Group performance

In this section we explain how we've done this year against our key performance indicators. We set out the group's financial results for the year; what we've focused on, and what we've achieved.

Progress against our KPIs

While we've again delivered strong financial results this year, our customer service was not good enough.

Our financial performance

Our financial strength has given us the ability to make investments that are delivering for the business.

Bold decisions

Our acquisition of EE is already having a big effect on how we do business and we're pleased with its performance since joining the group.

Alternative performance measures

We judge and explain our performance using certain alternative performance measures. These include trends in underlying revenue and operating costs excluding transit, adjusted and reported EBITDA, adjusted earnings per share, normalised and reported fee cash flow and net debt. 'Adjusted' means that a measure is before specific items. We describe on page 240 what we mean by specific items and we've disclosed specific items for this year and the last two years in note 8 to the consolidated financial statements.

These alternative performance measures are not defined under IFRS so they're termed 'non-GAAP' measures. But they're consistent with how management measures the group's financial performance. We've defined each of these measures on pages 240 to 242, where we've provided more detail, including reconciliations to the nearest measure under IFRS.

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You can find a review of the performance of our lines of business this year, from **page 57**

Group Finance Director's introduction

"The investments we've been making have driven our strong financial performance this year. EE has made a significant contribution to our results in the two months since we acquired the business at the end of January."

I'm pleased to say our key measure of the group's revenue trend, underlying revenue excluding transit (which by definition excludes EE), was up 2%. That's our best performance in more than seven years, and at the top end of our outlook range of 1% to 2% growth. And we've again delivered EBITDA and free cash flow growth, in line with the outlook we set at the start of the year.

BT Consumer revenue was up 7% reflecting 17% growth in broadband and TV revenue, benefiting from our investments in BT Sport and BT Mobile. Openreach revenue was up 2% with fibre broadband growth more than offsetting regulatory headwinds. And we met the milestone of bringing fibre broadband to 25m premises; this means, including other service providers, 90% of the UK can now access the speeds that it offers.

We've continued to make further cost savings, helped by major end-to-end programmes across our lines of business. We're confident there's plenty more we can do and we see the opportunity to take well over £1bn out of our gross costs over the next two years.

We grew adjusted EBITDA to £6.6bn, including £0.3bn from EE. Adjusted profit before tax was £3.5bn, up 9%, and adjusted EPS of 33.2p was up 5%.

Normalised free cash flow was £3.1bn, up 9%, helped by EE. Our ability to generate strong cash flow from the business has supported our growth and investment ambitions.

And finally, we're already making good progress on integrating EE. We now see the opportunity to deliver synergies of around £400m a year from the EE integration, 10% more than before and at a lower cost than we originally expected. We're refreshing our organisation to make sure we can deliver the best possible outcome for our customers and have made these changes with effect from 1 April 2016 (see page 58).

Tony Chanmugam
Group Finance Director
4 May 2016

Performance against our outlook

At the start of the year we published our outlook, which was for BT excluding EE. We refined this at our third quarter results to reflect our expectations for revenue growth. We've met our commitments.

These measures also impact directors' remuneration. So we have assessed our financial performance for the year against the targets that we set, excluding the impact of the EE transaction and its subsequent contribution to our group results.

2015/16 performance against our outlook, excluding the impact of EE

	Outlook	Result
Change in underlying revenue excluding transit[a]	Up 1%–2%	Up 2%
Adjusted EBITDA[b]	Modest growth	Up 1%
Normalised free cash flow[b]	c£2.8bn	£2.84bn
Dividend per share	Up 10%–15%	Up 13%
Share buyback	c£300m	£315m

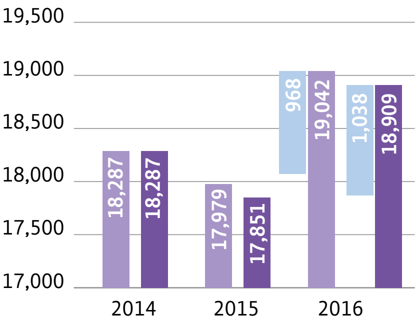
Outlook for 2016/17 and 2017/18

	2016/17	2017/18
Change in underlying revenue excluding transit[a]	Growth	Growth
Adjusted EBITDA[b]	c£7.9bn	Growth
Normalised free cash flow[b]	£3.1bn–£3.2bn	>£3.6bn
Dividend per share	≥10% growth	≥10% growth
Share buyback	c£200m	

[a] Defined on page 240.
[b] Defined on page 241.

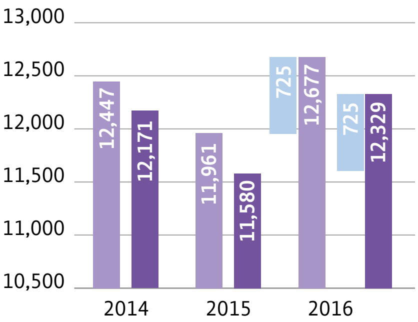
Financial highlights

Revenue
Year ended 31 March



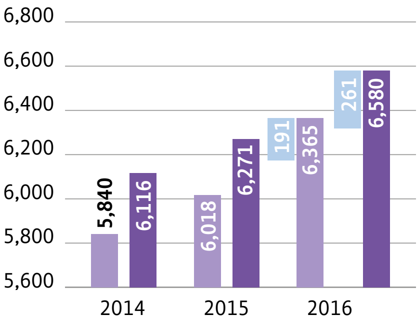
	2015	2016
reported	2% ∨	6% ∧
adjusted[a]	2% ∨	6% ∧
EE contribution		

Operating costs[b]
Year ended 31 March



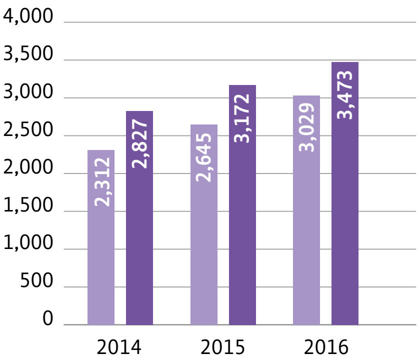
	2015	2016
reported	4% ∨	6% ∧
adjusted[a]	5% ∨	6% ∧
EE contribution		

EBITDA
Year ended 31 March



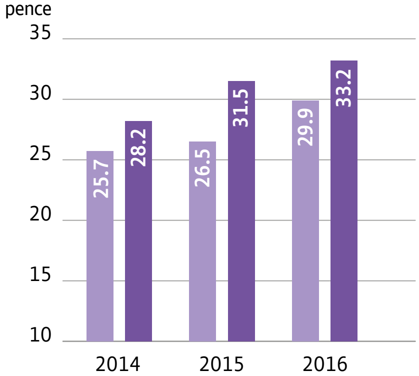
	2015	2016
reported	3% ∧	6% ∧
adjusted[a]	3% ∧	5% ∧
EE contribution		

