

BT GROUP PLC  
Form 6-K  
May 31, 2006

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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**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 31, 2006

**BT Group plc**

(Translation of registrant's name into English)

BT Centre  
81 Newgate Street  
London EC1A 7AJ  
England

(Address of principal executive offices)

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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

Form 40-F

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

Yes

No

**Enclosure: BT Group plc - Annual Report and Form 20-F 2006 as sent to shareholders**

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**SIGNATURES**

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

**BT Group plc**

By: /s/ Alan Scott

Name: Alan Scott

Title: Assistant Secretary

Date: May 31, 2006

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BT is one of the world's leading providers of communications solutions and services operating in 170 countries. Our principal activities include networked IT services, local, national and international telecommunications services, and higher-value broadband and internet products and services. In the UK, we serve around 20 million business and residential customers, as well as providing network services to other operators.

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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 2006. 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 annual review and notice of meeting (including summary financial statements) for the year ended 31 March 2006 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 the "financial year" are to the year ended 31 March of each year, eg the "2006 financial year" refers to the year ended 31 March 2006. Unless otherwise stated, all non-financial statistics are at 31 March 2006.

Please see cautionary statement regarding forward-looking statements on page 133.

For the purposes of US reporting requirements applicable to first time adopters of IFRS, BT hereby incorporates by reference from its Annual report on Form 20-F for 2005 the five year financial summary on pages 23 to 24 thereof, the discussion of the 2005 financial year on pages 26 to 143 in the Financial review section thereof and the Financial statements and supporting notes on pages 72 to 122 thereof.

## Edgar Filing: BT GROUP PLC - Form 6-K

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 and profit before specific items, earnings per share before specific items, 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 27, 65, 83 and 84.

Table of Contents**FINANCIAL HEADLINES**

- Revenue of £19,514 million, up 6%
- New wave revenue of £6,282 million, up 38%
- Profit before taxation and specific items<sup>s</sup> of £2,177 million, up 5%
- Earnings per share before specific items<sup>s</sup> of 19.5 pence, up 8%
- Net debt reduced from £7.9 billion to £7.5 billion
- Dividends of 11.9 pence per share for the year, up 14%

<b>Year ended 31 March</b>		
<b>In £ million unless otherwise stated</b>	<b>2006</b>	<b>2005</b>
Revenue	<b>19,514</b>	18,429
Operating profit	<b>2,495</b>	2,992
Profit before taxation	<b>2,040</b>	2,354
Profit for the year	<b>1,548</b>	1,829
Basic earnings per share	<b>18.4p</b>	21.5p
Specific items (charge) credit <sup>a</sup>	<b>(96)</b>	290
Profit for the year before specific items <sup>a</sup>	<b>1,644</b>	1,539
Basic earnings per share before specific items <sup>a</sup>	<b>19.5p</b>	18.1p
Net cash inflow from operating activities	<b>5,387</b>	5,574
Capital expenditure on property, plant and equipment and software	<b>3,142</b>	3,011
Dividends per share <sup>b</sup>	<b>11.9p</b>	10.4p

The financial information above is discussed in the Financial review on pages 26 to 39, together with the reasons for focusing on the results before specific items. The consolidated financial statements are on pages 64 to 122.

The group adopted International Financial Reporting Standards (IFRS) with effect from 1 April 2005. The comparative data for the year ended 31 March 2005 has been restated accordingly. IAS 32, "Financial Instruments: Disclosure and Presentation" (IAS 32) and IAS 39, "Financial Instruments: Recognition and Measurement" (IAS 39) were adopted with effect from 1 April 2005 and the comparative data does not reflect the effect of these standards. Amounts in the years prior to the year ended 31 March 2005 are presented in accordance with generally accepted accounting principles in the United Kingdom (UK GAAP). Information prepared under IFRS is not directly comparable with that prepared under UK GAAP.

For the purposes of US reporting requirements applicable to first time adopters of IFRS, BT hereby incorporates by reference from its Annual report on Form 20-F for 2005 the five year financial summary on pages 23 to 24 thereof, the discussion of the 2005 financial year on pages 26 to 143 in the Financial review section thereof and the Financial statements and supporting notes on pages 72 to 122 thereof.

<sup>a</sup>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 and profit before specific items, earnings per share before specific items, 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 28, 65, 83 and 84.

<sup>b</sup>Dividends per share represents the dividend proposed in respect of the relevant financial year.

<sup>c</sup>Amounts presented in respect of the years ended 31 March 2004, 2003 and 2002 are prepared in accordance with UK GAAP. UK GAAP is not directly comparable with IFRS.

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## CHAIRMAN'S MESSAGE

Our results for the 2006 financial year were excellent. Earnings per share before specific items grew by 8% to 19.5 pence. We continued to invest significantly in technologies and systems designed to transform our customers' experience, at the same time as generating free cash flow of £1.6 billion.

The news on dividends is again positive. Your Board is recommending a full-year dividend of 11.9 pence per share at a pay out ratio of 61% of earnings before specific items, compared with 57% last year. We continue our progressive dividend policy and expect our pay out ratio to rise to around two-thirds of earnings in the 2008 financial year.

We operated our share buy back programme again in the 2006 financial year. This is being funded from cash generated over and above that required for servicing our debt, which remains below £8 billion.

### BUSINESS PROGRESS

We continued to implement our strategy of growth through business transformation. Your Board has given its backing to targeted acquisitions that will help us confirm our status as a leading player in the global networked IT services market. In the 2006 financial year, we acquired Atlanet in Italy (as part of a major deal with Fiat), Cara Group in Ireland and Total Network Solutions in the UK. And in the UK, we now have almost eight million broadband lines over which we are able to offer customers exciting, next-generation voice and entertainment services. New wave revenue grew by 38% to £6.3 billion, and accounted for around one-third of our total business.

