action has also been taken to address the cost base, with particular focus on external procurement and total labour resource. We reviewed rates across our contractor base, and successfully reduced these rates by up to 35%. We have addressed spend of £450m with suppliers across seven categories of expenditure, including our contractor base, and have successfully

10 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

BT Global Services new structure

renegotiated contracts, resulting in price reductions of 12% on average, and up to 35% in some categories. In addition, we have focused on a number of areas of significant discretionary expenditure including travel, consultancy and conferencing and have achieved reductions in these areas. These actions are expected to deliver sustainable cost reductions in the 2010 financial year.

How BT Global Services is changing

The operational review was completed towards the end of 2009, resulting in a revised operating model and restructuring plan which will reshape and refocus the business, further enhancing BT Global Services' ability to serve customers and establish a significantly lower cost base.

Under the new operating model, BT Global Services will focus on three customer segments:

- 4 being the number one provider of networked IT services to corporate and public sector customers in the UK, building on BT Global Services' strong market position and the group's 21CN products and services
- 4 providing networked IT services to key multinational customers, differentiating BT Global Services through seamless global connectivity and delivery of BT's core portfolio of products and services
- 4 creating a BT Global Services Enterprises unit consisting of a discrete portfolio of businesses addressing specific customer needs in key countries.

Significant structural changes are being implemented. The majority will be completed in 2010 in order to deliver the benefits of the new operating model which include:

- 4 integrated sales, marketing, professional services, account management and delivery capability, competing effectively in each target market
- 4 enhanced bid management and start-up processes to improve win rates on selected deals and ensure standardisation and quality of delivery
- 4 a single global service model, consolidating a large number of individual centres into a small number of larger operational hubs, which will provide a single point of customer contact and enable improved right first time customer service
- 4 continued rationalisation of systems and networks, reducing the number of systems by a third and halving the number of global networks, thereby removing duplication and enabling significant cost savings
- 4 restructuring corporate support functions to serve the three customer segments more efficiently and effectively
- 4 strategic partnering for sales, service and infrastructure.

As a result of this operational review, the group has recorded specific item restructuring charges of £280m in 2009, with further charges of approximately £420m in total expected to be recorded over the next two financial years, the majority in 2010. These charges predominantly arise from legacy networks and products rationalisation and restructuring costs associated with people and property. Further analysis of these charges, including their cashflow impact, is provided in the **Specific items** section of the **Financial review** on pages 36 to 37.

Market context

We believe that we have identified a clear path to a profitable and sustainable business, building on a strong market position.

The global networked IT services market is valued at around £600bn. We remain well placed to help our global customers reduce costs and streamline their businesses in a challenging market environment. We are seeing continued interest in network operational efficiency, workforce management, security, unified communications (including

Telepresence and conferencing) and global hosted contact centre solutions, as our customers respond to the current economic environment.

Operational performance

In the UK

We serve businesses in virtually every sector of British industry, from banking and finance to transport, logistics and the public sector. We have around 1,800 multi-site customers in the UK.

We continue to make progress on our N3, Spine and London Local Service Provider contracts with the National Health Service (NHS) National Programme for Information Technology (NPfIT), the largest non-military IT programme in the world.

Building on our work as the local service provider responsible for upgrading NHS IT systems in London, we have taken on the running of IT systems at eight acute hospitals in the South of England. In addition, we are working with a further four acute trusts in the South of England which have yet to roll out systems as part of NPfIT, as well as implementing 25 new systems in community and mental health trusts in the region.

We are deploying one of the world's largest converged IP networks for the Department for Work and Pensions to be completed in 2010.

Reinforcing our presence in the local government sector, we agreed a ten-year strategic partnership with South Tyneside Council, worth more than £180m for delivery of a number of key council services. We also won an extension to our existing arrangement with Liverpool City Council and a new contract with Sandwell Metropolitan Borough Council and two contracts with Norfolk County Council with a combined value of £40m to provide voice and data services and a schools internet service.

We are the official communications services partner for the London 2012 Olympic Games and Paralympic Games. This involves the provision and management of voice and data networks, internet access and land lines required at each of the London 2012 Games venues.

We signed a number of deals with major UK corporate sector customers including:

- 4 a seven-year, £160m outsourcing deal with Nationwide Building Society to manage its networked IT services

Table of Contents**BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW****BT Global Services UK/Non UK revenue (£m)**

4 a three-year contract extension with Manpower to provide fully managed global wide area network (WAN) infrastructure and managed services

4 a five-year contract with Carillion worth £32m for voice/hosted voice, IP data, conferencing and private automated branch exchange (PABX) maintenance.

Outside the UK

BT Global Services signed orders with 529 new customers outside the UK in 2009 and we continued to strengthen our business with large multinational corporations.

We signed a number of major deals in 2009, including:

4 a five-year, US\$526m contract with Procter & Gamble to provide and manage local area network (LAN) and WAN infrastructure in more than 80 countries

4 a contract with BMW to manage a large part of its communications infrastructure, including voice over IP (VoIP), contact centres, email services and videoconferencing

4 a three-year managed services contract with SWIFT to connect strategic offices across Europe, the US and Asia with BT's unified communications video solution

4 a three-year contract with Munich Re to provide security and network services in 33 countries

4 a contract with the Emirates airline to consolidate and manage its worldwide contact centres

4 a seven-year, 118m extension of current services provided to Syngenta for data and voice services plus deployment of IP telephony, managed LAN and BT OneVoice to 112 sites and the deployment of BT managed mobile services to 13 countries.

Successes in the public sector outside the UK included a contract with Barcelona City Council for 500 wireless broadband hot spots, providing free internet access across the city, and a contract with the Colombian government supporting digital inclusion under which BT will convert 755 public schools into telecentres and provide additional bandwidth to a further 1,150 schools.

We are also part of the Match consortium that won a 30m contract with the Dutch Ministry of Home Affairs for the housing and hosting of the national government's IT infrastructure.

Financial performance

	2009	2008	2007
	£m	£m	£m
Revenue	8,828	7,889	7,312
Adjusted gross profit ^a	2,576	2,839	2,759
Adjusted SG&A costs ^a	2,267	1,978	2,024
Adjusted EBITDA ^a	309	861	735
Contract and financial review charges	1,639		
EBITDA ^b	(1,330)	861	735
Operating (loss) profit ^b	(2,106)	117	70

a

Adjusted items
are before
contract and
financial review
charges and
specific items.

^b Before specific
items.

