BT Group plc

Results for the third quarter to 31 December 2017

2 February 2018

BT Group plc (BT.L) today announced its results for the third quarter to 31 December 2017.

Key developments for the quarter

Strategic:

- Openreach to deliver FTTP to 3m premises by the end of 2020; sets course to reach 10m homes and businesses by mid-2020s with the right conditions
- Continued improvement in customer experience metrics; Group NPS[1] up 5.5 points and Right First Time up 3.6%
- BT TV customers to access premium sport and entertainment content under reciprocal wholesale TV deal with Sky
- Triennial valuation of the BT Pension Scheme is proceeding and constructive discussions continue with the Trustee. We are appealing the court decision against changing the index used for pension increases from RPI for Section C members
- Transformation programme and restructuring initiatives on track

Operational:

- Openreach fibre connections at record high of 600,000, with superfast fibre broadband passing 27.4m UK premises
- BT Consumer revenue generating units per customer increased 3% to 2.02, with ARPU up 5% to £41.3
- Mobile postpaid net additions of 235,000, with low churn of 1.2%; monthly mobile postpaid ARPU down 2% to £26.2
- Average BT Sport viewing increased 23% year on year; best quarterly performance since launch
- Order intake, on a rolling 12-month basis, up 12% to £3,591m for Business and Public Sector, down 38% to £1,257m for Wholesale and Ventures and down 25% to £3,732m for Global Services, reflecting market conditions

Financial:

- Reported revenue down 3% to £5,970m and underlying[2] revenue down 1.5%
- Adjusted[2] EBITDA decreased 2% to £1,826m, reflecting investment in mobile devices and customer experience, along with higher business rates and pension costs, partly offset by cost savings
- Net cash inflow from operating activities of £1,596m up £81m, and normalised free cash flow[2] of £702m up £96m mainly due to working capital phasing
- Full year outlook maintained

Gavin Patterson, Chief Executive, commenting on the results, said

"Our third quarter financial results are broadly in line with our expectations and we remain confident in our outlook for the full year. We continue to improve our customer experience metrics across the Group, with our sixth successive quarter of improved customer perception.

"We continue to work closely with the UK Government, Ofcom and our customers to expand the deployment of fibre and Openreach recently announced plans to accelerate our FTTP deployment to three million premises by the end of 2020.

"We agreed a reciprocal wholesale deal with Sky that will deliver market leading sports and entertainment channels to our BT TV platform by early 2019, reinforcing our strategic goal of being the best provider in the UK of converged network services.

"The triennial valuation of the BT Pension Scheme is proceeding and constructive discussions continue with the BTPS Trustee. We still expect to complete the valuation in the first half of the 2018 calendar year. Our aim remains to deliver fair, flexible and affordable pensions to all of our employees.

"We are delivering against our strategy, capitalising on opportunities and responding to market challenges with a robust set of actions. Looking ahead, we're confident in the steps we are taking to improve the performance of BT for all our stakeholders."

	Third quarter to 31 December 2017		Nine months to 31 December 2017	
	£m	Change[3]	**£m**	Change[3]
Reported measures				
Revenue	**5,970**	(3)%	**17,756**	(1)%
Profit before tax	**660**	25%	**1,744**	(9)%
Basic earnings per share	**5.0p**	32%	**13.2p**	(14)%
Net cash inflow from operating activities	**1,596**	£81m	**4,181**	£(402)m
Adjusted measures				
Change in underlying[2] revenue excluding transit		(1.5)%		(0.9)%
Adjusted[2] EBITDA	**1,826**	(2)%	**5,422**	(3)%
Adjusted[2] profit before tax	**818**	(1)%	**2,398**	(4)%
Adjusted[2] basic earnings per share	**6.4p**	(3)%	**19.1p**	(6)%
Normalised free cash flow[2]	**702**	£96m	**1,947**	£(1)m
Net debt[2]			**8,923**	£(58)m