### REGULATION

We believe that a fair and flexible regulatory regime is vital for our industry, for ensuring that we can meet customers' growing needs and for encouraging investment. We were pleased that, following its strategic review of telecommunications, Ofcom accepted the set of legally-binding Undertakings that BT proposed in order to transform the regulatory landscape in the UK. We believe that the impact of these Undertakings will be to focus regulation where it remains necessary at the same time as stimulating de-regulation wherever possible.

### PENSIONS

BT stands fully behind its pension promise to pensioners and members of the BT Pension Scheme (BTPS). The scheme is well-managed and its assets have grown very significantly in recent years, from £23 billion at the end of 2002 to more than £35 billion currently. The accounting deficit has almost halved in the last year alone. With the Trustees of the BTPS, we are continuing discussions on the triennial funding valuation of the scheme. In particular, we aim to review recent pensions legislation and guidelines, and examine the implications and extent of the Crown Guarantee given on privatisation in 1984. The Crown Guarantee, which applies to liabilities assumed by BT in 1984 and only in the event of insolvency, is an extra layer of security for BT pensioners.

### THE BOARD

There were a number of changes to your Board during the year. I would like to welcome Matti Alahuhta and Phil Hodgkinson as non-executive directors. Matti has been President of Kone Corporation since January 2005 and was previously at Nokia; Phil is Group Finance Director of HBOS. Both bring a wide range of commercial and senior management experience to your company. I would also like to thank Lou Hughes who stepped down as a non-executive director on 31 March 2006 for his excellent contribution over more than six years. I'm pleased that his experience is not lost to us: he has joined our Americas Advisory Board.

### OUR WIDER RESPONSIBILITIES

Our aim as a communications company is to operate in a socially responsible and sustainable way and to ensure that we help everyone benefit from improved communications and enhanced connectivity. I'm very proud of the fact that, for the fifth year in a row, BT was the highest placed telecommunications company in the Dow Jones Sustainability Index.

Climate change has been moving inexorably up the social and corporate agendas for a number of years now.

Although telecommunications technology is environmentally friendly, BT is one of the largest companies in the UK and one of the largest consumers of electricity. Our operations inevitably have an impact on the environment and we take the job of managing that impact seriously. We are now, for example, meeting almost all our UK electricity needs from environmentally friendly sources, including wind generation, solar, wave and hydroelectric schemes.

### **LOOKING FORWARD**

I am very grateful to our shareholders and our customers for their continued loyalty and the confidence that they have shown in BT's programme of transformation. I'd like to thank our employees for making that programme happen.

Your company is well set for continued success in the years ahead. Our performance underpins our confidence that we can continue to grow revenue, EBITDA, earnings per share and dividends over the coming year, and accelerate the strategic transformation of the business.

**Sir Christopher Bland**

Chairman

17 May 2006



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## CHIEF EXECUTIVE'S STATEMENT

Your company is ambitious. We are much more than a lines and calls business. Our aim is to make life easier, simpler, cheaper and more fulfilling for all our customers. We will continue to do this by providing our business customers, large and small, with productivity improvements and competitive edge in their markets. We will ensure consumers enjoy a joined-up communications experience, enabling them to communicate anywhere, anytime, using whatever device they choose.

### HELPING CUSTOMERS THRIVE IN A CHANGING WORLD

We enjoy the fantastic privilege of serving around 20 million customers in 170 countries around the world. Their needs and expectations are constantly changing, so too is the market in which we operate and the technology at our disposal. That's why an ability to embrace, and thrive on, change – developing new products and services, new ways of working and new ways of interacting with our customers – is essential to what we do at BT.

When so much is changing, companies have to be crystal clear about what they stand for. BT has a strong and trusted brand, widely recognised around the world by shareholders, customers, suppliers and employees. The brand captures the essence of BT and tells existing and new customers what they can expect from us. We have summed this up in a new vision and mission.

**Our vision is to be dedicated to helping customers thrive in a changing world.** And there's not a wasted word in there. Dedication to our customers is what will differentiate us in an intensely competitive environment. Helping these customers to thrive means enabling them to do the things they want to do, when they want to do them and at the right price. It means helping them to recognise that a changing world is a world of opportunity and new experiences. And it means helping them to seize those opportunities.

**Our mission is to be the leader in delivering converged networked services.** That's the yardstick by which we'll measure our success. Convergence is at the heart of everything we do for customers.

We believe that this combination of absolute commitment to understanding our customers and to exploring the possibilities of convergence (blurring the distinctions between networks and services, IT and communications, fixed and mobile, telecommunications and visual services) is extremely powerful.

Of course, customers are not interested in vision and mission statements. What they *are* interested in, however, are services that get the job done and that are hassle-free.

### THE RIGHT REGULATORY CLIMATE

We operate in a regulated industry and the right regulatory climate is also essential if our customers are to thrive. The regulatory climate is not, however, just something that happens to us; we are helping to shape regulatory thinking.

In response to Ofcom's strategic review of telecommunications in the UK, we proposed a series of Undertakings which we believe will result in a fair and flexible regulatory regime, deregulation where possible and the growth of competition through equivalence. Above all, they bring greater regulatory *certainty*. These Undertakings, which Ofcom accepted, are in our view fundamental to meeting customers' needs and to enabling us and other service providers to invest in the future with confidence.

A big part of meeting these Undertakings was the creation of Openreach. This line of business manages our access and backhaul networks and the associated portfolio of products and services. We have established an Equality of Access Board with a majority of independent members to oversee compliance. Service providers are benefiting from lower prices for both connection and rental thanks to the success of products such as wholesale line rental and local loop unbundling.

BT is committed to meeting its obligations, and we have made good progress so far – though much remains to be done.