In 2009, BT Global Services revenue increased by 12% to £8,828m (2008: £7,889m, 2007: £7,312m), compared with growth of 8% in 2008. Revenue in 2009 includes the impact of foreign exchange rate movements of £588m and acquisitions of £368m. Excluding these, underlying revenue was £7,872m, compared with reported revenue of £7,889m in 2008. Revenue from outside the UK has increased to 47% of BT Global Services total revenue (2008: 40%, 2007: 36%), reflecting the impact of organic growth as well as the impact of foreign exchange rate movements and overseas acquisitions.

Revenue from managed network solutions increased by 17% to £5,328m, compared with growth of 10% in 2008. The increase was driven by growth in revenue from both networked IT services and MPLS and reflects the impact of foreign exchange rate movements and acquisitions, together with substitution of UK calls and lines. Revenue from calls and lines decreased by 8% to £1,095m, compared with a decline of 6% in 2008. The decrease was due to the gradual decline in this revenue stream as customers switch to more email, IP network and conferencing products as shown by the growth in managed network solutions. Other revenue increased by 12% to £2,049m, compared with a growth of 11% in 2008. The increase was mainly driven by growth in revenue from the global carrier business and reflects the impact of foreign exchange rate movements and acquisitions. During the year, we won new networked IT services contracts worth £5.5bn (2008: £5.0bn, 2007: £5.2bn). Networked IT services contracts represent 68% of our total order value of £8.0bn (2008: £8.0bn, 2007: £9.3bn).

Adjusted gross profit decreased by 9% to £2,576m in 2009 (2008: £2,839m, 2007: £2,759m), compared with an increase of 3% in 2008, primarily due to high costs and the continued decline in higher margin UK business. Including the impact of the contract and financial review charges of £1.6bn, gross profit in 2009 decreased by 66% to £965m.

Gross profit is revenue less costs directly attributable to the provision of products and services reflected in revenue in the period. Selling, general and administrative (SG&A) costs are those costs that are ancillary to the business processes of providing products and services and are the general business operating costs.

Adjusted SG&A costs increased by 15% to £2,267m in 2009 (2008: £1,978m, 2007: £2,024m), compared with a decrease of 2% in 2008. SG&A costs include the impact of foreign exchange rate movements of £221m and acquisitions of £170m. Excluding these, underlying adjusted SG&A costs decreased by 5% to £1,876m, reflecting the renewed focus from the new management team on total labour resource, supplier negotiation and discretionary and general overhead expenditure in the second half of 2009. Including the impact of the contract and financial review charges of £28m included within SG&A costs, SG&A costs increased by 16% to £2,295m.

The decrease in gross profit together with the impact of higher SG&A costs resulted in adjusted EBITDA of £309m, a reduction of £552m compared with 2008. In 2008, EBITDA increased by 17% to £861m. Depreciation and amortisation increased by 4% to £776m

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

Average annual revenue per consumer household (£)

(2008: £744m, 2007: £665m), compared with an increase of 12% in 2008. The increase reflects the increased investment in our global infrastructure, customer related capital expenditure and the impact of acquisitions, as well as the impact of foreign exchange movements.

The above factors resulted in an operating loss of £2,106m, compared with an operating profit of £117m in 2008 (2007: £70m).

BT Retail

Business overview

BT Retail aims to help its customers enhance the way they live their lives and run their businesses. At home we enable our customers to keep in touch with friends and families and to enjoy fast, reliable, secure and safe connection to the internet. We are bringing broadband to the TV and TV to broadband so that people can watch what they want when they want. At work we serve small and medium-sized enterprises (SMEs) (typically with up to 1,000 employees, although some are significantly larger) and enable them to cut their costs and improve their service by using communications and IT services that were once available only to the largest businesses. We do this by taking the drudgery out of implementing new technologies so our customers can focus on doing what they do best.

There are four divisions in BT Retail: BT Consumer, BT Business, BT Ireland and BT Enterprises.

We are the UK's largest communications provider, with 20.7m fixed lines and 4.8m broadband lines.

Market context

Market conditions have been challenging: the rate of growth in demand for broadband has been slowing as the market matures and competition intensifies, both from local loop unbundlers with large customer bases to whom they can sell broadband, and from the mobile operators who are now offering mobile broadband as well as mobile voice. At the same time the economic downturn is causing business and personal customers to shop around for the very best value.

We have responded by offering customers complete packages that meet their needs and deliver great value for money.

Operational performance

BT Consumer

Voice

We offer value for money services with three main packages of calls and lines – Unlimited Weekend Calls, Unlimited Evening and Weekend Calls and Unlimited Anytime Calls. All offer competitive terms but customers who use us the most receive the best value.

In 2009, we announced our new Friends & Family Mobile scheme which now offers discounts of up to 40% on calls to mobiles – making it cheaper to call a mobile from a BT landline than from prepay mobiles. We also announced that calls to 0845 and 0870 numbers would be included for free in our packages – a first for the UK market.

Our new BT Basic tariff offers very low line rentals to vulnerable customers on low income benefits. We are the only communications provider in the UK to provide this service. In addition we design our handsets to be inclusive and meet the needs of older and disabled customers.

Our range of handsets won praise in 2009 for its contribution to reducing carbon emissions with new energy saving power supplies.

Broadband

BT Total Broadband is the UK's most popular broadband service. We offer a more complete experience than our rivals by including in the price all the extras customers need to have a safe and enjoyable broadband experience. For example, we offer McAfee security on up to seven PCs in the house, and Digital Vault, which enables customers to back-up valuable digital material including music and pictures.

The BT Home Hub is at the centre of BT Total Broadband. It has an iconic design and is the market-leading wireless router. Its latest release offers unbeatable wireless coverage and reduced energy consumption.

Some customers want access to the internet on the move. We offer these customers 3G dongles as part of their Total Broadband package. Further, BT FON enables customers who agree to share a small, secure section of their

home broadband connection access to broadband via other BT FON members' locations and BT Openzone Wi-Fi hotspots. Between them, BT Openzone and BT FON offer BT customers the chance to get online at more than 150,000 locations in the UK and Ireland and another 50,000 locations worldwide through roaming partners.

We also offer lower priced broadband and voice services under the award winning Plusnet brand. Acquired in 2007, Plusnet offers customers a leading online self-service experience.

BT was named as the Reader's Digest most trusted internet service provider (ISP) and voted joint top for broadband customer service in a poll conducted by the Broadband Genie comparison website.

BT Vision

Consumers increasingly want to buy telephony, broadband and TV from a single provider. BT Vision – our on-demand television service – enables us to meet these needs. It is available on subscription or pay-per-view terms.

BT Vision gives customers access to more than 70 TV and radio channels and pay-per-view services from a wide range of content providers, including blockbuster movies and live Premiership football. At 31 March 2009, BT Vision was the UK's largest on-demand service with more than 5,000 hours of programming available.