Profit before taxation
Year ended 31 March



	2015	2016
reported	14% ∧	15% ∧
adjusted[a]	12% ∧	9% ∧

Earnings per share
Year ended 31 March

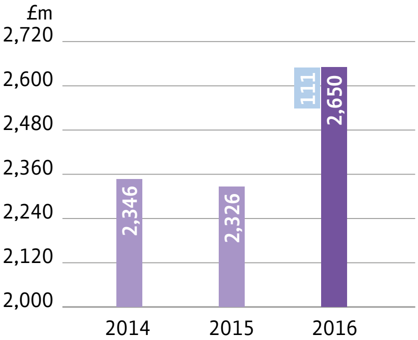


	2015	2016
reported	3% ∧	13% ∧
adjusted[a]	12% ∧	5% ∧

Proposed full year dividend
Year ended 31 March

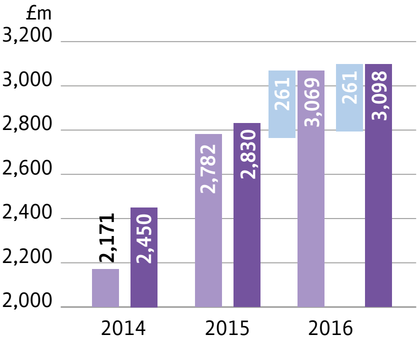
2016	14.0p
2015	12.4p
Change	13% ∧

Capital expenditure
Year ended 31 March



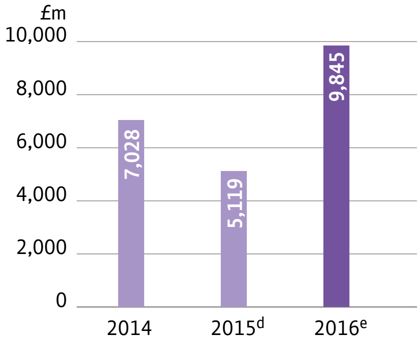
Impact from EE

Free cash flow
Year ended 31 March



	2015	2016
reported	28% ∧	10% ∧
normalised[c]	16% ∧	9% ∧
Impact from EE		

Net debt
At 31 March



[a] Items presented as adjusted are stated before specific items. See page 240 for further details.
[b] Before depreciation and amortisation.
[c] See definition on page 241 and summarised cash flow statement on page 101.
[d] Includes the impact of the £1.0bn equity placing we made in February 2015.
[e] Reflects the impact from EE. See page 102.

Group performance

Progress against our KPIs

We've performed well against our three financial KPIs. But our customer service performance was down 3.0%, and we want to do much better.

We use four key performance indicators (KPIs) to measure how we are doing against our strategy. Our financial KPIs measure: the trend in underlying revenue excluding transit; our adjusted earnings per share; and normalised free cash flow. Customer service improvement is also a key non-financial KPI for us.

Our KPIs are chosen because they reflect the key elements of our strategy. We use these to measure the variable elements of our senior executives' pay each year, as we've explained in the **Report on Directors' Remuneration** (see page 128).

We've outlined our performance against each KPI here, together with an explanation in italics of how we define each measure. You can find reconciliations of the financial measures to the closest IFRS measure in the **Additional information** section on pages 240 to 242.

Profit forecast considered within the Listing Prospectus

On 26 January 2016 we published a Listing Prospectus in relation to our acquisition of EE. In this, we provided information relating to our 2015/16 profit forecast. This information confirmed our outlook as stated on 29 October 2015, when we published our unaudited results for the six months ended 30 September 2015, in which we stated that for 2015/16 we expected modest growth in adjusted EBITDA relative to the £6,271m we achieved in 2014/15.

This profit forecast did not take into account any impact of the acquisition of EE.

Our adjusted EBITDA in 2015/16 for BT, excluding EE, was £6,319m, up £48m, consistent with the statement we made in the Listing Prospectus.

Outlook for 2016/17 and 2017/18

We expect growth in underlying revenue excluding transit in 2016/17. Adjusted EBITDA is expected to be around £7.9bn, after a net investment of around £100m in launching handset offerings to BT Mobile customers. Normalised free cash flow is expected to be £3.1–£3.2bn. This is after up to £300m of upfront capital expenditure in the Emergency Services Network (ESN) contract, as well as around £100m of EE integration capital expenditure.

For 2017/18, we expect growth in underlying revenue excluding transit and adjusted EBITDA. We also expect to incur capital expenditure of around £100m on the ESN contract and around £100m again on integration. We are confident in our cash flow generation, as a result of the investments we are currently making, the ability of our business to respond to a dynamic industry environment, and ongoing cost transformation and synergy realisation opportunities. As such, we expect to generate normalised free cash flow of more than £3.6bn in 2017/18.

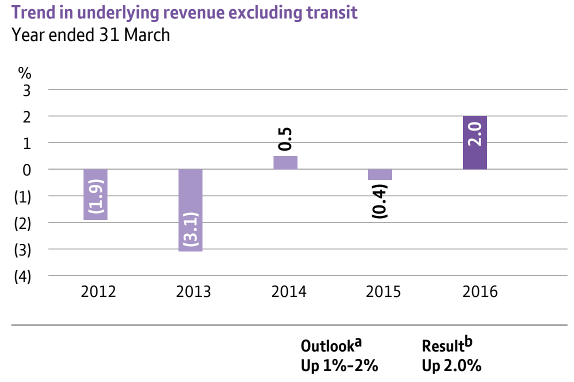
We expect to grow our dividend per share by at least 10% in both 2016/17 and 2017/18. We expect to buy back around £200m of shares in 2016/17 to help counteract the dilutive effect of all-employee share option plans maturing in the year. This is below the £315m buyback we completed in 2015/16 reflecting the lower number of shares that are expected to be required for our share option plans.

Trend in underlying revenue excluding transit

Our key measure of the group's revenue trend, underlying revenue excluding transit, was up 2.0%, at the top end of our outlook range of 1% to 2%. And it's our best growth in more than seven years.

2016 2.0%

2015 (0.4)%



Our positive revenue performance, which excludes the impact of EE, was driven by BT Consumer where revenue was up 7% reflecting 17% growth in broadband and TV revenue, helped by our investments in BT Sport Europe and BT Mobile. We explain more about the performance of our lines of business from page 57.

Underlying revenue reflects the overall performance of the group that will contribute to sustainable profitable revenue growth. We exclude the impact of acquisitions and disposals, foreign exchange movements and specific items from this measure. We focus on the trend in underlying revenue excluding transit because transit traffic is low margin and affected by reductions in mobile termination rates, which are outside our control.

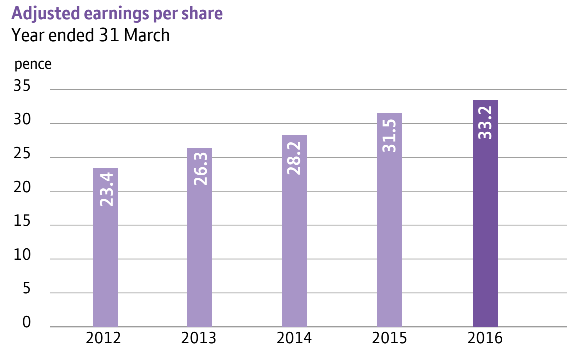
Adjusted earnings per share

Adjusted earnings per share increased 5% to 33.2p.

2016 33.2p

2015 31.5p

Change 5%



Adjusted profit after tax grew 13% this year reflecting the impact of the acquisition of EE, our cost transformation activities and a lower interest expense together with a reduction in the effective tax rate from 19.9% to 17.5%.

Adjusted earnings per share grew 5% to 33.2p. The weighted average number of shares in the market increased 7% reflecting the additional shares we have issued as part of the EE acquisition.

Adjusted earnings per share is the adjusted profit after tax attributable to our shareholders, divided by the weighted average number of shares in issue. Being an 'adjusted' measure, it excludes the impact of specific items and as such it is a consistent way to measure the performance of our business over time.

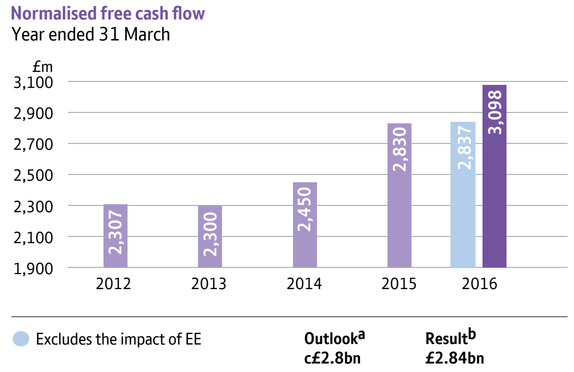
Normalised free cash flow

We generated normalised free cash flow of £3,098m. This was up £268m compared with last year. Normalised free cash flow excluding the impact of EE was £2,837m, in line with our outlook of around £2.8bn.