### OUR STRATEGY

Like our brand, our strategy for profitable growth and transformation is subject to continuous review. There are four parts to our strategy:

- to pursue profitable growth in new wave markets
- to maximise the return from our traditional business
- to transform our networks, systems and services for the twenty-first century
- to create long-term partnerships with our customers.

## NEW WAVE GROWTH

Around one third of BT's revenue in the 2006 financial year was from new wave activities □ that's up from effectively nothing a few years ago.

By new wave activities we mean networked IT services, broadband and mobility.

In short order, BT has established itself as a key player in the global networked IT services market with a strong track record of winning and delivering big, complex contracts for large corporations and other organisations. Major wins such as the contract with Fiat in Italy and the revised agreement with the Department for Work and Pensions in the UK confirmed our credentials. The total value of our networked IT services order intake in the year was £5.4 billion.

Having hit our target of five million broadband lines in April 2005 (a year ahead of schedule), we've boosted that number by more than 50% in the past financial year. For the majority of customers, access to broadband is now a given.

But broadband is more than just another technology, it enables broader, richer, more compelling experiences. Our focus is increasingly on what customers can do with it. We are delivering speeds of up to 8Mbit/s and launching innovative consumer broadband products and services. One of these, BT Vision, scheduled for launch in the autumn, is broadband TV and will bring a new dimension to home entertainment as customers choose from a huge range of on-demand film, music and TV programming as well as interactive services.

BT is a mobile virtual network operator in both the business and consumer markets, with more than 340,000 connections. In a convergent world, we aim to offer customers the best of fixed and the best of mobile. We launched BT Fusion, the world's first service enabling customers to switch seamlessly

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between fixed and mobile lines depending on where they are. And in the wholesale market, we are one of the first companies in Europe to offer a broadcast digital TV and radio service via mobile handsets, BT Movio.

**MAXIMISE THE RETURN FROM OUR TRADITIONAL BUSINESS**

The number of fixed-voice calls is no longer the best guide to the success of a telecommunications company as we encourage our customers to take up non-voice and subscription-based packages. At 31 March 2006, 67% of call revenue in the consumer market was under contract. We continue to develop and enhance our traditional services to make them more attractive to customers, as the success of BT Together and BT Privacy has demonstrated.

In our traditional markets, as in the rest of our business, we are committed to working smarter – avoiding the costs of failure and duplication – and ever more cost effectively through using the internet. For example, over two million customers now receive e-bills.

**TRANSFORM OUR NETWORKS, SYSTEMS AND SERVICES FOR THE TWENTY-FIRST CENTURY**

Our twenty-first century network (21CN) programme is further evidence of our ambitions. It is a massive investment in the UK's infrastructure and in the UK's continued competitiveness in world markets. Based on IP technology, it is designed to ensure that the delivery of the next generation of converged services is rapid and cost efficient.

**CREATE LONG-TERM PARTNERSHIPS WITH OUR CUSTOMERS**

We never take our customers for granted. Nothing is more important than building successful, innovative, mutually-rewarding relationships with them. In recent years, we have focused in particular on driving down levels of customer *dissatisfaction*. The emphasis now is increasingly on improving customer *satisfaction*. In the 2006 financial year, we achieved a 3% increase in the number of customers reporting that they are "very satisfied" or "extremely satisfied" with the services they receive from BT.

Because the quality of service we offer customers is key to their satisfaction levels, much of our investment in training and development is directed towards developing a truly customer-centric culture in BT.

**OUR PEOPLE**

BT is a people business, not a technology business.

Recruiting, developing, rewarding and retaining the right people is critical. Another "must do" is celebrating the power of diversity, ensuring that our people reflect the customers we serve.

A people business only really fires on all cylinders when its top team is on top of its game, which is why we have rigorously defined the capabilities we expect of leaders in this business and developed programmes to help them become even more customer focused.

Achieving our ambitions depends as much on the quality and commitment of our people as on world-class products and services, on technology and on a clear strategy. *People* understand how technology can add value to their customers' lives and *people* deliver strategies. People not only know what a business stands for, but they also embody its values. I'd like to thank BT people for their commitment, imagination and dedication to our customers. In my view, they are truly inspirational.

**Ben Verwaayen**

Chief Executive  
17 May 2006

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## OPERATING AND FINANCIAL REVIEW

### BUSINESS REVIEW

The Business review is divided into the following sections:

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- 12 Transform our networks, systems and services for the twenty-first century**
- 12 Create long-term partnerships with our customers**
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Please see **Cautionary statement regarding forward-looking statements** on page 133.

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## **INTRODUCTION TO THE BUSINESS REVIEW**

BT Group plc is one of the world's leading providers of communications solutions and services operating in 170 countries.

Our vision is for BT to be dedicated to helping customers thrive in a changing world. Our mission is to be the leader in delivering converged networked services. We are committed to increasing shareholder value by transforming the customer experience through service excellence, by the effective management of our powerful brand, and by leveraging our large scale networks and our existing customer base. We aim to find new and mutually-rewarding ways of engaging with around 20 million customers, to capitalise on the possibilities of convergence, to offer global reach combined with the service values associated with local delivery, and to continue to provide innovative services and solutions.

Our principal activities include networked IT services; local, national and international telecommunications services; and broadband and internet products and services. We have ISO 9001 certification (the international quality management system standard) for most of our operations in the UK and worldwide.

We are committed to enhancing our positive impact on society through leadership in CSR (corporate social responsibility), and our policy is to achieve best practice in our standards of business integrity in all our operations, in line with our published statement of business practice – *The Way We Work*.

### **How BT operates**

BT consists principally of four lines of business: BT Global Services, Openreach, BT Retail and BT Wholesale.