The take-up of BT Vision accelerated during the financial year. By the end of March 2009, we had 423,000 customers, around double the number at the end of the previous year. More customers

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

BT Retail broadband market share* year end (000 lines)

* DSL + LLU installed base

opt for the subscription unlimited views packs and subscribers viewing of the service has more than tripled.

In December 2008, we announced a partnership with the BBC and ITV to launch a new digital entertainment platform (subject to any relevant approvals). The new platform aims to build on BT Vision and Freeview and will bridge the gap between two previously separate technologies, bringing TV to broadband and broadband to the TV. It will combine free digital channels with free on-demand content from the public service broadcasters as well as pay-TV delivered over the broadband line. We aim to launch the service in mid 2010.

BT Business

Voice

In the business voice market, we aim to simplify the management of communications, give better value for money and drive innovation so that customers get more benefit from their investment in communications. We have seen strong take-up from customers for packages that bring together calls, lines, broadband and mobile, with consistent service (BT Business One Plan). At 31 March 2009, BT Business One Plan had more than 460,000 locations, and accounted for 35% of call revenues from business customers.

We have seen an increased take-up of voice over IP (VoIP) and are developing services that use the internet to integrate voice with other business applications.

We have seen strong growth in conferencing, with customers using communications to reduce business travel costs.

We have made communications-enabled applications a reality with the launch of Ribbit for salesforce.com. This service makes it easy for sales professionals to update key customer relationship management (CRM) systems using seamless voice-to-text technology, both from the desk and on the move.

Broadband

BT Business remained UK SMEs preferred internet service provider. During 2009, we enhanced this service to include mobile broadband. Customers are provided with a plug-and-play 3G dongle, enabling them to connect and work wherever they are. We also reduced entry-level prices to support customers feeling the impact of the recession. When we sell broadband to customers, we also offer them value-added services and now have an attachment rate of 113% (ie on average we sell a little more than one value-added service every time we sell a broadband service). We have seen strong growth in web hosting in particular, as customers recognise the benefits of seamless business-grade service for hosting and internet access.

Mobility

We have seen strong growth in mobile sales. Our focus has been on helping customers work on the move rather than just making mobile phone calls and this approach has driven strong growth in mobile messaging especially in the sale of BlackBerry smart phones. We have also seen growing sales of business applications and are seeing strong growth in telemetry solutions.

Other services

The creation of BT Engage IT (incorporating Basilica and Lynx, which we acquired in September 2007) enables us to offer customers a wide range of IT services, including data centre virtualisation, unified communications and managed services. We have seen good growth with mid-market companies and are also growing our customer solutions business to provide fully managed and outsourced IT and communications solutions.

We see great potential in the development of cloud computing as a way of delivering IT services to SMEs at significantly lower prices and with considerable benefits of simplicity, security and agility. We are leading with business applications, exploiting the growing trend towards software as a service whereby SMEs access and use applications over the internet as and when they need it rather than paying to have the applications permanently on their own computers. As an example we are working with salesforce.com to enable our SME customers to access customer relationship management (CRM) systems of a sophistication previously only available to very large companies, with support and service from BT.

We continue to grow BT Tradespace, our online trading community that brings businesses and individual sellers together with potential customers and partners. At 31 March 2009, there were 338,000 members of the BT Tradespace community, and we were adding around 2,500 each week. Towards the end of the financial year, we launched a number of enhancements including tools that enable service businesses to take bookings over the web, and support SMEs in search marketing.

BT Ireland

BT Ireland operates across Northern Ireland and the Republic of Ireland.

We are one of the leading communications providers to consumers and SMEs in Northern Ireland. We are also one of the leading networked IT services partners of government and major customers and are responsible for providing regulated wholesale access via Openreach.

In the Republic of Ireland we are a leading provider of networked IT services to government and major businesses, and one of the largest and most successful providers of wholesale network services. We are one of the largest DSL broadband providers to consumers and SMEs.

We gained significant traction in the private and public sectors and secured a number of the largest managed services contracts awarded in the market. O₂ Ireland outsourced its network operations to BT in a seven-year deal, while 3 Ireland selected BT as its principal subcontractor to support the delivery of the National Broadband Scheme. The Scheme is run by the Department for Communications, Energy and Natural Resources with the aim of achieving broadband availability throughout the Republic of Ireland. Other key contracts were won in the banking, engineering and public sectors.

14 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents**BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW****BT Retail external revenue by unit (%)**

We continued the rollout of our 21CN, which delivers carrier grade Ethernet services for both mobile operators and specifically to support the delivery of our new managed services contracts with 3 Ireland and O₂. Our investment in local loop unbundling (LLU) is bringing broadband with speeds of up to 24Mb to telephone exchanges serving over 330,000 homes and businesses in the Republic of Ireland, and in March 2009 we were delighted to announce that Belfast would be one of the first regions in the UK to benefit from BT's investment in super-fast broadband.

BT Enterprises

Enterprises are a number of stand-alone businesses, including:

- 4 BT Conferencing a leading global provider of audio, video and internet collaboration services
- 4 BT Directories comprising Directory Enquiries (118 500), operator and emergency services, and The Phone Book. In July 2008 we acquired Ufindus, supporting the increasing demand for online directory enquiries
- 4 BT Payphones providing street, managed, prison, card and private payphones
- 4 BT Redcare providing alarm monitoring and tracking facilities
- 4 BT Expedite offering integration solutions and services to retailers
- 4 BT Shop and dabs.com a leading internet-based retailer of IT and technology products.

BT Conferencing was one of the main drivers of growth in Enterprises in 2009. Conferencing services are attractive to customers because they can help to save travel costs and reduce environmental impact. The acquisition of Wire One Holdings Inc (Wire One) one of the leading providers of videoconferencing services in the US enhanced BT Conferencing's position as the leading videoconferencing operator in the world.

Efficiency

Although we continue to invest in new products and services, there is an intense focus on cost transformation activities in all parts of BT Retail. We have a range of programmes which aim to improve the customer experience and take the cost of failure out of the business. Customer service improvements included a 65% reduction in the time it takes consumer customers to get through to an adviser and a 20% improvement in the average time to clear network telephony faults experienced by business customers.

Financial performance

	2009	2008	2007
	£m	£m	£m
Revenue	8,471	8,477	8,346
Gross profit	3,186	3,114	2,938
SG&A costs	1,552	1,619	1,581
EBITDA	1,634	1,495	1,357
Operating profit	1,209	1,050	912

In 2009, BT Retail revenue was flat year on year at £8,471m (2008: £8,477m, 2007: £8,346m), reflecting growth in revenue from broadband and convergence, managed solutions and conferencing, offset by a decline in revenue from calls and lines. Revenue includes £65m in respect of foreign exchange rate movements and £146m in respect of acquisitions. Excluding these, underlying revenue of £8,260m declined by 3% compared with reported revenue in 2008. In 2008, revenue increased by 2%, driven by growth in broadband and managed solutions revenue, which was

only partially offset by a decline in calls and lines revenue.