[1] Group NPS measures Net Promoter Score in our retail businesses and Net Satisfaction in our wholesale businesses

[2] See Glossary on page 2

[3] Measured against the comparative period in the prior year

Group results for the third quarter to 31 December 2017

	Third quarter to 31 December			Nine months to 31 December		
	2017 £m	2016 £m	Change %	**2017 £m**	2016 £m	Change %
Revenue						
- reported	**5,970**	6,128	(3)	**17,756**	17,940	(1)
- adjusted[1]	**5,979**	6,126	(2)	**17,779**	17,954	(1)
- change in underlying[1] revenue excluding transit			(1.5)			(0.9)
EBITDA						
- reported	**1,722**	1,624	6	**4,931**	5,148	(4)
- adjusted[1]	**1,826**	1,870	(2)	**5,422**	5,576	(3)
Operating profit						
- reported	**854**	729	17	**2,306**	2,529	(9)
- adjusted[1]	**958**	975	(2)	**2,797**	2,957	(5)
Profit before tax						
- reported	**660**	526	25	**1,744**	1,914	(9)
- adjusted[1]	**818**	826	(1)	**2,398**	2,501	(4)
Basic earnings per share						
- reported	**5.0 p**	3.8 p	32	**13.2 p**	15.4 p	(14)
- adjusted[1]	**6.4 p**	6.6 p	(3)	**19.1 p**	20.4 p	(6)
Capital expenditure	**878**	852	3	**2,571**	2,432	6
Normalised free cash flow[1]	**702**	606	16	**1,947**	1,948	-
Net debt[1]				**8,923**	8,981	£(58)m

Customer-facing unit results

	Adjusted[1] revenue			Adjusted[1] EBITDA			Normalised free cash flow[1]		
Third quarter to 31 December	**2017 £m**	2016 £m	Change %	**2017 £m**	2016 £m	Change %	**2017 £m**	2016 £m	Change %
BT Consumer	**1,261**	1,262	-	**250**	260	(4)	**114**	162	(30)
EE	**1,357**	1,311	4	**259**	277	(6)	**128**	141	(9)
Business and Public Sector	**1,125**	1,190	(5)	**362**	393	(8)	**317**	302	5
Global Services	**1,266**	1,398	(9)	**143**	40	258	**30**	(115)	126
Wholesale and Ventures	**506**	528	(4)	**189**	211	(10)	**138**	151	(9)
Openreach	**1,286**	1,284	-	**641**	676	(5)	**332**	362	(8)
Other	**1**	2	(50)	**(18)**	13	(238)	**(357)**	(397)	10
Intra-group items	**(823)**	(849)	3	-	-	-	-	-	-
Total	**5,979**	6,126	(2)	**1,826**	1,870	(2)	**702**	606	16

[1] See Glossary
n/m = not meaningful

Glossary of alternative performance measures

Adjusted	Before specific items
Free cash flow	Cash generated from operations (after capital expenditure) excluding pension deficit payments and after interest, tax and non-current asset investments
Net debt	Loans and other borrowings (both current and non-current), less current asset investments and cash and cash equivalents. Currency denominated balances within net debt are translated to Sterling at swapped rates where hedged
Normalised free cash flow	Free cash flow before specific items and the cash tax benefit of pension deficit payments
Specific items	Items that in management's judgement need to be disclosed separately by virtue of their size, nature or incidence. Further information is provided in note 1 on page 23
Underlying	Excludes specific items, foreign exchange movements and the effect of acquisitions and disposals. Further information is provided in note 2 on page 23

Reconciliations to the most directly comparable IFRS measures are in Additional Information on pages 23 to 25. Our commentary focuses on the trading results on an adjusted basis. Unless otherwise stated in the commentary, revenue, operating costs, earnings before interest, tax, depreciation and amortisation (EBITDA), operating profit, profit before tax, net finance expense, earnings per share (EPS) and normalised free cash flow are measured before specific items. Further information is provided in note 1 on page 23.