Openreach was established on 21 January 2006 in response to Ofcom's strategic review of telecommunications. It operates the physical (as opposed to the electronic) assets of the local access and backhaul networks and provides the services which use these networks to communications providers, both internally and externally. (See **Regulation, competition and prices**) For financial reporting purposes Openreach remained part of BT Wholesale until the end of the 2006 financial year. It will be reported as a separate line of business in the 2007 financial year.

Openreach, BT Retail and BT Wholesale operate almost entirely within the UK, where BT is the UK's largest communications service provider, by market share, to the residential and business markets, supplying a wide range of communications products and services, including voice, data, internet and multimedia services, and offering a comprehensive range of managed and packaged communications solutions.

In the 2006 financial year, 87% of our revenue was derived from operations within the UK.

BT Global Services addresses the networked IT services needs of multi-site organisations both in the UK and internationally.

## **OUR CUSTOMERS**

### **Major corporate customers**

Our core target market is 10,000 multi-site organisations including major companies with significant global requirements, together with large organisations in target local markets. We aim to provide them with networked IT services and a complete range of managed solutions.

In the 2006 financial year, major corporate revenue increased by 16% to £6,880 million, with new wave revenue increasing by 35% and traditional revenue declining by 4%. The increase in new wave revenue for major corporate customers globally was driven by networked IT services, broadband and mobility. New wave revenue accounted for 59% of our total revenue in the major corporate market, compared with 51% in the 2005 financial year.

The continued migration of our customers from traditional voice and data services to networked IT services enables us to build closer, high-value relationships with these customers, enabling them to manage their businesses more effectively and gain competitive advantage in their markets. Such relationships will, we believe, deliver long-term, profitable revenue, more than offsetting the decline in our traditional business revenue.

As well as local, national and international communications services and higher-value broadband and internet products and services, we offer a comprehensive portfolio of networked IT services focused on messaging and conferencing, CRM (customer relationship management), convergence, outsourcing and security. We also offer consultancy services to help organisations understand network performance, operate their networks and applications efficiently and transform their businesses to gain advantage in the digital networked economy.

Our extensive global communications network and strong partnerships enable us to serve customers in the key commercial centres around the world using a combination of direct sales and services capabilities and strategic partners.

### **Business customers**

At 31 March 2006, in the UK we had around 1.5 million business customers, with more than eight million exchange lines.

In the SME (small and medium-sized enterprises) market (typically companies with up to 500 employees), our strategy is to provide customers with tailored IT and communications products and services that enable them to manage their businesses more simply and efficiently.

In the 2006 financial year, 23% of revenue was from new wave activities, compared with 19% in the 2005 financial year. However, we face challenging market conditions and, overall in the SME market during the 2006 financial year, revenue reduced by 5% to £2,324 million, primarily reflecting the impact of CPS (carrier pre-selection) and WLR (wholesale line rental).

In April 2006, we announced that we had acquired dabs.com plc, one of the UK's leading internet retailers of IT and technology products. dabs.com has around one million customers throughout the UK, and this move strengthens our online IT and digital products sales and service presence for SME and consumer customers.

### **Consumer customers**

At 31 March 2006, we had over 18 million UK consumer customers with around 20 million residential customer lines (exchange line connections). In the 2006 financial year, consumer revenue declined by 5% to £5,296 million, primarily reflecting the impact of CPS, WLR and regulatory price reductions in mobile termination rates.

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In the consumer market we aim to provide customers with a range of services that help them communicate more effectively, be entertained and manage their lives. By increasing revenue from broadband, mobility and internet services, we intend to reduce further our dependence on revenue and profit from traditional, fixed-line voice services. We also aim to maximise the returns from our traditional business and defend market share vigorously, through service offerings backed by innovative marketing and excellent quality of service.

Consumer new wave revenue grew by 55% from £412 million in the 2005 financial year to £638 million in the 2006 financial year, driven principally by broadband. Residential broadband customers increased by 52% to more than two million.

### **Wholesale customers**

In the UK wholesale market, we provide network services and solutions to over 700 communications companies, including fixed and mobile network operators, ISPs (internet service providers) and other service providers. We interconnect with more than 150 other operators, as well as carrying transit traffic between telecommunications operators.

In the 2006 financial year, external revenue from our wholesale activities increased by 13% to £4,996 million.

In the UK, external revenue from our wholesale activities was £4,226 million in the 2006 financial year, compared with £3,820 million in the 2005 financial year.

New wave revenue was £1,033 million, up 56% on the 2005 financial year. This increase was driven by the success of broadband as well as a strong emphasis on building innovative network solutions that help our wholesale customers grow their businesses and reduce their costs.

We have a long and successful tradition of delivering network-based connectivity to the carrier and intermediate telecommunications markets throughout the UK, and have developed value-enhancing services and solutions. We have a number of agreements with service providers and mobile operators to upgrade their IP capability. In addition, we have used our expertise and geographic reach to provide bespoke data housing solutions.

In our global carrier business, revenue was £691 million in the 2006 financial year, compared with £565 million in the 2005 financial year. This strong growth was mainly driven by revenue from Albacom which we acquired in February 2005. Our global carrier business customers include other fixed-line telecommunications operators, mobile operators and selected ISPs outside the UK.

### **OUR STRATEGY**

Our strategy is to:

- pursue profitable growth in new wave markets
- maximise the return from our traditional business
- transform our networks, systems and services for the twenty-first century
- create long-term partnerships with our customers.

The successful delivery of this strategy depends on the commitment of all BT people and our continued ability to manage their development and reward them.

The key performance indicators against which we measure the success of our strategy are earnings per share before specific items (see **Earnings per share** in the **Financial review** on page 35), free cash flow (see **Financing** in the **Financial review** on page 36) and customer satisfaction (see **Create long-term partnerships with our customers**).