	2009	2008	2007
	£m	£m	£m
BT Retail external revenue			
Managed solutions	519	456	361
Broadband and convergence	1,298	1,189	985
Calls and lines	4,825	5,167	5,409
Other	1,470	1,382	1,345
Total external revenue	8,112	8,194	8,100
Internal revenue	359	283	246
Total	8,471	8,477	8,346

Managed solutions revenue increased by 14% to £519m in 2009 (2008: £456m, 2007: £361m) due to growth in BT Business and reflecting the acquisitions of Basilica and Lynx in the second quarter of 2008. Towards the end of 2009 the group saw a slowdown in new contracts, reflecting the impact of the current economic environment on the SME sector.

Broadband and convergence revenue increased by 9% to £1,298m in 2009 (2008: £1,189m, 2007: £985m), reflecting the successful retention of customers in the maturing broadband market, together with revenue from services such as BT Vision and mobility. The broadband installed base increased by 355,000, to 4.8m customers at 31 March 2009. These net additions represented a 31% share of the total broadband DSL and LLU net additions in 2009. At 31 March 2009, our share of the installed base was 34% (2008: 35%, 2007: 34%).

Calls and lines revenue decreased by 7% in 2009 to £4,825m, compared with a decrease of 4% in 2008. The acceleration of the decline in 2009 reflects the increasingly competitive environment and further market declines.

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

DSL broadband connections year end (m)

Other revenue increased by 6% to £1,470m in 2009 (2008: £1,382m, 2007: £1,345m), driven by growth in BT Conferencing and the acquisition of Wire One in May 2008.

Gross profit increased by 2% in 2009 to £3,186m (2008: £3,114m, 2007: £2,938m), compared with an increase of 6% in 2008. Gross profit margin increased by 0.9% to 38% in 2009, showing steady growth across all three years under review (2008: 37%, 2007: 35%).

SG&A costs were £1,552m in 2009, compared with £1,619m in 2008 and £1,581m in 2007. The 4% reduction in SG&A costs was driven by a focus on cost transformation, labour efficiency and supplier savings, being partially offset by the integration of acquisitions and foreign exchange. Excluding the impact of acquisitions of £34m and foreign exchange movements of £12m, underlying SG&A costs of £1,506m reduced by 7% in 2009. The increase in SG&A costs in 2008 was driven by extra investment in product development, marketing and acquisitions, the impact of which was partly offset by savings from cost efficiency programmes.

The above factors resulted in EBITDA increasing by 9% to £1,634m in 2009 (2008: £1,495m, 2007: £1,357m), and a 15% improvement in operating profit to £1,209m in 2009 (2008: £1,050m, 2007: £912m).

BT Wholesale

Business overview

BT Wholesale's strategy is to transform itself from a traditional, high-volume product wholesaler, to a next generation communications products wholesaler and managed solutions provider. We are establishing BT as a leading provider of innovative managed network solutions that will enable our customers to serve their customers, manage their costs and transform their businesses. This means helping our customers operate in a network lite way. If they have their own infrastructure and platforms, we can manage them. If they do not, we can provide them.

Our customers gain access to BT's platforms, skills, investment and technology, and can benefit from the economies of scale we bring.

BT Wholesale has around 700 customers in the UK, comprising fixed and mobile operators, internet service providers and other communications providers (CPs). BT Wholesale leads the wholesale sector worldwide, working closely with the Global Telecoms Markets unit of BT Global Services to meet our wholesale customers' global requirements.

We manage around 60% of the ADSL broadband lines traffic in the UK and support the voice requirements of more than a third of all homes and businesses. We also play a central role in helping mobile operators manage the connections between their base stations and the core UK network.

Market context

Increasingly, our customers are positioning their businesses as service providers rather than network operators. Many of the services they provide are extremely bandwidth hungry and this presents CPs with a challenge. Particularly at a time of economic downturn, they may be reluctant to commit to the high levels of capital investment that network renewal requires. This presents BT Wholesale with opportunities to supply a range of managed network and outsourced services.

Consolidation continues to impact BT Wholesale's market, as do broadband volume decreases resulting from LLU migrations. Regulation also continues to have a major impact on our business, including the reduction in mobile termination rates internationally.

Operational performance

Managed network solutions

To date, we have signed managed network solutions contracts with eight of our top 15 customers by revenue. These contracts are typically for between three and five years and enable us to build long-term, mutually beneficial relationships.

In the year, we signed managed network solutions contracts worth a projected total of £1.2bn over their lifetimes. These included:

4

in June 2008, we announced a three-year deal with Sky to provide it with wholesale voice services to support over one million Sky Talk customers and in February 2009 we announced an agreement to provide Sky with a managed directory enquiries service

4 in August 2008, we signed a five-year managed network solutions agreement with Mobile Broadband Network Limited (MBNL) on behalf of the joint venture partners 3 UK and T-Mobile UK to provide and manage high-speed connectivity between their base stations and our core national network in the UK.

The managed network solutions business is growing rapidly and accounted for 15% of BT Wholesale's external revenue in 2009, up from 8% the previous year.

White label managed services

At 31 March 2009, 4.1m UK homes and businesses were receiving voice and broadband services through our white label platforms. White label managed services are provided to customers who have not invested in their own infrastructure but who want to enter new markets quickly. These customers market such services under their own brands, even though we frequently manage them end to end, from taking orders to issuing bills. Our customers for such services include the Post Office and Scottish and Southern Electricity.

Wholesale products

Wholesale Ethernet

BT Wholesale offers high-speed Ethernet services across the widest national footprint in the UK market. Enabled by 21CN, these services offer customers high-speed data connectivity, resilience

16 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents**BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW**

and flexibility. At 31 March 2009, 21CN Ethernet was available from more than 600 nodes throughout the UK.

Wholesale broadband

We continued to develop a variety of tools and techniques to help our customers deliver an excellent broadband experience to end users and get more from their broadband connections. The I-Plate, for example, is a self-installable device that can be fitted to an end user's master telephone socket to improve broadband speeds by eliminating electrical interference.

Wholesale Broadband Connect, our next generation 21CN broadband service, offers customers average speeds of around 10Mb, guaranteed service level agreements, the ability to trade speed for stability, and enhanced line diagnostics. At 31 March 2009, less than a year after it was first introduced, this service was available from exchanges serving more than 10m homes and businesses, around 40% of the UK addressable market.