2016 £3,098m

2015 £2,830m

Change 9%



The increase of £268m or 9% in our normalised free cash flow primarily reflects the £261m generated by EE in the period since acquisition. Excluding EE, normalised free cash flow was £2,837m, in line with our outlook.

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

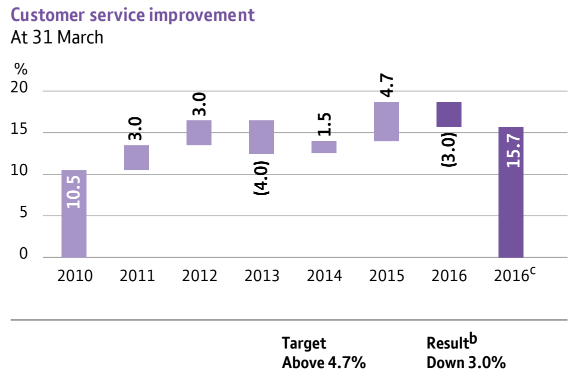
Normalised free cash flow excludes significant non-operational payments and receipts that distort the trend in our cash flow. So in calculating normalised free cash flow we take out the impact of specific items, purchases of telecommunications licences, pension deficit payments and the tax benefit from pension deficit payments.

Customer service

Our customer service measure 'Right First Time' was down 3.0% compared with up 4.7% last year.

2016 3.0%

2015 4.7%



Improving the service we deliver is key. Our 'Right First Time' measure was down 3.0% (2014/15: up 4.7%). This was disappointing. We're making good steps in some areas. Openreach achieved all 60 of the minimum service levels set by Ofcom. But despite these improvements, we're not where we want to be, across all of our lines of business. You can read more about our customer service on page 22.

'Right First Time' is our key measure of customer service. This tracks how often we keep the promises we make to our customers. This could be about keeping to appointment times, fixing faults within an agreed period or answering calls promptly and dealing with queries or orders efficiently. As well as improving service and the customer experience, keeping our promises should mean that there is less work to do in correcting our mistakes, and so reduces our costs.

[a] Financial outlook which was given at the start of the year and reaffirmed in February.
[b] Excludes impact of EE.
[c] Cumulative improvement since 1 April 2009.

Our acquisition of EE

EE being a part of the BT family is already having a big effect on what we can offer our customers (for more about EE's operations, see page 76).

EE contributed revenue and EBITDA of £1,038m and £261m respectively to the group's results in 2015/16.

And our balance sheet reflects the assets we've acquired. Consideration of £11.0bn paid on acquisition was made up of £3.5bn cash and 1,595m shares valued at £7.5bn. After a provisional fair value exercise, we've allocated this between goodwill of £6.4bn and net assets with a fair value of £4.6bn. You can find out more about the goodwill and purchase price allocation later in the balance sheet section, and in note 14 to the consolidated financial statements.

We're making good progress on integrating EE into the group and have identified further synergy opportunities. We now expect operating cost and capital expenditure savings to reach around £400m in the fourth full year (previously £360m) of which we expect to realise around £100m in 2016/17. We also expect the cost of integrating EE to be lower than previously planned, at around £550m (previously around £600m). The capital expenditure part of this, including around £100m in each of 2016/17 and 2017/18, will not be treated as a specific item and will therefore be reflected in our normalised free cash flow in these years.

The financial measures we've used throughout the next sections include the impact of EE, unless we've specifically indicated otherwise. But our 'underlying' measures by definition exclude EE; as we've set out on page 240, we exclude the impact of acquisitions, disposals and foreign exchange from these.

Income statement

Summarised income statement

Year ended 31 March Before specific items	2016 £m	2015 £m	2014 £m
Revenue	**18,909**	**17,851**	**18,287**
Operating costs[a]	(12,329)	(11,580)	(12,171)
EBITDA	**6,580**	**6,271**	**6,116**
Depreciation and amortisation	(2,630)	(2,538)	(2,695)
Operating profit	**3,950**	**3,733**	**3,421**
Net finance expense	(483)	(560)	(591)
Associates and joint ventures	6	(1)	(3)
Profit before taxation	**3,473**	**3,172**	**2,827**
Taxation	(607)	(631)	(613)
Profit for the year	**2,866**	**2,541**	**2,214**

[a] Excluding depreciation and amortisation.

Revenue

Our key revenue measure of underlying revenue excluding transit (which excludes EE), was up 2.0%, at the top end of our outlook range of 1% to 2%. And it's our best growth in more than seven years.

Reported revenue, which includes specific items, was up 6%. Adjusted revenue was also up 6% at £18,909m. EE contributed £1,038m to adjusted revenue in the two months since we acquired it.

We had a £127m negative impact from foreign exchange movements, a £109m reduction in transit revenue and a £6m negative impact from disposals. Excluding these, underlying revenue excluding transit was up 2.0% (2014/15: down 0.4%).

BT Consumer revenue was up 7% with a 17% increase in broadband and TV revenue and a 2% increase in calls and lines. And the market-wide demand for fibre broadband led to a 2% increase in Openreach revenue. This was despite regulatory price impacts of around £130m.

Underlying revenue excluding transit was up 1% in BT Wholesale and down 2% in BT Global Services, whilst BT Business remained broadly flat.

You can see a full breakdown of reported revenue by major product and service category in note 4 to the consolidated financial statements.

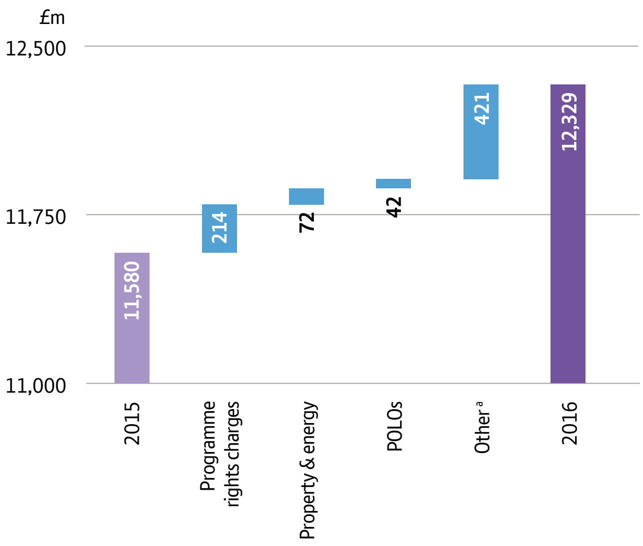
Operating costs

Operating costs before depreciation and amortisation increased 6%, mainly because of EE.

Our total operating costs before depreciation and amortisation were £12,329m, up £749m (2014/15: down £591m). Of this £725m relates to EE with a large proportion within Other costs. For the group Other costs were up £406m or 12%, primarily reflecting EE's subscriber acquisition and retention costs, offset by favourable foreign exchange movements.

Underlying operating costs excluding transit were up 2%. This year we no longer benefited from the sale of redundant copper and our costs were impacted by higher leaver charges (as last year most were included within specific items), a higher pensions operating charge and our investment in BT Sport Europe. Without these effects, underlying operating costs excluding transit would have been down 2%.

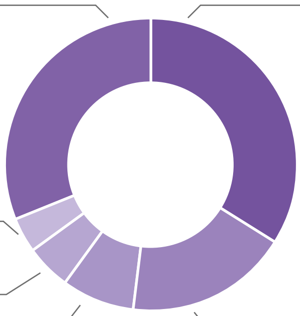
Operating costs before depreciation, amortisation and specific items
Year ended 31 March



[a] Includes all other movements in costs.