## OUTLOOK

Our performance underpins our confidence that we can continue to grow revenue, EBITDA, earnings per share and dividends over the coming year. Revenue growth will continue to be fuelled by new wave services; the EBITDA improvement will be driven by the continued growth in BT Retail's profitability and an acceleration through the year of the EBITDA growth in BT Global Services.

We are confident in our ability to improve shareholder returns and accelerate the strategic transformation of the business. (See **Group risk factors** on page 20 and 21)

## PURSUE PROFITABLE GROWTH IN NEW WAVE MARKETS

In the 2006 financial year, 32% of our revenue was from new wave activities – networked IT services, broadband and mobility.

### Build on our networked IT services capability

Our strategy in the networked IT services market is to reinforce BT's position as a global player capable of competing with the world's best in selected markets. Our portfolio of services includes IP infrastructure, CRM, security, applications, managed mobility, hosting and outsourcing.

In recent years, we have developed a track record of winning and delivering complex, large-scale networked IT services contracts for large business customers and other organisations (including the public and government sectors) around the world. We have shown that we have the experience and expertise to help our customers succeed in a world in which business applications are increasingly being networked and networks are seen as increasingly vital to productivity and competitive advantage.

We are, for example, playing a prominent role in the NHS National Programme for IT, delivering:

- the national broadband network (N3) – we successfully installed more than 14,000 connections on the N3 ahead of schedule
- the spine transactional and messaging database – which now has about 200,000 registered users
- the London local service provider IT systems – we deployed the first patient administration system specifically designed for the NHS National Programme.

In March 2005, we announced that BT had won a contract worth up to £1.5 billion over eight and half years to provide and manage secure data networks for Reuters' products and services worldwide. In accordance with the contract, the parties have tested a number of Reuters' products over the BT IP-enabled MPLS (multi-protocol label switching) network and have started its migration process in a number of countries.



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In May 2006, we were awarded a three-year extension worth around an additional £270 million to the existing contract to deliver Unilever's voice, data and mobile services around the world until 2012. The original contract, announced in November 2002 and with an estimated value of £670 million over seven years, was the first comprehensive global telecommunications outsourcing contract won by BT and is one of our largest and most significant global deals.

In the 2006 financial year, we secured networked IT services orders in the UK and internationally worth £5.4 billion, including a number of major contracts:

- in June 2005, we signed a contract worth approximately €175 million over a seven-year period with leading global brewer InBev, for the outsourcing of its communications infrastructure data and voice around the world
- in July 2005, we signed a two-year contract to manage Microsoft's OneCall call centre routing initiative. Under the agreement, we will design, build, deploy and manage a solution to unify the majority of Microsoft's contact centres around the world into a single, networked contact centre environment
- in December 2005, we reached agreement with the Department for Work and Pensions (DWP) on the simplification of the contracts that the Department inherited when it was created from the former Department of Social Security and the Department for Education and Employment. Under the agreement, we will supply services based on modern, reliable IP communications that take advantage of our 21CN programme to deliver consistent and flexible services which will, we believe, lead to substantial efficiencies and new capabilities for the DWP and its clients
- in February 2006, we completed an agreement to become Fiat's supplier of global telecommunications services in 40 countries, in a deal worth approximately €450 million over almost five years. (See also **Acquisitions and disposals in the 2006 financial year**)

BT is listed in the leader quadrant in the Gartner Magic Quadrants for Global and pan-European NSPs (network service providers), and in 2005 was listed for the first time in the leader quadrant for Asia Pacific NSPs. Gartner's reports evaluate the NSPs operating in the various regions for their completeness of vision and ability to execute, and BT was consistently ranked in the top five. The NSPs that score well are those that go the extra mile to deliver superior service quality through their pan-regional networks, local service and support and service level commitments.

Networked IT services revenue for the 2006 financial year was £4,065 million, a rise of 33% on the 2005 financial year.

**Deliver on broadband**

In the 2006 financial year, we continued our drive to enhance the awareness, availability and attractiveness of broadband. As at 31 March 2006, in the highly competitive retail market, our market share of consumer and business DSL (digital subscriber line) and LLU (local loop unbundling) broadband connections in the UK was 33% (2.6 million connections).

**Broadband for wholesale customers**

In early April 2005, we reached our target of five million broadband lines one year ahead of schedule. At 31 March 2006, we had 7.9 million lines, including those provided via BT Retail and LLU. In total, 5,501 exchanges had been upgraded by 31 March 2006, making broadband available to 99.7% of the UK's homes and businesses.

We continue to look for commercially viable ways of bringing broadband to those customers for whom availability remains an issue. We are, for example, exploring the feasibility of installing broadband equipment at locations closer to the customer than the BT exchange, as well as the possibility of delivering broadband over existing fibre cables. Both trials will run until summer 2006.

As a demonstration of our commitment to delivering higher speed broadband to UK consumers, 59% of wholesale broadband lines were 2Mbit/s at 31 March 2006, compared with 17% a year earlier.

Having conducted trials of broadband speeds of up to 8Mbit/s in association with a number of service providers, we launched BT ADSL (asymmetric digital subscriber line) Max and BT ADSL Max Premium broadband services nationally with effect from 31 March 2006. By upgrading more than 5,300 exchanges across the UK to support this service, we are providing the UK market with a stable, high-speed broadband service across the widest national footprint in the world.

Although the broadband speed that can be supported on an individual line is governed by a wide range of physical factors, our trials suggest that 78% of BT phone lines should support rates of at least 4Mbit/s. In addition,

we have enhanced broadband line stability to ensure that customers can run more bandwidth-hungry applications, including video, gaming and music downloads, at the same time as sending/receiving e-mails and surfing the internet.

#### Broadband for consumers

We offer a family of broadband packages designed to meet the diverse needs of our customers, simply and cost effectively in a highly competitive market. In October 2005, in partnership with Yahoo!, we simplified our broadband packages into four options, each of which offers new and existing customers a premium Yahoo! broadband experience, enhanced security features and the option of cheap internet telephony.