Capacity and call-based products

We continue to sell a wide range of capacity and call-based products and services, including regulated interconnect services and new, non-regulated products and services. As we refresh our core portfolio with next generation replacements, we will, over time, migrate these services to 21CN, enabling the decommissioning of certain parts of our legacy systems.

Efficiency

In 2009, we maintained our focus on the cost reduction opportunities that arise as our business changes. We reduced BT Wholesale's cost base by 19% through headcount reduction (down 17% in the year on a like-for-like basis), eliminating duplication, achieving further operational efficiencies and aligning our resources more effectively with the evolving needs of our customers. By March 2009, 99% of broadband circuits were delivered to customers by the day promised, our best ever performance.

Financial performance

	2009	2008	2007
	£m	£m	£m
Revenue	4,658	4,959	5,386
Internal revenue	1,228	1,252	1,277
External revenue	3,430	3,707	4,109
Gross profit	1,427	1,593	1,796
SG&A costs	161	198	296
EBITDA	1,266	1,395	1,500
Operating profit	580	502	592

In 2009, BT Wholesale revenue declined by 6% to £4,658m (2008: £4,959m, 2007: £5,386m), an improvement in the rate of decline compared with the previous year (2008: 8%). Broadband revenue decreased by 23% to £482m (2008: £624m, 2007: £771m) primarily due to the continued trend of CPs switching to LLU provided by Openreach. Revenue from the transit business declined by 16% to £1,134m (2008: £1,349m, 2007: £1,485m), compared with a decline of 9% in 2008. The decline in the transit business has arisen as mobile operators build their own networks and are able to bypass BT. These declines, however, have been partially offset by growth in the managed network solutions business, where revenue increased by 76% to £518m (2008: £295m, 2007: £306m), principally due to new contracts signed in the year.

Gross profit decreased by 10% to £1,427m in 2009 (2008: £1,593m, 2007: £1,796m), a marginal improvement in the rate of decline compared with the previous year (2008: 11%). BT Wholesale reduced the gross margin impact of

the revenue declines through focused margin management initiatives. The impact of some of the downward trends on our revenue and gross margin has been offset by our continued focus on reducing costs. In 2009, SG&A costs decreased 19% to £161m (2008: £198m, 2007: £296m) compared with a reduction of 33% in 2008. BT Wholesale has benefited from continued cost efficiency programmes including the right first time initiative, which aims to reduce or eliminate the cost of failure from existing processes.

EBITDA decreased by 9% to £1,266m in 2009 (2008: £1,395m, 2007: £1,500m), compared with a decrease of 7% in 2008. EBITDA margin in 2009 was 27%, compared with 28% in 2008 and 2007. Depreciation and amortisation decreased by 23% to £686m as a result of lower depreciation on legacy assets (2008: £893m, 2007: £908m). Largely due to lower depreciation and amortisation, operating profit increased by 16% to £580m in 2009, compared with a decrease of 15% to £502m in 2008 (2007: £592m).

Openreach

Business overview

Openreach is responsible for the crucial first mile of the telecommunications network in the UK. It offers all CPs (currently, more than 420) including other BT lines of business fair, equal and open access to our access and backhaul networks.

One of the UK's vital infrastructure assets, this first mile connects millions of homes and businesses to local telephone exchanges, via fixed-line local and backhaul connections.

Openreach's 21,000 field engineers work on behalf of all CPs, enabling them to provide their customers with a range of services from analogue telephone lines to complex networked IT services. It is committed to delivering a better network and an environment in which its customers can thrive.

Our strategy in 2009 was to continue to deliver and comply with the Undertakings made to Ofcom, while driving efficiencies, providing the right levels of resourcing and enhancing service levels.

Table of Contents**BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW****£1.5bn****planned investment in super-fast broadband****Market context**

In spite of the current economic downturn and increasing competition in the local access market, the use of Openreach's fixed-line network for the provision of broadband services continues to grow. This growth is driven by the increasing numbers of homes with personal computers, intense competition between CPs driving improved and cheaper products, and the need for ever higher bandwidth. Prior to the delivery of Openreach's super-fast access product, some CPs have started to compete on bandwidth over our copper network by investing in new technologies such as ADSL2+ and bonded copper.

We also saw growth in the Ethernet market as CPs are under pressure to transfer large quantities of data to support the growth of new applications. In 2009, Openreach continued to protect its market leading position in the provision of Ethernet services by investing in its product portfolio to provide greater flexibility and increased bandwidth and setting more competitive prices.

Operational performance**Service performance**

In 2009, Openreach made significant improvements in the quality of service delivery of its products. The number of provision and repair orders that did not meet target delivery dates in 2009 reduced by nearly three quarters and over a third, respectively. There has been a more than 65% reduction in the number of customers waiting more than three days for a fault to be fixed.

In addition to reactive provision and repair, improved service requires investment in reinvigorating the access network infrastructure. In 2009, Openreach invested £63m in a proactive maintenance programme, which reduced access fault rates by more than 20% in the year.

Openreach operates a large fleet of more than 20,000 vehicles and is committed to finding innovative ways to minimise its environmental impact. In addition to introducing more efficient vehicles to the fleet and modifying racking systems to reduce vehicle weight, we are also conducting trials of electric and other alternative vehicle technologies. Openreach was awarded Transport for London's Greenfleet Private Sector Fleet of the Year Award in 2009.

Delivering on the Undertakings

During 2009, Openreach continued to deliver on its Undertakings made to Ofcom (see **Regulation**, pages 26 to 27), including further physical separation of customer records and migration of customers over to equivalent analogue and digital wholesale line rental (WLR) products. As we have now delivered a large proportion of the Undertakings, the emphasis is increasingly on ongoing monitoring. In 2009, a programme of compliance health checks was completed and periodic reporting against KPIs was initiated.

Openreach products**Wholesale line rental**

WLR enables CPs to offer telephony services with their own brand and pricing structure over BT's network.

At 31 March 2009, Openreach was providing 20m WLR lines to other BT lines of business and 5.6m to other CPs. Of the lines provided to other CPs, 4.6m were WLR analogue lines (up 21% on 2008) and 1.0m were WLR digital channels (up 19% on 2008).

Local loop unbundling

Local loop unbundling (LLU) enables CPs to use the lines connecting BT exchanges to end users' premises and to install their own equipment in those exchanges.

At 31 March 2009, there were 13.8m unbundled lines in the UK (up 9% on the previous year). Of these, 8.1m were for BT lines of business and 5.7m were for other CPs. More than 20 CPs were providing unbundled services and Openreach was fulfilling more than 94,000 LLU orders a week.