Programme rights charges increased £214m to £544m, primarily reflecting our investment in BT Sport Europe. Property and energy costs were up 7%, payments to telecommunications operators (POLOs) were up 2% and network, operating and IT costs were up 1%, with these again being impacted by EE. Net labour costs were flat despite leaver costs of £109m (2014/15: £8m), the additional EE employees joining the group and a £27m increase in the pensions operating charge.

2015/16 operating costs[a]



[a] Excluding depreciation, amortisation and specific items.

You can see a detailed breakdown of our operating costs in note 5 to the consolidated financial statements.

EBITDA

Adjusted EBITDA, which is before specific items, was £6,580m. Adjusted EBITDA for the group excluding EE's contribution of £261m was £6,319m, up 1% and in line with our outlook for the year of modest growth.

Adjusted EBITDA of £6,580m was up 5%. This reflects revenue growth, the results of EE since 29 January and our cost transformation activities and is despite the headwinds we mentioned above (see operating costs on page 98).

Adjusted EBITDA was up in Openreach, BT Business and BT Consumer. BT Global Services adjusted EBITDA was flat, but was up 1% excluding foreign exchange movements. Adjusted EBITDA was down 3% in BT Wholesale reflecting the higher ladder pricing revenues recognised last year as well as continuing migration to lower-margin IP services.

Specific items

As we've explained on page 93, in this performance review we primarily explain our results before specific items. That's because this is how we measure the sustainable performance of our business.

The table below outlines items we've treated as specific items:

Year ended 31 March	2016 £m	2015 £m	2014 £m
Specific revenue			
Retrospective regulatory matters	(203)	(128)	–
Fair value adjustment to deferred revenue on acquisition of EE	70	–	–
	(133)	**(128)**	**–**
Specific operating costs			
Retrospective regulatory matters	203	75	–
EE acquisition-related costs	99	19	–
Integration costs	17	–	–
Property rationalisation costs	29	45	–
Restructuring charges	–	315	276
Profit on disposal of property	–	(67)	–
Profit on disposal of businesses	–	(6)	–
Specific operating costs	**348**	**381**	**276**
EBITDA impact	**215**	**253**	**276**
Specific net finance expense	**229**	**299**	**235**
(Profit) loss on disposal of interest in associates and joint ventures	**–**	**(25)**	**4**
Tax credit	**(166)**	**(121)**	**(319)**
Net specific items charge after tax	**278**	**406**	**196**

This year, specific items resulted in a net charge after tax of £278m (2014/15: £406m). The impact on EBITDA was £215m (2014/15: £253).

We recognised £203m of both transit revenue and costs with no EBITDA impact, being the effect of ladder pricing agreements with the UK mobile operators relating to prior years following a Supreme Court judgment in 2014. Last year, we recognised £128m of revenue and EBITDA in relation to this.

We recognised a fair value adjustment as part of the acquisition of EE which reduced the amount of deferred income by £70m in relation to its mobile subscriber base. This non-cash item has been charged against revenue in February and March, being the period in which the related services were delivered.

Specific items charged to operating costs include £99m of transaction costs we incurred to buy EE (2014/15: £19m). These were primarily adviser fees and stamp duty. We incurred a further £8m (2014/15: £7m) in financing costs. An additional £3m was directly related to the shares we issued to EE's shareholders in January 2016 as part of the purchase consideration, so we have recognised this amount in equity. We've incurred £17m of costs this year in relation to the integration. In addition to this, £5m of integration activity has been included in capital expenditure.

We recognised a £29m charge relating to the rationalisation of the group's property portfolio.

In addition to the above, we also treated a number of other items as specific, such as the net interest expense on pensions of £221m (2014/15: £292m). The decrease from 2014/15 mainly reflects a fall in the IAS 19 discount rate between 31 March 2014 and 31 March 2015.

We also recognised a tax credit of £96m for the re-measurement of deferred tax balances due to the upcoming changes in the UK corporation tax rate from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020 (the UK Finance Bill, not yet enacted, is expected to reduce this to 17%). There was no credit last year as all deferred tax balances had already been remeasured at 20%.

The tax credit on specific items (excluding the re-measurement of deferred tax) was £70m (2014/15: £121m).

You can see details of all revenue and costs that we have treated as specific items in the income statement in the last three years in note 8 to the consolidated financial statements.

Profit before tax

Adjusted profit before tax was up 9% at £3,473m.

The increase in adjusted profit before tax reflects our EBITDA performance, and in particular the contribution from EE.

Reported profit before tax (which includes specific items) was up 15% to £3,029m.

We discuss depreciation, net finance expense and tax in later sections of this performance review.

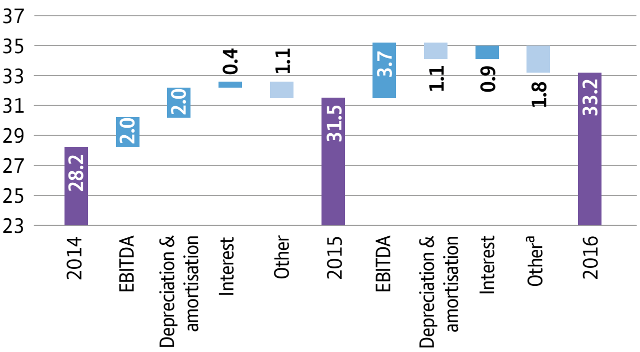
Earnings per share

Adjusted earnings per share increased 5% to 33.2p.

Adjusted earnings per share is one of our key performance indicators (see pages 96 and 97) and has increased 18% over the last two years. The graph below shows the key drivers of this increase.

Reported earnings per share, which includes specific items, was 29.9p, up 13%.

Adjusted earnings per share
Year ended 31 March



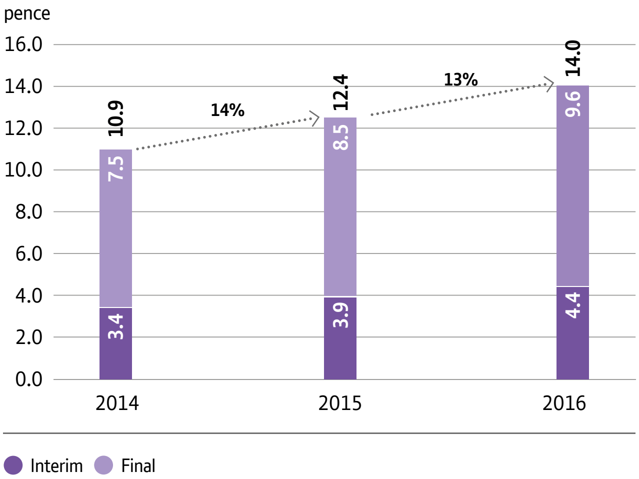
[a] Other primarily reflects the impact of the change in the weighted average number of shares.

Dividends

The Board is proposing a final dividend to shareholders of 9.6p, up 13%. This brings the full year dividend to 14.0p, also up 13%, and compares with an increase in the 2014/15 full year dividend of 14%.

This year's dividend is in the middle of our outlook range. It will be paid, subject to shareholder approval, on 5 September 2016 to shareholders on the register on 12 August 2016.

Dividends per share
Year ended 31 March



The Board has reviewed the group's dividend policy and continues to believe that a policy of paying progressive dividends is the most appropriate. The Board believes this best aligns with the group's financial objectives of growing sustainable profitable revenue growth and transforming the cost base in order to drive long-term growth in cash flows. In reaching this decision, the Board took into account forecasts for future debt reduction as well as the level of dividend cover expected over the medium-term.

We've set out our dividend expectations for 2016/17 and 2017/18 in our Outlook on page 96.