We are helping to define next-generation television – which is being made possible by the convergence of digital broadcast TV and broadband technology. During the 2006 financial year, we put in place a number of the key building blocks designed to enable us to launch the BT Vision broadband TV service in autumn 2006. Microsoft will help to provide the software platform over which BT Vision will run and the set top boxes will be provided by Philips, Europe's largest electronics company.

The service aims to combine access to digital terrestrial channels, an extensive video-on-demand library, catch-up TV and a range of interactive services, offering customers choice, convenience and control over their home entertainment. Other services which should be available at launch or shortly afterwards will include: personal video recording; more than 30 digital terrestrial TV channels; communications services – instant messaging, chat and video telephony on the TV, and interactive services – online gaming, retail opportunities and community services – all without the need to pay an up-front subscription.

We have signed content deals with BBC Worldwide, Paramount, Warner Music Group, Endemol, i-concerts, Eagle Rock, Cartoon Network, National Geographic Channel, HIT Entertainment and Nelvana.

We are also playing a lead role in the development of internet telephony or VoIP (voice over IP). International calls made with BT Communicator – which enables customers to make voice calls over the internet using a PC or laptop – are proving cheaper than those offered by many other suppliers. BT Communicator comes with Yahoo! Messenger which provides

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access to a range of features including instant messaging, e-mails and texts. BT Broadband Talk enables customers to make and receive broadband calls using an ordinary phone. We aim to introduce an enhanced VoIP offering, featuring high-definition sound quality, in June 2006.

### Broadband for business customers

Broadband is increasingly critical to the success of small and medium businesses and BT Business Broadband remained the leading internet service provider for SMEs in the UK. At the end of the 2006 financial year, we had 453,000 BT Business Broadband customers.

We recognise that businesses need solutions that combine fast and reliable access with superior support and a range of business applications and services. Many of these customers opt for such value-added services as the Internet Security Pack and the Internet Business Pack.

In October 2005, as part of our drive to encourage broadband take-up in the SME market, we launched our most comprehensive broadband package for business to date, offering reduced prices, increased value and higher levels of support than were previously available, including support for LAN (local area network) and IT equipment that customers connect to their broadband line. At 31 March 2006, we were providing remote support for 24,000 PCs for SME customers. Customer feedback has been extremely positive, with an average 99% satisfaction level.

In the 2006 financial year, we invested in platforms that will enable us to offer a wider range of services using Microsoft's Connected Services Framework. BT Business E-mail was the first service to be launched on this platform and provides "anywhere access" to critical business information, supported by advanced security and collaboration features, and there were 12,000 users of this service at 31 March 2006. In January 2006, we launched BT Business Broadband Voice, our first "flat top" internet telephone or VoIP call package for broadband customers.

### Create convergent mobility solutions

In a convergent world, individuals and businesses increasingly need to connect and communicate whenever and wherever they happen to be, using whatever devices they choose.

Our aim is to offer all our customers the right combination of the quality, reliability, cost advantages and bandwidth associated with fixed-line communications, and the convenience, personalisation and flexibility associated with mobile communications.

BT is both an MVNO (mobile virtual network operator) and a service provider in the business and consumer mobility markets. At 31 March 2006, BT Mobile had over 340,000 GSM and BT Fusion business and consumer connections.

BT Openzone is one of the leading providers of Wi-Fi services in the UK and Ireland. We operate our own network of high-quality sites and offer more wholesale and roaming connections than any other UK Wi-Fi network operator. Recently awarded the Brainheart European Wi-Fi award in recognition of its contribution to the growth of the European Wi-Fi industry, BT Openzone offers customers a high-speed, wireless broadband connection over which they can access the internet to work, talk or play.

We have already built BT Openzone networks in Westminster and Cardiff and we have announced our intention to Wi-Fi enable a further ten cities by the end of the 2007 financial year.

At 31 March 2006, our BT Openzone customers had access to around 8,400 hotspots throughout the UK and Ireland and more than 30,000 globally.

Revenue in the mobility market in the 2006 financial year was £292 million, an increase of 42% on the 2005 financial year.

### Mobility for consumers

In the consumer mobility market our strategy is to build a foundation for the delivery of fixed/mobile convergent solutions.

BT Fusion (launched in June 2005) is the world's first intelligent mobile service that switches calls to a BT broadband line when the user is at home, offering customers the convenience of mobile in combination with the cost and quality advantages of a fixed-line phone. BT Fusion brings with it a range of mobile services including text and picture messaging. Users can connect PCs, laptops, games consoles, printers and broadband wirelessly via the

BT Hub that comes with BT Fusion. At 31 March 2006, there were 24,000 consumer BT Fusion connections.

In July 2005, the 3G network we built and operate for 3 in the Republic of Ireland was launched. The contract with 3 requires the development of 700 new radio sites to achieve its coverage targets. At 31 March 2006, the network for advanced 3G services covered more than 70% of the population of the Republic of Ireland. BT Ireland is building on its success in this market to offer wholesale services to other mobile operators in Ireland.

In November 2005, we joined forces with Nintendo to provide Wi-Fi access to users of Nintendo's DS wireless games console, a move which will enable users to play games around the world for free and will, we believe, bring Wi-Fi to a mass market.

#### Mobility for business and major corporate customers

Our strategy is to integrate traditional fixed, mobile and IP services to offer a single communications solution to our customers – both through commercial packaging and through the exploitation of technological convergence.

In addition, we provide a range of managed mobile services to UK and global customers who either outsource their mobile communications entirely or rely on BT to provide specific managed services.