Ethernet

Openreach's Ethernet products offer CPs a wide choice of high-bandwidth circuits to build or extend their customers data networks. We made major reductions in the connection and rental costs of services in our Ethernet portfolio with effect from 1 February 2009, which support and improve the access and backhaul markets in the UK at lower cost and support the growth of data-intensive applications.

Next generation access

Starting in summer 2009, Openreach will be running operational pilots of fibre to the cabinet (FTTC) between the exchange and customer premises. Two exchanges – one in Muswell Hill in North London and one in Whitchurch, South Glamorgan – will conduct FTTC pilots involving up to 15,000 customer premises in each area. End users should experience headline speeds of up to 40Mb.

We plan to make fibre available to 1m homes and businesses throughout the UK early in the 2010 calendar year. Parts of Belfast, Cardiff, Edinburgh, Glasgow, London and Greater Manchester will be involved in the initial deployment, as well as two rural locations – Calder Valley (near Halifax) and Taffs Well (near Cardiff). Openreach will deploy the technology, but CPs will develop and sell services based on it.

We already provide Ethernet-based fibre to the premises of more than 130,000 businesses in the UK. Since August 2008, as part of an initial trial, Openreach has been deploying fibre to the premises (FTTP) on a new 1,000 acre greenfield site at Ebbsfleet Valley in Kent. At this site, Openreach is offering the communications industry a wholesale fibre-based broadband product, facilitating competition at a retail level. The service can support speeds of up to 100Mb – the fastest headline speed available to residential customers in the UK.

18 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents**BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW****Efficiency**

Openreach's continued focus on service resulted in some significant cost savings in 2009. Investment in reducing the number of engineer visits, providing training to enhance good workmanship and the introduction of new technology to diagnose network faults before they occur have helped lower Openreach's direct labour requirements. This, together with reduced demand resulting from the economic downturn, has enabled us to reduce the number of contractor and agency staff by 40% and the number of permanent employees by 4%.

We also achieved efficiencies in our non-pay costs. Supplier contract renegotiations, engineering process improvement and reduced service level guarantee payments – as a result of improved network reliability and more orders delivered right first time – have all helped to reduce costs further.

Financial performance

	2009	2008	2007
	£m	£m	£m
Revenue	5,231	5,266	5,223
Internal revenue	4,253	4,380	4,538
External revenue	978	886	685
Operating costs	3,235	3,355	3,296
EBITDA	1,996	1,911	1,927
Operating profit	1,218	1,222	1,220

In 2009, Openreach revenue decreased by 1% to £5,231m (2008: £5,266m, 2007: £5,223m), compared with an increase of 1% in 2008. This decrease has been driven by reduced connections as the WLR and LLU markets react to the economic slowdown. Ethernet and LLU now forms just over 23% of our revenue, with WLR at 59%, reflecting the change in mix compared with 2007 when 18% of our revenue was from Ethernet and LLU and 64% was from WLR. This is the result of growth in the broadband market and unbundling activity taking place within the exchanges.

External revenue was £978m in 2009, an increase of 10% (2008: 29% increase) and reflects the continued growth of the broadband and Ethernet markets and active competition among CPs. The significant growth in 2008 was largely the result of high LLU connection revenue as CPs invested in growing their infrastructure. In 2009, CPs have focused more on obtaining returns from this investment, partly as a response to the changing economic environment. External revenues now form 19% of our revenue compared with 17% in 2008 and 13% in 2007.

Revenue from other BT lines of business decreased by 3% to £4,253m in 2009 (2008: £4,380m, 2007: £4,538m). These reductions reflect the shift of WLR and LLU volumes from other BT lines of business to external CPs. These reductions have been partially mitigated by the significant growth in the Ethernet portfolio, assisted by the launch of new products towards the end of 2009.

Operating costs decreased by 4% in 2009, compared with an increase of 2% in 2008. The decrease in the year reflects the success in our cost saving initiatives primarily around improving our service and structuring our business so it is better equipped with a more flexible and agile workforce for the future.

Over the past few years, we have made significant investments in improving our service. We have seen savings in our service level guarantee payments, which have reduced by 49% in 2009, despite starting to pay them out to external CPs proactively as opposed to on a claims basis.

EBITDA was £1,996m in 2009, a 4% increase year on year. In 2008, EBITDA reduced by 1%. EBITDA margin was 38% in 2009, compared with 36% and 37% in 2008 and 2007, respectively.

Depreciation and amortisation was £778m in 2009, 13% higher than 2008. In 2008, depreciation and amortisation decreased by 3%. The increase in 2009 is mainly driven by high value software being brought into use and the flow through of high capital investment in 2008. The reduction in the prior year was due to a number of the access network assets reaching the end of their useful economic lives.

Operating profit was £1,218m in 2009, broadly flat when compared with 2008 and 2007.

BT Design

BT Design is responsible for designing and building the platforms, IT systems and processes that support the products and services we provide to our customers around the world. It is also responsible for network planning and the implementation of BT's global 21CN platform.

The development activities undertaken by BT Design are aligned with customer needs and the requirements of BT's customer-facing businesses. BT Design has simplified and automated BT's processes so that customers can choose to do it all themselves, ask for managed services or a combination of the two. New products and services are created using agile development methods and resource management principles to increase the productivity of both in-house and third-party development resources. BT's platforms have been built in an open way to facilitate collaboration with third-party developers.

In 2009, BT Design was able to deliver significant cost savings for the group, largely as a result of a reduction in its workforce, at the same time as increasing output.

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

BT was named the UK's strongest telecommunications brand in the 2009 Business Superbrands survey

BT Operate

BT Operate is responsible for making sure that BT's products and services run smoothly. It manages BT's IT and network infrastructure platforms as a single converged operation providing a seamless information and communications technology (ICT) infrastructure. BT Operate also runs parts of other CPs' networks on behalf of the customer-facing lines of business. The scope of its operations enables it to achieve efficiency and avoid duplication and enhance our customers' experience. BT Operate also sets and manages security policy and processes throughout BT enabling us to meet the security requirements of our customers, both in the UK and globally.

BT Operate manages the group's energy policy, which aims to reduce consumption, establish security of supply and reduce carbon emissions. The renewal of our green energy contract (in 2007) until 2010 means that we now meet approximately 40% of our electricity needs in the UK from renewable sources and almost 60% from combined heat and power generation. We are investigating how to use more renewable electricity or new technologies throughout our international operations.

We were one of the first companies in the UK to achieve the new, independently assessed Carbon Trust Standard certification, in recognition of our preparation for the UK Government's new Carbon Reduction Commitment. Starting in 2010, this new legislation will rank organisations in the UK on energy performance – bonuses and penalties will be administered through the Environment Agency. Organisations will be required to purchase carbon allowances (effectively permits to use energy) at the start of each year.