Cash flow

We generated normalised free cash flow of £3,098m, up £268m or 9%. Excluding EE, this was £2,837m, in line with our outlook of c£2.8bn for the year.

Free cash flow
The increase in normalised free cash flow is mainly due to the addition of EE which contributed £261m.

This year we paid £482m for our existing FA Premier League, UEFA Champions League and UEFA Europa League broadcast rights.

The net cash cost of specific items was £232m (2014/15: £154m). This included: EE acquisition-related costs of £114m (2014/15: £nil); restructuring costs of £85m (2014/15: £267m); and ladder pricing receipts of £41m (2014/15: £88m).

Summarised cash flow statement

Year ended 31 March Before specific items	2016 £m	2015 £m	2014 £m
EBITDA	6,580	6,271	6,116
Capital expenditure[a]	(2,459)	(2,411)	(2,346)
Net interest	(541)	(573)	(608)
Taxation[b]	(459)	(415)	(424)
Working capital movements	(105)	(220)	(380)
Other non-cash and non-current liabilities movements	82	178	92
Normalised free cash flow	**3,098**	**2,830**	**2,450**
Cash tax benefit of pension deficit payments	203	106	77
Specific items	(232)	(154)	(356)
Reported free cash flow	**3,069**	**2,782**	**2,171**
Pension deficit payments	(880)	(876)	(325)
Dividends	(1,075)	(924)	(778)
Disposals and acquisitions	(3,379)	10	(22)
Share buyback programme	(315)	(320)	(302)
Proceeds from issue of own shares	90	1,201	75
(Increase) reduction in net debt from cash flows	(2,490)	1,873	819
Net debt at 1 April	(5,119)	(7,028)	(7,797)
(Increase) reduction in net debt from cash flows	(2,490)	1,873	819
Non-cash movements	(2,236)	36	(50)
Net debt at 31 March	**(9,845)**	**(5,119)**	**(7,028)**

[a] Net of government grants.
[b] Excluding cash tax benefit of pension deficit payments.

Reported free cash flow, which includes specific item outflows of £232m (2014/15: £154m) and a £203m (2014/15: £106m) tax benefit from pension deficit payments, was £3,069m (2014/15: £2,782m).

We made pension deficit payments of £880m (2014/15: £876m) and paid dividends to our shareholders of £1,075m (2014/15: £924m).

Our acquisition of EE resulted in a net cash outflow of £3,371m which comprised the purchase consideration of £3,464m offset by cash acquired of £93m.

We spent £315m (2014/15: £320m) on our share buyback programme to help counteract the dilutive effect of our all-employee share option plans maturing. Exercises of share options generated proceeds of £90m (2014/15: £201m). Last year we also raised £1.0bn from an equity placing to support our acquisition of EE. We expect to buy back around £200m of shares in 2016/17 which is below the buyback we completed in 2015/16, reflecting the lower number of shares that are expected to be required for our share option plans.

Non-cash movements within net debt primarily reflect £2,107m of net debt acquired with EE.

You can see a reconciliation to normalised free cash flow from the net cash inflow from operating activities, the most directly comparable IFRS measure, on page 242.

Net debt

Net debt increased by £4,726m. This included the £3,464m cash consideration as part of the EE acquisition and EE net debt of £2,107m. This was partly offset by strong cash generation from business operations.

Overall our net debt has increased to £9,845m.

We funded the cash element of the consideration for EE by drawing down £3.2bn of our £3.6bn acquisition facility on 29 January 2016 as well as using £0.3bn of existing cash. We repaid the majority of the drawdown through the issue of £3,019m of Euro bonds on 10 March 2016. The effective Sterling interest rates on the five, seven and ten-year Euro bonds were 2.34%, 2.74% and 3.25% respectively. As at 31 March 2016, £181m of the acquisition facility remains available and is fully drawn. We also took on EE net debt of £2,107m.

Excluding the acquisition-related borrowing and EE's net debt we decreased our net debt by £752m this year. We've achieved this whilst investing for the future, including in our networks, research and development, sports and TV content, supporting our pension fund and funding our share buyback programme. We've also paid progressive dividends to our shareholders.

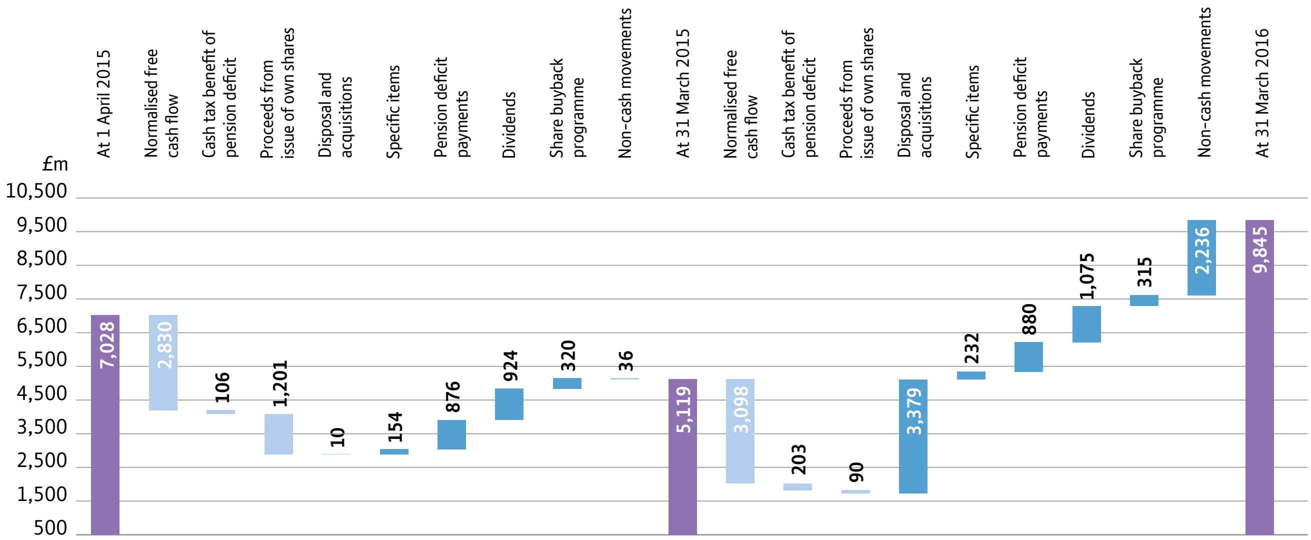
We regularly review the liquidity of the group and our funding strategy takes account of what we'll need in the medium term, like funding the pension deficit and share buyback.

Gross debt, translated at swap rates, at 31 March 2016 was £13,260m. That's made up of term debt of £11,458m, finance leases of £240m, bank loans of £350m, syndicated loan facilities of £619m and other loans of £593m.

In June and July 2015 our $750m and €1,000m bonds matured, resulting in a cash outflow of £1,271m.

In the table below, foreign exchange on net debt includes translation on finance leases, short-term borrowings, investments and cash balances. It also includes the benefit of translating our debt balances to Sterling at swap rates.