During the 2006 financial year, we launched a number of new services designed to integrate customers' fixed and mobile communications services, including:

- BT Business Plan with Mobile, launched in March 2006, offers small and medium businesses one bill, an annual 5% discount on combined fixed and mobile calls, capped rates on fixed-line calls and preferential rates on mobile-to-mobile and mobile-to-the-office calls. The package also includes BT Billing Analyst, which helps businesses to monitor and control their call spend
- in February 2006, we launched a version of BT Fusion for SMEs, enabling them to benefit from the convenience of a mobile phone while enjoying rates similar to those for fixed lines.

#### Mobility for wholesale customers

In the 2006 financial year, we saw continued growth in the UK wholesale mobile arena – increasing the volume and value of wireless-originated traffic over our network.

In February 2006, we announced that Virgin Mobile will be the first operator to sign up to the BT Movio broadcast digital TV and radio service, making it the first mobile operator in

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Europe to offer its customers digital TV and radio content on a mobile device using broadcast technology.

We have also developed a strategic relationship with Microsoft to enable a secure and efficient environment for delivering broadcast services on a mobile handset. Microsoft's Windows Media technologies will enable BT Movio to deliver high-quality audio and video content over a DAB (digital audio broadcast) network using minimal bandwidth. The BT Movio service also incorporates Windows Media DRM (digital rights management) technology to ensure secure delivery of premium video and music content.

BT Movio is the first wholesale mobile broadcast TV offering of its kind in Europe and we plan to make it available to all mobile operators in the UK.

In June 2005, selected mobile phone users in Cardiff became the first in the UK to benefit from our innovative new mobile delivery system, Microconnect Distributed Antenna – part of our growing portfolio of low-power, mobile coverage solutions for mobile operators, designed to minimise the visual impact of masts and cabinets in city centres and heritage sites. 3 became the first mobile operator in the UK to take advantage of the system that enables operators to share small antennas, and in December 2005, Selfridges' London store became the first in the UK to use the Microconnect In-Building service.

### **MAXIMISE THE RETURN FROM OUR TRADITIONAL BUSINESS**

We face continued challenges in our traditional markets as a result of regulatory intervention, competition and a shift in our customers' buying patterns, as we provide them with higher-specification, high-value, new wave products.

Total fixed-to-fixed voice call minutes in the UK market as a whole declined by 3% in the 2006 financial year. This was driven by customers making use of alternatives such as mobile calls, e-mail, instant messaging, corporate IPVPNs (internet protocol virtual private networks) and VoIP, continuing the trends of recent years.

However, the call minutes measure is becoming less important to BT as customers increasingly opt to sign up for pricing packages and take other non-PSTN (public switched telephone network) services.

#### **Traditional services for consumers**

We continued to develop the services we have traditionally offered in order to make them more attractive to consumers. Examples included:

- at 31 March 2006, more than two million customers had signed up for BT Together Options 2 and 3 and 67% of consumer call revenue was under contract
- at 31 March 2006, 3.7 million customers had signed up for BT Privacy, a caller display service which enables customers to preview incoming call numbers and filter out unwanted calls. All BT Privacy customers are automatically added to the Telephone Preference Service register which filters out most unsolicited marketing calls
- between January and April 2006, actor Tom Baker was the voice of BT Text, the text-to-speech service that enables users to send and receive texts on their home landline phones. BT Text volumes increased by 94% in the 2006 financial year. At 31 March 2006, 268,000 BT customers were registered on the service and around 1.2 million text messages were being sent to landlines every week
- since autumn 2005, over one million customers have registered to have their Friends & Family calling circle automatically updated to ensure that the numbers they dial most frequently attract maximum discounts
- we manage around 64,000 public payphones, including more than 800 multimedia kiosks and more than 1,000 textphones throughout the UK. We remain committed to ensuring that public payphones are available in communities throughout the UK. Future growth opportunities will focus on maximising returns from existing sites and capabilities, including hosting Wi-Fi services and mobile antennas.

#### **Traditional services for business and major corporate customers**

We continued to enhance BT Business Plan. From June 2005, for example, we cut the cost of calls for business customers by reducing the cap on landline-to-mobile calls lasting less than one hour from 30 pence to 25 pence. At 31 March 2006, BT Business Plan had over 513,000 locations, up 15% on the 2005 financial year.

Our BT Local Business initiative helped to secure BT's position as a key player in the SME market. At the end of the 2006 financial year, BT Local Business was active in 83 locations around the country, managing £1.2 billion of annual billed revenue.

### **Traditional services for wholesale customers**

We continued to sell a wide range of capacity and call-based products and services including regulated interconnect services; access products such as WLR and LLU; and new, non-regulated products and services.

During the year, the sale of WLR services continued to grow, reaching a total of 2.9 million lines by 31 March 2006. Rental charges for consumer lines were reduced by 50 pence a month from 1 August 2005 and a further 35 pence from 1 March 2006. The monthly charge for business lines was reduced by 78.3 pence from 1 March 2006.

WLR and LLU products will be reported within Openreach for the 2007 financial year.

### **Transforming our costs**

We remain focused on financial discipline and on delivering efficiency programmes that will generate sustainable cost savings.

We continue to benchmark ourselves against the best in the industry and aim to achieve savings of at least £400 million in each of the next three years. In the 2006 financial year, efficiency programmes delivered savings of over £400 million, enabling us to invest in growing our new wave activities.

A key area of focus has been enhancing the ways in which customers can deal with BT, simultaneously saving costs and improving customer service. Programmes have targeted the cost of failure by, for example, minimising the number of times a customer call is transferred before resolution and reducing the amount of call waiting time through better call routing.

The number of transactions via bt.com grew by 28% in the 2006 financial year, and we now have approximately 2.3 million customers receiving e-bills – half a million of whom do not receive a paper bill.

We have also been reducing the complexity of our systems and processes and intend, for example, to transform our billing function – rationalising more than 90 systems and at the same time improving the end-to-end customer experience.