In 2009, BT Operate achieved a significant reduction in its workforce, more efficient business operations and improved supply chain management.

Our resources

Our trusted reputation

We are proud to have a strong brand that is widely recognised in the UK and around the world. It helps to shape our relationships with customers and suppliers and between the people who work for the company. BT was named the UK's strongest telecommunications brand and 21st overall in the 2009 Business Superbrands survey. This ranks brands according to the views of an expert panel and more than 1,500 business professionals.

The strength of BT's brand is more valuable than ever, as customers turn to suppliers they know they can rely on. So, in turn, we have focused intensely on customer service in the past year and will continue to do so in the year ahead.

Our partnership with the London 2012 Olympic Games and Paralympic Games is a powerful signal of the inspiring and innovative brand we aim to be. We have already started delivering the communications services network for the 2012 Games at locations around the UK. We look forward to using our experience, people and technology to realise the potential of this exciting event over the next three years.

Our people

At 31 March 2009, BT employed around 85,000 full-time equivalent people in the UK and around 20,000 outside the UK. We also employ 42,000 people indirectly, through agencies and contractors, giving BT a total labour resource (TLR) of around 147,000.

Our aim is to create a team of high-performing, engaged and motivated people who can make a difference for customers, shareholders, the company and themselves.

Leadership

The quality of our leadership is vital to the transformation of BT. We ensure that leaders at all levels understand what is expected of them, including their sustainability obligations, have access to appropriate development opportunities and are able to benchmark their performance against that of their peers.

Learning and development

We offer employees a wide range of learning and re-skilling opportunities. Online and instructor-led courses are available through Route2Learn, our group-wide web-based learning portal.

Key to delivering excellent customer service is developing a customer-centric culture in BT, giving our people the skills and the tools necessary to ensure that every customer experience is an excellent one. A number of development initiatives designed to improve our right first time performance were launched in 2009.

BT employees are encouraged to volunteer in their communities more than 3,000 people are actively involved. The community benefits from their involvement, while they benefit from the opportunity to enhance existing skills and acquire new ones.

20 BT GROUP PLC ANNUAL REPORT & FORM 20-F

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

We also participate in the Federated Apprentice Scheme, which offers young adults employed by SMEs in the South of England the opportunity to gain a qualification in ICT.

We have recently introduced alternatives to voluntary redundancy and the emphasis has shifted to redeployment, retraining and skills management. We have, for example, developed an innovative scheme in which BT employees are placed with other organisations to work outside BT to help develop their skills. We are working with an external recruitment agency to use their network to maximise these opportunities. As our skills requirements change, so those people can be brought back in house.

Reward and recognition

We conduct a review of salaries every year. The 2009 review took into account the current difficult economic climate, market conditions and the need to maintain a sustainable and competitive cost base. Following discussions with our trades unions, BT has advised all employees including senior executives that there will be no increases to salary in the UK arising from the 2009 review. This principle will be followed as closely as possible in all other countries in which we operate.

Around 40,000 managers are eligible for variable, performance-related bonuses. The long-term incentives for our most senior managers are linked to BT's total shareholder return performance measured over a period of three years. For Openreach senior managers, the key measure is Openreach's performance over a three-year period. For 2009, our bonus scheme was restructured to improve alignment to overall business results and affordability.

Employees outside the UK receive an annual award of free BT shares or a cash equivalent depending on local legal and/or regulatory requirements. In the UK, employees receive free broadband. Employees in more than 25 countries also have the opportunity to save to buy BT shares at a discount to the price at the start of the savings period. Under the BT Employee Share Investment Plan, UK employees can buy BT shares from their pre-tax and pre-National Insurance salaries. More than 50% of eligible employees participate in one or more of these plans.

Pensions

Most of our UK employees are members of a pension scheme, either the BT Pension Scheme (BTPS), a defined benefit scheme, or until recently, the BT Retirement Plan (BTRP), a money purchase scheme. The BTPS was closed to new members on 31 March 2001 and the BTRP on 31 March 2009.

During 2009 we conducted a review of our UK pension arrangements, including extensive consultation with the trade unions and employees. The aim was to ensure the schemes remain flexible, fair and sustainable for the long term.

Changes to future benefit accruals under the BTPS were effective from 1 April 2009. Benefits built up before 1 April 2009 remain linked to final pensionable salary. The changes include increasing the normal retirement age to 65, moving to a career average revalued earnings basis, changes to member contributions and ceasing to contract out of the State Second Pension.

The BTPS has around 64,000 active members, 181,000 pensioners and 96,000 deferred members.

The BT Retirement Saving Scheme was set up on 1 April 2009 as a successor to the BTRP and the Syntegra Limited Flexible Pensions Plan (SLFPP). It is a contract-based, defined contribution arrangement, which means that what the pension members receive is linked to contributions paid, the performance of the fund and the annuity rates at retirement, rather than their final BT salary. Former BTRP and SLFPP members are being invited to transfer their accumulated assets to this scheme. All these pension schemes are controlled by independent trustees.

We have reached agreement with the Trustee of the BTPS that deficit contributions of £525m per annum will be made in cash, or in specie, over the next three years. This agreement has been approved by the Pensions Regulator. See **Pensions** in the **Financial review** on page 42 for further details.

Flexibility and diversity

We continue to create an inclusive working environment in which employees can develop their careers regardless of their race, sex, religion/beliefs, disability, marital or civil partnership status, age, sexual orientation, gender identity, gender expression or caring responsibilities. This inclusiveness is supported by our flexible working arrangements.

Examples of diversity include the fact that 22% of our workforce is female and women hold 21% of our top 400 leadership roles. In addition, more than 10% of our most highly rewarded people in the UK are from an ethnic minority background. Our policy is for people to be paid fairly regardless of gender, ethnic origin or disability.

We work with specialist recruitment agencies to attract people with disabilities to work for BT, and in partnership with Remploy, we run a retention service to ensure that talented people can stay with us even if their capabilities change.

Outside the UK, we are working to ensure that our policies and practices are tailored to address legislation country by country, as well as respecting cultural differences.

Health and safety

The health and safety of our people are of paramount importance and we continue to seek improvements by focusing on behavioural/lifestyle change.

More detailed information on employee engagement, our health and safety performance and diversity in BT can be found in the chart on pages 24 and 25.

Employee communications

Employees are kept informed about our business through a wide range of communications channels, including our online news service, email bulletins, webchats and webcast briefings and a printed publication.

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

£1.1bn

invested in R&D in 2009

We conduct a quarterly pulse survey, which focuses on key aspects of our employees' experience including attitudes to team working and relationships with line managers. See chart on pages 24 and 25 for some key results. We encourage managers to discuss the results with their teams and build on any strengths identified and address any areas for improvement.