Movements in net debt

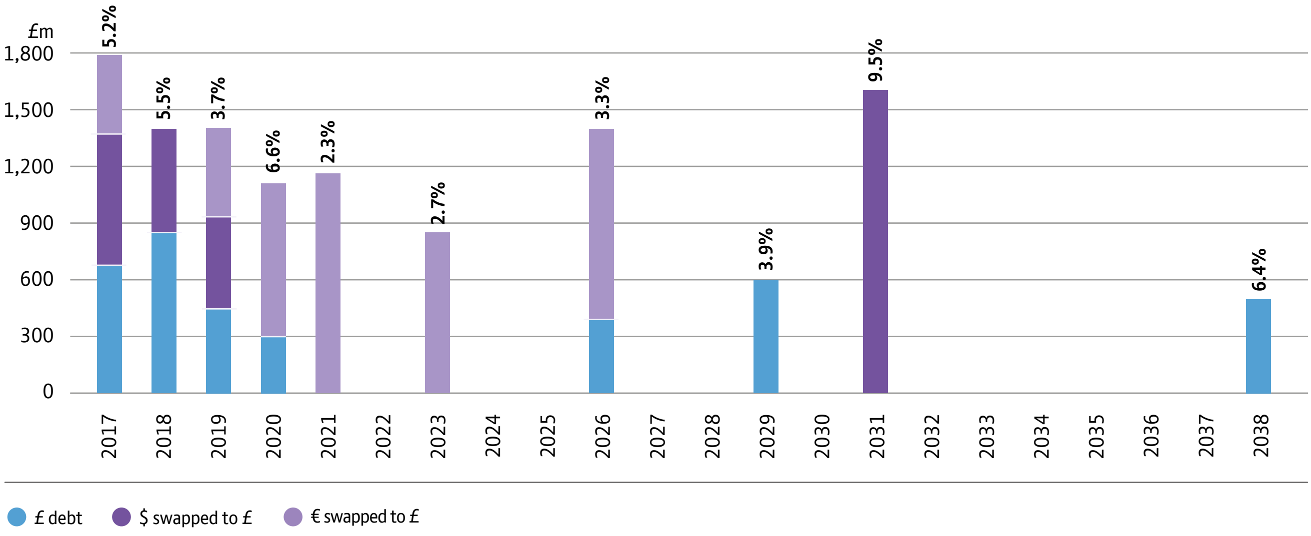


The table below shows the key components of our net debt and of the increase this year of £4,726m.

£m	At 1 April 2015	Term debt issuance/ (maturities)	Other cash flow	Fair value move-ments[d]	Foreign exchange	Transfer to within one year	Other movements[e]	At 31 March 2016
Debt due within one year[a]	1,900	(1,271)	162	–	173	1,787	486	3,237
Debt due after one year	7,868	3,019	4	36	206	(1,787)	1,686	11,032
Impact of cross-currency swaps[b]	(357)	–	–	–	(295)	–	–	(652)
Removal of accrued interest and fair value adjustments[c]	(337)	–	–	(36)	–	–	16	(357)
Gross debt	**9,074**	**1,748**	**166**	**–**	**84**	**–**	**2,188**	**13,260**
Less:								
Cash equivalents	(434)	–	(89)	–	25	–	1	(497)
Current assets investments	(3,523)	–	665	–	(38)	–	(22)	(2,918)
Removal of accrued interest[c]	2	–	–	–	–	–	(2)	–
Net debt	**5,119**	**1,748**	**742**	**–**	**71**	**–**	**2,165**	**9,845**

[a] Including accrued interest and bank overdrafts.
[b] Retranslation of debt balances at swap rates where hedged by cross-currency swaps.
[c] Removal of accrued interest applied to reflect the effective interest rate method and removal of fair value adjustments.
[d] Includes £49m fair value adjustment relating to EE acquired debt less £10m amortisation of de-designated fair value hedge.
[e] Includes £2,223m of gross debt and £23m of investments acquired from EE.

Maturity profile of gross debt (excluding leasing) and average coupon rate
Year ended 31 March



Financing and debt maturity

The main source of our cash inflow in recent years has been the cash generated from our operations.

Together with our committed bank facility of £1.5bn, we expect that this will be our key source of liquidity for the foreseeable future. The facility has been extended by one year and will now mature in September 2020 with the option to extend the term in August 2016. If agreed this will mature in September 2021.

In February 2015 we agreed a £3.6bn facility to part-finance the acquisition of EE. We drew £3.2bn from this facility when the deal was completed on 29 January 2016. We repaid the majority of the drawdown in March 2016 with proceeds from term debt of £3,019m that we raised on the long-term Euro market.

The £1.5bn committed bank facility remains undrawn at 31 March 2016.

Debt due within one year, at hedged rates, or on demand is £3,005m.

Net finance expense

Adjusted net finance expense of £483m decreased by £77m due to our average net debt and weighted average interest rate on net debt being lower than last year.

We've shown below an overview of our average gross debt, investments and cash balances, and net debt and the related weighted average interest rates over the past three years.

The weighted average interest rate on net debt was reduced from 8.1% to 7.5% as the new debt issuances and debt acquired from EE are at lower interest rates than the average rate of the existing debt.

You can see a reconciliation of net finance expense to net interest cash outflow in note 26 to the consolidated financial statements.

Year ended 31 March	**2016** £m	2015 £m	2014 £m
Average gross debt	9,036	9,012	9,336
Weighted average interest rate on gross debt	5.4%	6.0%	6.1%
Average investments and cash balances	2,616	2,446	1,467
Weighted average interest rate on investments	0.4%	0.4%	0.4%
Average net debt	6,422	6,566	7,869
Weighted average interest rate on net debt[a]	7.5%	8.1%	7.2%

[a] Excludes interest relating to unwinding of discount on provisions and derivatives not in a designated hedge relationship.

Taxation

Our effective corporation tax rate before specific items was 17.5% compared with 19.9% in 2014/15. This is lower in both years than the UK corporation tax rate of 20% (2014/15: 21%).

Our tax contribution

We are proud to be a major contributor of taxes to the UK economy.

This year we paid UK corporation tax of £200m (2014/15: £225m).

In both years we have benefited from tax deductions associated with our employee share schemes and pension schemes. We expect to continue to benefit from tax deductions from our pension schemes and also from EE's historic tax losses.

Additionally, we paid non-UK corporate income taxes of £56m (2014/15: £84m), which primarily reflects the fact that most of our business is UK-based.

This year the total taxes we both paid and collected for the UK Government totalled £2.9bn (2014/15: £3.0bn). The Hundred Group Total Tax Contribution Survey for 2015 ranked us as the 7th highest UK contributor. We also contributed £0.4bn (2014/15: £0.4bn) in our largest non-UK jurisdictions.

Our approach to tax

Our aim is to comply with the tax laws and regulations in each of the countries in which we do business.

We seek to have open and co-operative working relationships with tax authorities worldwide.

We manage our tax affairs conservatively and in a manner consistent with the group's wider purpose and strategy. We take the benefit of widely claimed tax incentives and apply OECD principles.

Tax governance

We have a global framework for managing taxes, which is set centrally at a group level and agreed by the Board.

The application of tax rules is not always clear, and discussions with tax authorities can and do take many years to resolve. We actively monitor our potential tax exposures.

Our group tax team supports regional management to meet local tax regulations.

Tax expense

Our total tax expense before specific items was £607m (2014/15: £631m). This is not the same as the total corporation tax we paid in the year and it excludes tax deductions associated with our pension schemes.

Our effective tax rate on profit before tax and specific items is impacted by our accounting for deferred tax on non-UK losses and changes to our estimates of prior year uncertain tax positions. Excluding these, we would expect our effective tax rate to be around the UK corporation tax rate, as the majority of our business occurs in the UK. This is shown in the table below.

Year ended 31 March	**2016** %	2015 %	2014 %
Tax at UK statutory rate	20.0	21.0	23.0
Non-UK results taxed at different rates	0.1	0.8	0.2
Net permanent differences	0.3	–	0.3
	20.4	**21.8**	**23.5**
Changes to prior year estimates	(2.5)	(1.1)	(0.6)
Deferred tax accounting for non-UK losses	(0.4)	(0.8)	(1.2)
Effective tax rate	**17.5**	**19.9**	**21.7**

The reduction in the UK corporation tax rate since 2011/12 has had a major impact on our effective tax rate.

The UK corporation tax rate will fall to 19% from 1 April 2017 and is expected to fall to 17% from 1 April 2020. We expect that this will continue to have a major impact on our effective tax rate and our tax cash payments.