Other programmes relate to innovative procurement and sourcing. Our IT team, for example, has moved to global sourcing and 90-day delivery cycles, and implemented “hot housing” principles – bringing customers and suppliers together in an intense design session at the beginning of a project, reducing risks and driving up benefits.

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We continue to look at ways of streamlining our organisation and eliminating duplication. The integration during the 2006 financial year of the BT team serving major corporate customers in BT Global Services (previously part of BT Retail) should enable more effective account management for our global customers.

We also continued to reduce overheads such as accommodation, using buildings more efficiently and introducing flexible working practices. In the 2006 financial year, we vacated around 135 buildings and installed an additional 250 flexible workstations which can be shared by multiple users.

A number of other programmes are underway, including structural changes in our network management and planning divisions. Some of these are related to our 21CN initiative and will, we believe, help achieve the significant reduction in operational and capital expenditure that we expect from this programme in the next few years.

## **TRANSFORM OUR NETWORKS, SYSTEMS AND SERVICES FOR THE TWENTY-FIRST CENTURY**

### **Our UK network today**

BT has the most comprehensive communications network in the UK, with around 5,600 exchanges, 680 local and 103 trunk processor units, more than 121 million kilometres of copper wire and more than eight million kilometres of optical fibre, and the most extensive IP backbone network in the UK. The network services we provide include frame relay, ATM (asynchronous transfer mode) and IPVPN.

### **Our global reach today**

We have one of the broadest IP-enabled networks in Europe and our network-based services extend to and across North and South America and the Asia Pacific region.

As at 31 March 2006, our flagship MPLS network service provided coverage and support to over 90 countries from more than 1,200 points of presence. Our MPLS revenue grew by 34% during the 2006 financial year, exceeding £400 million.

Global customer service is provided via service and network management centres around the world, 24 hours a day, seven days a week.

### **Twenty-first century network**

We believe that our 21CN programme is the most ambitious business transformation programme in the global telecommunications industry today and one of the largest ever investments by a private company in the UK's infrastructure.

An end-to-end, next-generation IP network, 21CN is designed to consolidate BT's complex network and systems infrastructure to ensure that the delivery of the next generation of converged services is fast, efficient and highly cost effective. In the 2006 financial year, for example, we developed the first new 21CN services based on re-usable capabilities. Rather than being product-specific, re-usable capabilities form the basis for a range of products and applications, enhancing the customer experience by reducing product development and launch times and proving more cost effective for BT.

In April 2005 we announced the preferred suppliers that will help us build the 21CN. Following one of the largest procurement programmes ever undertaken in the communications industry, formal contractual agreements were reached with all eight – Alcatel, Ciena, Cisco, Ericsson, Fujitsu, Huawei, Lucent and Siemens. The first equipment orders have been placed under these contracts.

Following extensive technical trials in the 2006 financial year – including successfully carrying more than six million voice calls over a trial IP network – we developed a comprehensive national migration and roll-out plan, which is currently subject to industry consultation.

As the first stage of the mass migration of customers to 21CN, we will be rolling out the new network to business and residential customers in Cardiff and the surrounding area, including many served by other telephone and internet service providers and mobile operators. We anticipate that the full, national roll out of 21CN will be substantially complete by 2010.

We are committed to building open, transparent and inclusive relationships with the rest of the industry and launched Consult21 in the 2005 financial year in order to promote a shared understanding of the 21CN vision and the progress we are making towards it. Since then, many of our wholesale customers have contributed to what is

now the largest voluntary industry consultation programme of its kind anywhere in the communications world today.

#### **What 21CN will mean for customers**

21CN will mean the ability to customise, personalise and change in real time services based on the convergence of voice, mobility, video, data and content. Ultimately, it is expected to support the introduction of many more new services than are currently available, offering greater customer choice.

Corporate and public sector customers will be able to work more efficiently with suppliers, structure their internal processes, enhance customer service and drive down costs by deploying integrated networked IT solutions across their entire supply chains.

#### **CREATE LONG-TERM PARTNERSHIPS WITH OUR CUSTOMERS**

We believe that our relationships with our customers are key in a market going through major transformation. Understanding customers' needs and responding to them flexibly, comprehensively and with insight is critical in helping to differentiate us from our competitors. That is why we aim to put the customer at the heart of everything we do – strengthening that relationship and building trust and delivering what we promise. This will encourage customers to move from short-term contracts based on individual transactions, to longer-term arrangements under which they sign up for packages of services.

Keeping a relentless focus on improving customer satisfaction is also key to these long-term partnerships.

In the 2006 financial year, our aim was to increase the number of customers who are "very satisfied" and "extremely satisfied" with the service they receive from BT by 5%, while ensuring that we maintained the reductions achieved in previous years in levels of customer dissatisfaction.

For the 2006 financial year, the average score for customers "very satisfied" and "extremely satisfied" was 3% higher than in the 2005 financial year, although the customer dissatisfaction score was slightly worse than in the 2005 financial year.

The 2006 financial year was particularly challenging for the delivery of customer satisfaction because many of our new wave products and services require complex customer interactions. During the year, we recruited a further 900 engineers to ensure that we could meet customer demand.

We recognise that the quality of service we offer customers is key to driving up customer satisfaction levels and much of our training and development activity remains focused on removing any barriers to the delivery of excellent customer service and a



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high-quality customer experience. Our core people engagement initiative, the "my customer" programme, aims to enable all BT people to deliver great customer service through teamwork. In the 2006 financial year, "my customer" included:

- a "back to the floor" event for 1,100 senior managers
- more than 4,500 BT people participating in customer satisfaction improvement programmes
- the introduction of a "customer connected" programme for BT people who do not interact with customers directly but who, nevertheless, play a critical role in delivering customer satisfaction.

**ACQUISITIONS AND DISPOSALS**