We have a record of stable industrial relations and enjoy constructive relationships with recognised unions in the UK and works councils elsewhere in Europe. In the UK, we recognise two main trade unions – the Communication Workers Union and Connect. We also operate a pan-European works council, the BTECC.

Our UK network

We have the most comprehensive fixed-line communications network in the UK, with around 5,600 exchanges, 680 local and 120 trunk processor units, more than 128m kilometres of copper wire and over 11m kilometres of optical fibre, and an extensive IP backbone network.

Our global research and development capability

We have created a global research and development (R&D) capability to support BT's drive to meet customers' needs around the world. We have a world-class team of researchers, scientists and developers, including people at Adastral Park near Ipswich (England), a research team based in Malaysia and a new research centre in China. We have recently established a collaborative research and innovation centre in the United Arab Emirates with the Emirates Telecommunications Corporation (Etisalat) and Khalifa University. We also play a leading role in the India-UK Advanced Technology Centre, a research consortium of industry and academic partners from India and the UK.

We have established two global development centres in the UK and India, and are currently establishing three more in Europe, the US and China. These bring all our global development teams together, and use online collaboration and videoconferencing systems for virtual joint working.

Open innovation

We embrace open innovation, reaching out beyond the company to find the best people and the best ideas, wherever they are in the world. We are involved in partnerships at every stage of the innovation process, from scientific research to the development of new products and services.

We have dedicated innovation scanning teams in the US, Asia, Europe and the Middle East who identify more than 600 new technologies, business propositions and market trends a year.

In 2009, we invested £1,119m (2008: £1,252m) in R&D to support our drive for innovation. This investment comprised capitalised software development costs of £529m (2008: £720m) and R&D operating costs of £590m (2008: £532m).

We work with more than 30 universities around the world and have key partner relationships with the University of Cambridge, University of Oxford, University College London and MIT (Massachusetts Institute of Technology).

Building on our long tradition of innovation, we filed patent applications for 120 inventions in 2009. We routinely seek patent protection in different countries including the US, Japan, France, Germany and China, and we currently maintain a total worldwide portfolio of around 7,600 patents and applications.

Table of Contents

BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW

Corporate responsibility

We measure progress towards our corporate responsibility (CR) goals using our non-financial KPIs, which are shown in the chart on pages 24 and 25. We also report the direct costs to BT and the indirect impacts on society associated with the way we manage environmental and social issues. This is in accordance with the principles of the Connected Reporting Framework sponsored by HRH, the Prince of Wales. Our sustainability report (www.bt.com/betterworld) provides full details of our CR progress.

Supporting communities

All our lines of business support our community involvement activities.

UK

In 2009, we helped to launch Communicating for Success, a co-funded partnership between BT and the Football Foundation, to tackle digital exclusion and improve communications skills in the UK.

We partner with a number of charities, including Childline, Children in Need and the Disasters Emergency Committee (DEC) in 2009, for which BT and BT employees raised over £4m. BT people volunteer to take donations in our call centres as part of major charity telephone and online appeals. We also manage the telephone networks and provide the online donation technology.

For the past three years, Openreach has supported iCAN, a charity working for children with speech and language difficulties.

Rest of the world

The Inspiring Young Minds programme, our global development partnership with UNICEF, which brings IT skills to children, launches in China in 2010, following Brazil in 2008 and South Africa in 2007. In India, we support the work of the Katha IT and E-commerce school in one of Delhi's poorest areas.

We launched our first global disaster relief secondee programme with the Red Cross. BT volunteers with critical skills can be deployed into disaster zones alongside the aid charity's own workers.

Protecting the environment

We aim to be a leader in the new low carbon economy. On the one hand, we recognise that the IT and communications industries constitute nearly 2% of global carbon emissions, and we are working hard to reduce these. On the other hand, communications technology reduces the need for people to travel and offers scope for improved logistics, energy distribution and energy management which in turn reduces carbon emissions.

We have been rated number one in the telecommunications sector in the Dow Jones Global Sustainability Index for the past eight years. We also hold the Queen's Award for Enterprise for Sustainable Development and Business in the Community's Community Mark.

We meet the guidelines of the Association of British Insurers in reporting on social performance and have also applied the Prince of Wales Accounting for Sustainability reporting framework.

Corporate responsibility risks

During 2009, we continued to develop our knowledge and understanding of our corporate responsibility risks. Our most significant CR risks continue to be:

4 breach of our code of business ethics

4 climate change

4 diversity

4 health and safety

4 privacy

4 supply chain working conditions.

Each of these risks has an owner and a mitigation strategy in place. These risks are not regarded as material in relation to the group and consequently are not included in **Principal risks and uncertainties**.

Table of Contents**BUSINESS AND FINANCIAL REVIEWS BUSINESS REVIEW****Non-financial corporate responsibility KPIs**

	Key performance indicators	Direct company impacts: Non-financial indicators			
		Target 2010	2009	2008	2007
Customers	Customer service A measure of success across BT's entire customer base	To improve customer service based on getting things right first time (RFT) in line with our corporate scorecard	17% improvement in RFT service from 2008	9% improvement in RFT service from 2007	3% increase in customer satisfaction (our previous measure)
	Employee engagement index A measure of the success of BT's relationship with employees, through its annual employee attitude survey	Maintain or improve the 2009 level of employee engagement. We moved to a five point scale this year, and have restated previous scores	3.61	3.60	3.62
Employees	Diversity A measure of the diversity of the BT workforce	BT will maintain a top 10 placement in four of five major diversity benchmarks. Includes four UK benchmarks and the Schneider-Ross Global Diversity benchmark (from 2008)	BT is in the top 10 placement in four out of the five major diversity benchmarks	BT is in the top 10 placement in four out of the five major diversity benchmarks	BT is in the top 10 placement in three out of four main UK diversity benchmarks
	H&S: lost time injury rate Lost time injury cases expressed as a rate per 100,000 hours worked on a 12 month rolling average	Reduce to 0.157 cases	0.160 cases	0.188 cases	0.238 cases

	<p>H&S: sickness absence rate Percentage of calendar days lost to sickness absence expressed as a 12 month rolling average</p>	<p>Reduce to 1.9% calendar days lost due to sickness</p>	<p>2.17%</p>	<p>2.43%</p>	<p>2.43%</p>
<p>Suppliers</p>	<p>Supplier relationships A measure of the overall success of BT's relationship with suppliers, based on our annual supplier survey</p>	<p>To achieve a rating of 80% or more, based on the question: How would you describe the quality of your company's relationship with BT?</p>	<p>85%</p>	<p>78%</p>	<p>New measure in 2008</p>