Recognition of deferred tax assets on historic trading losses may also reduce our effective tax rate in the future. In addition, future changes to our estimates of uncertain tax positions may increase or reduce our effective tax rate.

We receive a tax benefit from R&D incentives in the UK and do not expect this to be reduced as a result of the OECD Base Erosion and Profit Shifting project.

Key tax risks

Our key risks relate to the uncertainty of the tax treatment of providing telecommunications services globally. We follow OECD guidelines and have a tax control framework in place to monitor and manage tax.

Additionally, we have extensive and long-standing UK operations that necessarily require the use of estimates. We routinely work with HMRC to validate these estimates.

Tax losses

We have an asset of £325m (2014/15: £44m) relating to tax losses on our balance sheet. This relates mainly to historic UK losses acquired with EE. We expect to be able to use this against future profits of EE.

We have £3.9bn of tax losses arising from trading (2014/15: £3.6bn) that we've not given any value to on our balance sheet. These arose mostly in our non-UK companies in earlier financial years. We might be able to use the non-UK losses to offset tax liabilities in the future, but this will depend on us making profits in countries where we've previously made losses and agreeing the value of the tax losses with the local tax authorities. This is why we judge that these amounts should not be recognised as assets on our balance sheet.

We also have £17.0bn (2014/15: £17.1bn) of capital losses in the UK. We have no expectation of being able to use these losses in the long term.

We've given more details in note 9 to the consolidated financial statements.

Capital expenditure

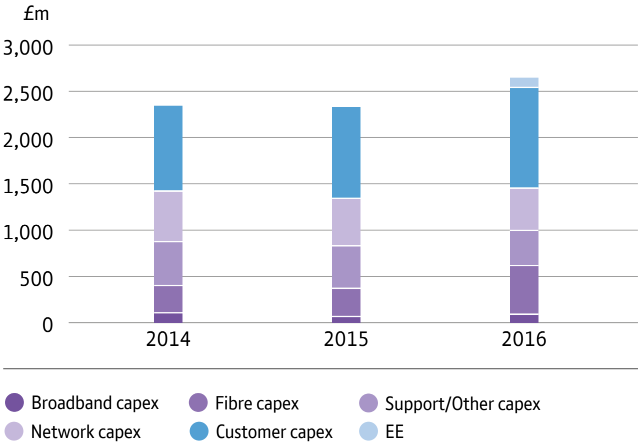
We're making significant investments in our strategic growth areas and to improve our customer service.

The Design Council is responsible for BT delivering an efficient and optimised investment plan, meeting the strategic needs of the group to help drive sustainable profitable revenue growth.

Capital expenditure now includes the investment EE is making to maintain mobile network leadership. We're also investing in the integration of EE into the wider group.

For the year, our capital expenditure net of grant funding was £2,650m (2014/15: £2,326m). We've shown below how we spent this across our major capital programmes. Of the total group capital expenditure EE accounted for £111m and capital expenditure related to the integration of EE was £5m. We expect this to grow to around £100m in both 2016/17 and 2017/18 as our integration of EE gathers pace to drive synergies.

Capital expenditure
Year ended 31 March



In recent years we've prioritised our capital expenditure to underpin our growth strategy, and in particular to expand and enhance our next generation access network, which includes both fibre and Ethernet. Ongoing investments this year to support our strategy include:

- increasing the footprint of our fibre broadband network, including extending the reach of fibre to rural areas under the BDUK programme. We've now passed more than 25m homes and businesses representing around 80% of UK premises;
- continuing to build our TV capabilities, including BT Sport Ultra HD and TV Everywhere, as well as enhancing our content distribution network;
- developing our capabilities and propositions for Mobility and Future Voice to exploit the convergence of fixed and mobile services;
- expansion of our next generation networks, including more capacity on our IP Exchange platform;
- continued development of customer contract-specific infrastructure for our global clients; and
- improving customer experience by developing new systems and replacing elements of our network to reduce faults and speed up repair times.

We recognised net grant funding of £109m (2014/15: £392m), mainly relating to our capital activity on the BDUK programme. The total amount of grant funding recognised is lower than last year as we have deferred £229m of grant income (2014/15: £29m) due to strong levels of take-up. This continued increase in take-up across our fibre network is a result of customers wanting to consume more data at faster speeds. And so we increased our base-case assumption for take-up in BDUK areas from 20% to 33% and under the terms of the BDUK contract, we have a potential obligation to either re-invest or repay grant funding. We're actively working with the local bodies to extend coverage further with this deferred grant funding.

The BDUK programme provides CPs with the platform and network reach to provide additional services for new and existing customers. Going forward, we will continue to invest in our fibre network, expanding the reach. And we have started deployment trials of our new G.fast technology to deliver even faster speeds in the future.

Of our total capital expenditure, £248m (2014/15: £231m) arose outside the UK. Capital expenditure contracted but not yet incurred was £922m at 31 March 2016 (2014/15: £507m).

Depreciation and amortisation

Depreciation and amortisation has increased by 4% to £2,630m (2014/15: £2,538m) due to the inclusion of EE depreciation and amortisation since acquisition. Excluding EE, depreciation and amortisation has reduced by 3% due to lower capital expenditure in previous years as we have become more efficient in delivering our capital investment programmes.

Balance sheet

Our balance sheet this year includes the impact of acquiring EE. It also reflects our continued investment in the network infrastructure assets that are the foundation of our business, as well as the working capital with which we manage our business day by day.

On 29 January 2016 we purchased EE for a total consideration of £10,971m which included cash consideration of £3,464m and shares with a fair value of £7,507m. You can find more about how we have provisionally allocated the total consideration across the acquired assets and liabilities and the resulting goodwill in note 14 to the consolidated financial statements.

Purchase consideration[a]	£m
Cash paid	3,464
Ordinary shares issued	7,507
Total purchase consideration	**10,971**
Net identifiable assets acquired[a]	4,541
Add: goodwill	6,430
Net assets acquired	**10,971**

[a] Provisional fair values at 31 March 2016.

The impact of EE is reflected in the group's consolidated balance sheet at 31 March 2016, as we've explained below.

At 31 March	2016 £m	2015 £m	Movement £m
Property, plant & equipment, software and telecommunications licences	20,570	15,216	5,354
Goodwill & other intangible assets	10,876	1,459	9,417
Other non-current & current assets	2,288	1,754	534
Trade & other receivables	4,296	3,324	972
Investments, cash & cash equivalents	3,415	3,957	(542)
Total assets[a]	**41,445**	**25,710**	**15,735**
Loans & other borrowings	(14,269)	(9,768)	(4,501)
Trade & other payables	(7,289)	(5,276)	(2,013)
Other current & non-current liabilities	(2,043)	(2,244)	201
Provisions	(723)	(564)	(159)
Deferred tax liability	(1,262)	(948)	(314)
Pensions, net of deferred tax	(5,235)	(6,102)	867
Total liabilities	**(30,821)**	**(24,902)**	**(5,919)**
Total equity	**10,624**	**808**	**9,816**

[a] Excluding deferred tax asset relating to BT's defined benefit pension schemes.

Our core fixed and mobile network infrastructure is included within property, plant and equipment, software and telecommunications licences. This is the backbone of the UK telecommunications industry. These assets were held at a net book value of £20.6bn at 31 March 2016.

The net increase of £5,354m in the year is mainly due to EE's assets which we have brought onto our balance sheet at a fair value of £5,209m. This included £2,524m of spectrum licences, £2,270m of network assets and £415m of software. Capital expenditure during the year was £2,650m which was offset by depreciation and amortisation of £2,630m.

Goodwill and other acquisition-related intangible assets increased by £9,417m. The majority of this relates to our acquisition of EE. We recognised intangible assets at fair values of £402m for the EE brand and £2,610m for customer relationships.