Overview of the third quarter to 31 December 2017

OVERVIEW

Our third quarter has seen a decline in reported revenue of 3% to £5,970m and underlying[1] revenue excluding transit was down 1.5%. The main contributor to revenue decline was Global Services whose reported revenue declined 9% due to ongoing challenging market conditions and a reduction in IP Exchange volumes in line with our strategy to reduce low margin business.

Adjusted[1] EBITDA of £1,826m was down 2%, reflecting investment in mobile devices and customer experience, along with higher business rates and pension costs, partly offset by cost savings. Reported profit before tax for the third quarter was up 25% at £660m due to higher specific items in the prior year. Net cash inflow from operating activities was up £81m at £1,596m. Normalised free cash flow[1] was £702m, up 16% mainly due to working capital phasing.

STRATEGIC AND OPERATIONAL UPDATE

Deliver great customer experience

Customer experience remains key to driving growth and every part of BT is playing a role. We continue to see a rise in our customers' overall perception of BT with Group NPS[2] increasing by 5.5 points compared to the 2016/17 baseline, our sixth successive quarter of improved customer perception. Our 'Right First Time'[3] performance also increased by 3.6% over the same period. We are investing to improve our network, the quality of our service, and to develop products that offer better value to our customers and to enhance customer experience.

There are now fewer faults in the UK copper network with proactive maintenance driving a 4.1% reduction compared to last year. Openreach on-time repair performance has remained over 80% with improved winter planning allowing us to deal more effectively with some challenging weather conditions.

We are seeing fewer service calls into our BT Consumer, EE, and Business and Public Sector contact centres, with a reduction of 8% compared to the 2016/17 baseline. Our customers continue to increase their use of our digital channels with more than 2m BT Consumer customers having now downloaded the My BT App and the use of online chat up more than a quarter this year. Our recently launched Business and Public Sector specific app had been downloaded by 18,000 business customers by the end of the quarter. Those who do call are rating their experience better than last year and call waiting times are down. For example, EE call centre satisfaction has improved 7% on the 2016/17 baseline and in BT Consumer wait times have reduced by two thirds to just under 60 seconds year on year.

We are encouraged that we have received fewer complaints in the latest set of Ofcom results. Year on year BT Consumer broadband saw 31% fewer complaints, with BT Consumer landlines and BT Consumer TV both seeing a 26% reduction. EE recorded their best ever results. In addition, the Institute of Customer Service ranked BT within the top 20 most improved organisations, across all sectors, for Customer Satisfaction over the last year.

In January, BT Consumer launched ultrafast products at 152Mbps and 314Mbps, with minimum speed guarantees. These are important products as they give us headroom to continue growth of ARPU as roll out continues.

Ethernet services are critical to our customers and we continue to focus on improving our Ethernet delivery performance. On average, it now takes fewer than 40 working days to provide a connection.

We have increased the number of EE stores to over 600 and we continue to improve how network coverage is communicated to consumers. We have introduced the new 'Time on 4G'[4] metric and we are investing to improve this. For example we are planning specific rail coverage upgrades as commuters in particular have lower than average 'Time on 4G'.

Overall, we are moving in the right direction but we know we can do better and we continue to invest in customer experience to achieve this.

[1] See Glossary on page 2
[2] Group NPS measures Net Promoter Score in our retail businesses and Net Satisfaction in our wholesale businesses
[3] Measured against Group-wide 'Right First Time' (RFT) index
[4] 'Time on 4G' is a measure that shows the percentage of time a customer is connected to 4G – rather than 3G or 2G – when they're using the EE mobile network

Invest for growth

Mobile

Strategically, on 15 November we announced that EE in partnership with Huawei had demonstrated 2.8Gbps download speeds across an end-to-end 5G test network in its UK mobile lab. This demonstrates a major step forward of our network function virtualisation (NFV) capabilities with a fully virtualised 5G core network on commercial-off-the-shelf hardware.