The provisional residual goodwill was £6,430m. This is attributable to the revenue synergies expected to be generated from new cross-selling and bundling opportunities across the enlarged customer base as well as EE's ability to generate a new subscriber base in the future to replace subscriber churn. It also includes expected benefits from the existing workforce skills and expertise, and savings on operating costs and capital expenditure as a result of joint efficiencies expected from being part of the enlarged group.

We review the recoverable amounts of goodwill annually, and for EE in particular, we have reviewed the recoverability during the year of acquisition. We've also considered this across our legacy cash generating units which hold goodwill, which are BT Global Services, BT Business and BT Consumer and are satisfied that these support the carrying value of goodwill (see note 14 to the consolidated financial statements).

Other non-current and current assets and liabilities relate primarily to our financial instruments, which we've described in note 27 to the consolidated financial statements. It also includes inventories which have increased by £95m reflecting the addition of handsets inventory in EE.

Trade and other receivables increased by £972m to £4,296m while trade and other payables of £7,289m were £2,013m higher, and both include the impact of EE. Adjusting for the impact of the EE opening balance sheet and the increase in programme rights, working capital was an outflow of £105m in the year.

Investments, cash and cash equivalents, loans and other borrowings are reconciled to net debt of £9,845m in note 25 to the consolidated financial statements. We've discussed net debt on page 102. Net debt reflects the cash element of the consideration paid of £3,464m, as well as the debt acquired with EE of £2,107m.

Provisions increased by £159m to £723m. We have a significant property portfolio which includes both office buildings and former telephone exchanges (see page 36). Property provisions, which mainly comprise onerous lease provisions, amounted to £296m. The acquisition of EE increased these assets and obligations by £98m and £72m respectively. EE's property portfolio includes office buildings as well as retail stores, some of which are undergoing a rationalisation programme. We have also taken on EE's asset retirement obligation relating to leased mobile sites forming part of the network, which amounts to £78m. You can find more information about these provisions in note 19 to the consolidated financial statements.

We've shown deferred tax movements in note 9 to the consolidated financial statements. Pensions, net of deferred tax, fell by £0.9bn to £5.2bn and are discussed below. And the share issue used as part of the consideration for the acquisition of EE is reflected in the improvement in equity of the group at 31 March 2016 compared with the prior year.

Pensions

Overview

We provide a number of retirement plans for our employees:

- The BT Pension Scheme (BTPS), a defined benefit plan in the UK, is the largest of these plans. Although closed to new members, the BTPS still has around 35,000 active members, 197,500 pensioners and 69,000 deferred members.
- The BT Retirement Saving Scheme (BTRSS) is the current arrangement for UK employees who joined BT after 1 April 2001. It has around 29,500 active members.
- EE operates the EE Pension Scheme (EEPS), which has a defined benefit section that is closed to future accrual and a defined contribution section which has around 12,500 active members.
- We also maintain retirement arrangements around the world with a focus on these being appropriate for the local market and culture.

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

The BTPS and EEPS are managed by separate and independent Trustee bodies. Details of the governance of the BTPS, its financial position, the performance of its investments and a summary of member benefits are available in the BTPS Annual Report published by the Trustee in December 2015, on the BTPS Trustee website (www.btpensions.net).

We've given more information on our pension arrangements and on the funding and accounting valuations in note 20 to the consolidated financial statements.

BTPS funding valuation and future funding obligations

The funding of the BTPS is subject to legal agreement between BT and the Trustee of the BTPS and is determined at the conclusion of each triennial valuation. The most recent triennial funding valuation at 30 June 2014 and the associated deficit contribution plan was agreed with the Trustee in January 2015.

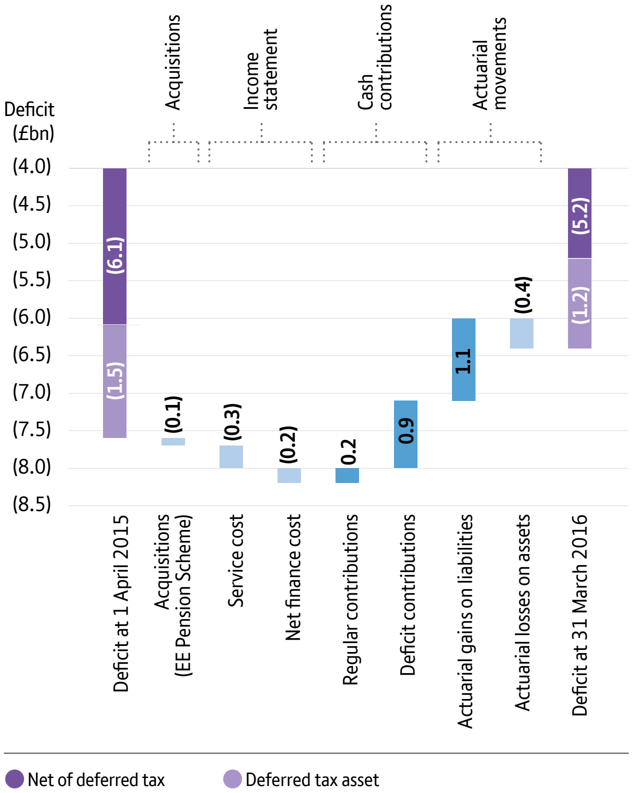
At 30 June 2014, the market value of assets was £40.2bn and the funding deficit was £7.0bn. There are a wide range of assumptions that could be adopted for measuring pension liabilities. Legislation requires that this deficit is based on a prudent view – for example, assuming a lower future investment return than might be expected in practice.

A 16-year deficit contribution plan was agreed reflecting BT's long-term and sustainable cash flow generation. Under this plan, we made deficit payments of £875m in March 2015, £625m in April 2015 and £250m in March 2016. A further payment of £250m will be made in 2016/17, bringing the total for the three years to 31 March 2017 to £2.0bn.

Accounting position under IAS 19

The accounting deficit, net of tax, fell over the year from £6.1bn to £5.2bn. The movements in the deficit for the group's defined benefit plans are shown below.

Movements in IAS 19 deficit



Actuarial losses on plan assets for 2015/16 reflect actual investment returns in the BTPS over the year of around 2% which were below the IAS 19 discount rate of 3.25%. The return reflects strong performance for property, currency gains and broadly flat returns on other asset classes.

Actuarial gains on the liabilities primarily reflect lower than expected inflationary increases in pension payments that will be made in 2016, and other scheme and membership experience following the use of updated membership data.

Contractual obligations and commitments

We've shown in the table below our principal contractual financial obligations and commitments at 31 March 2016. You can see further details on these items in notes 20, 25 and 30 to the consolidated financial statements; note 30 includes details relating to our financial commitments and contingent liabilities.

		Payments due by period			
	Total £m	Less than 1 year £m	Between 1 and 3 years £m	Between 3 and 5 years £m	More than 5 years £m
Loans and other borrowings[a]	**13,850**	3,229[b]	3,092	2,279	5,250
Finance lease obligations	**240**	8	28	25	179
Operating lease obligations	**7,588**	669	1,233	1,045	4,641
Capital commitments	**922**	837	80	2	3
Other commitments	**481**	191	260	30	–
Device purchase commitments	**260**	260	–	–	–
Programme rights commitments	**2,026**	744	1,145	137	–
Pension deficit obligations	**7,903**	271	1,420	1,436	4,776
Total	**33,270**	**6,209**	**7,258**	**4,954**	**14,849**

[a] Excludes fair value adjustments.
[b] Includes £178m of accrued interest due within less than one year.

At 31 March 2016 our cash, cash equivalents and current asset investments were £3,415m. We have an unused committed borrowing facility of £1.5bn. We expect that these resources and our future cash generation will allow us to settle our obligations as they fall due.