Operationally, our investment in 4G continues, with our geographic coverage now reaching 90% of the UK's landmass.

Our mobile base is now 29.8m of which 19.6m are on 4G. We added 235,000 postpaid mobile customers, taking the postpaid customer base to 17.5m. The number of prepaid customers reduced by 299,000, in line with industry trends, taking the base to 6.0m.

Broadband

We have passed 27.4m premises with our superfast fibre broadband network, which contributed to the Government's success in achieving 95% superfast broadband coverage. We achieved 600,000 fibre broadband net connections. This brings the number of homes and businesses connected to around 9.2m.

On 1 February, Openreach announced an acceleration of its Fibre to the Premises (FTTP) build programme to reach three million premises by the end of 2020. The initial phase of the 'Fibre First' programme will start in 2018 and connect up to 40 UK towns, cities and boroughs, including Birmingham, Bristol, Cardiff, Edinburgh, Leeds, Liverpool, London and Manchester. Openreach will also continue to focus on delivering FTTP to rural areas, in partnership with the Government, to make sure some of the hardest to reach communities in the UK get access to future-proofed, FTTP networks.

Openreach has the largest FTTP footprint in the UK and is best placed to deliver the ambition to build a large-scale FTTP network. The pace and extent of this large-scale investment will depend on the speed with which the conditions to enable an acceptable return on the investment are secured. Support is needed from Communication Providers (CPs), central and local Government and Ofcom to achieve low build and connection costs, rapid take-up of and incremental revenue from the platform, and a supportive regulatory and public policy framework. As with any infrastructure investment, if Openreach is unable to secure an acceptable return, it will need to review its ongoing capital commitments to the programme.

Reaching three million premises by 2020 will set Openreach on the right trajectory to achieve its ambition of building a 10 million FTTP footprint by the mid-2020s and, if the conditions are right, to go significantly beyond, bringing the benefits of FTTP to the majority of homes and business across the UK.

Ultrafast speeds, using our FTTP and Gfast network, are now available to 886,000 premises.

The UK broadband market[1] grew by 157,000, of which our retail share was 22%. Our retail fibre broadband additions increased by 208,000 taking our base to 5.5m; 59% of our retail customers are now on fibre.

TV and BT Sport

Average BT Sport viewing figures for the quarter increased 23% year on year, making it our best performing quarter since launch, driven mainly by continued strong performance of the UEFA Champions League as well as exclusive coverage of the Ashes. All of our BT Sport customers are now on a paid sport tariff, illustrating our commitment to monetise our investment in sport.

In the quarter we announced a multi-year deal with Sky to sell Sky's NOW TV service to BT TV customers, through the BT TV platform. Starting from early 2019, our customers will have the ability to access Sky's most popular content including Sky Sports, Sky Cinema and Sky's entertainment channels including Sky Atlantic, and at the same time we have agreed to wholesale our BT Sport channels to Sky, allowing Sky customers to buy BT Sport. This reinforces our strategic goal of being the best provider in the UK of converged network services. The deal is expected to be broadly financially neutral over the initial three year contract period given approximately £50m upfront costs.

Transform our costs

Our transformation programme and restructuring initiatives remain on track across the Group.

[1] DSL and fibre, excluding cable

Key operational metrics

Our key operational metrics are as follows:

Third quarter to 31 December	2017	2016
Mobile		
Total mobile	**29.8m**	30.2m
Net adds		
- Postpaid[1]	**235,000**	276,000
- Prepaid[1]	**(299,000)**	(326,000)
Base		
- Postpaid	**17.5m**	16.7m
- Prepaid	**6.0m**	7.3m
Postpaid churn[1]	**1.2%**	1.1%
Broadband		
Total broadband[2]	**20.6m**	20.3m
Openreach fibre net adds[1]	**600,000**	498,000
Openreach fibre base	**9.2m**	7.2m
Premises passed - superfast fibre broadband network[3]	**27.4m**	26.3m
- of which premises passed - ultrafast capable[4]	**886,000**	345,000
Retail fibre net adds[1]	**208,000**	260,000
Retail fibre base	**5.5m**	4.7m
TV		
Net (losses) adds[1]	**(5,000)**	52,000
Base	**1.8m**	1.7m
Lines		
Openreach	**25.1m**	25.3m
Lines sold through BT lines of business	**12.5m**	13.4m
Revenue generating units per customer		
BT Consumer[1]	**2.02**	1.96
Average revenue per user (ARPU)		
BT Consumer (rolling 12 month basis)	**£41.3**	£39.4
Mobile postpaid[1]	**£26.2**	£26.7
Mobile prepaid[1]	**£4.9**	£4.7
Order intake (rolling 12 month basis)		
Business and Public Sector	**£3,591m**	£3,213m
Global Services	**£3,732m**	£4,952m
Wholesale and Ventures	**£1,257m**	£2,014m

[1] Quarterly performance

[2] DSL and fibre, excluding cable

[3] During the quarter, an update to the Ordnance Survey Addressing product has increased both the reported number of premises passed by our fibre network and total UK premises. Additionally, given our focus on improving broadband speeds in the UK, we have moved from reporting total premises passed by fibre broadband to a metric of premises able to receive superfast fibre broadband speeds of 24 Mbps or more which aligns to the measure used by the Government for its 95% superfast coverage target

[4] In previous quarters, we have reported numbers of ultrafast premises built. We have now moved to reporting numbers of ultrafast premises built and available for sale to CPs. For comparability, the 771k ultrafast premises built by the end of Q2 equates to 647k ultrafast premises available for sale

OTHER DEVELOPMENTS

Regulation

Spectrum auction

On 11 July 2017, Ofcom issued its decisions on competition issues for the forthcoming auction of spectrum in the 2.3GHz and 3.4GHz bands. Under Ofcom's auction rules, we are unable to bid for spectrum in the 2.3GHz band and are restricted to no more than 85MHz in the 3.4GHz band. As a result of Three's challenge to the proposals, seeking a tighter cap on BT/EE, we made the difficult decision to also challenge the proposals. On 20 December 2017, the High Court ruled that both challenges were unsuccessful, leaving the cap set by Ofcom intact. Ofcom has issued the final auction regulations, although the start of bidding will await the hearing of Three's appeal in February 2018.

Spectrum annual license fees

We were successful in our Court of Appeal challenge to the Fees Regulation issued by Ofcom in 2015 that tripled our annual licence fees for our 1800MHz spectrum. This challenge, which was supported by all of the mobile network operators, concurs with our view that the increase in fees was excessive and would harm network investment. We will now seek to recover the overpayment since 2015. We expect Ofcom to make a new decision on Annual Licence Fees in due course.

Universal Service Obligation (USO)

In December 2017, the UK Government decided not to take up our proposal to deliver universal broadband through a voluntary agreement. Instead, the Government will introduce a regulatory Universal Service Obligation via secondary legislation, to give people the right to request a broadband connection of at least 10Mbps. We respect the Government's decision. Once legislation is in place, we expect Ofcom to take two years to review with industry how this new obligation will take effect, including how it will be funded, who will be tasked with delivering it and what costs it is reasonable for USO providers to bear. We'll work closely with Government, Ofcom and industry to help deliver the regulatory USO.

Wholesale Local Access (WLA) Market Review

On 1 December 2017, Ofcom issued a further consultation on 'Wholesale Local Access Market Review - Promoting network competition in superfast and ultrafast broadband' focusing on geographic fibre pricing. We have responded to this consultation and believe that Ofcom's proposal to prohibit any geographic discounting of Openreach's FTTC and Gfast services will distort fair and effective competition at the wholesale and retail level, harming consumers in the short and long term.

We continue to engage on Ofcom's other proposals in their WLA market review. We expect Ofcom to issue a final statement during the current quarter, with proposals to take effect from April 2018, and remain in place until March 2021.

Wholesale Broadband Access (WBA) Market Review

In June 2017, Ofcom issued a consultation on the WBA proposing that BT has significant market power in only 2% of premises. It also proposes to remove the charge control on WBA prices. We responded to Ofcom's consultation and welcomed Ofcom's recognition that competition is effective for 98% of UK premises. We expect Ofcom to issue a final statement in March 2018.

Business Connectivity Markets

We successfully appealed the market definition of Ofcom's 2016 Business Connectivity Market Review (BCMR). In November, the Competition Appeal Tribunal remitted all matters back to Ofcom for reconsideration. Subsequently, Ofcom decided to use emergency powers for the first time to impose temporary significant market power conditions for Ethernet services up to and including 1Gbps in the London Periphery and the Rest of the UK (excluding the central business districts of Birmingham, Glasgow and Leeds). Conditions included charge controls and minimum service levels. These will be in place until April 2019.

Also in November, Ofcom issued a consultation to introduce a new dark fibre access remedy for Ethernet services at and below 1Gbps from April 2018 until April 2019, in the markets covered by the temporary finding of significant market power. BT and Openreach responded to this consultation on 29 December 2017. We expect Ofcom to issue a final statement in early March. We continue to be of the view that a dark fibre remedy is not required and in April 2018 Openreach will launch a new, alternative product, Optical Spectrum Access Filter Connect, which we believe can meet the connectivity demand for very high bandwidth data services.

Future Telecoms Infrastructure Review

On 27 November 2017, the Government announced the Future Telecoms Infrastructure Review to understand the incentives for investment in new digital infrastructure. The review will assess whether any additional policy interventions might support long term investment in the next generation of telecoms infrastructure and what consequences such interventions could have on competitive dynamics, markets and consumers. We will provide input to this review, which will report to Government in mid-2018.

Investigation into our Italian business

During the quarter we continued to take steps to address the historical issues in Italy, working alongside the authorities as necessary, including improving the control environment. We recognise that we have further activities to complete during the fourth quarter, including the assessment of our internal controls over financial reporting as of 31 March 2018 for the purposes of the US Sarbanes-Oxley Act 2002. Since the end of the quarter, we have finalised the local statutory accounts of BT Italia for 2016-17 which we expect to file in February.

OUTLOOK

There is no change to our financial outlook for 2017/18.

	2017/18
Change in underlying[1] revenue excluding transit	Broadly flat
Adjusted[1] EBITDA	£7.5bn - £7.6bn
Normalised free cash flow[1]	£2.7bn - £2.9bn
Dividend per share	Progressive

[1] See Glossary on page 2

Group results for the third quarter to 31 December 2017

Income statement

Reported revenue was down 3% to £5,970m. This includes a £16m adverse impact from foreign exchange movements and a £45m reduction in transit revenue. Underlying[1] revenue excluding transit was down 1.5%.

Reported operating costs of £5,116m were down 5%. Adjusted[1] operating costs, before depreciation and amortisation, of £4,153m were down 2%, reflecting the decline in revenue and cost savings partially offset by increased investment in mobile devices, customer experience, higher business rates and pension costs. This includes an £11m favourable impact from foreign exchange movements and a £45m decrease in transit costs.

Adjusted[1] EBITDA of £1,826m was down 2%. Depreciation and amortisation of £868m was down 3%. Reported net finance expense was £193m while adjusted[1] net finance expense was £139m. Reported profit before tax was up 25% at £660m due to higher specific items in the prior year. Adjusted[1] profit before tax was down 1% at £818m.

We now expect our effective tax rate on profit before specific items for the year to be 20.7%, with the rate being higher than the standard UK corporation tax rate (19%) principally due to higher overseas tax rates, disallowable costs and a 0.4% increase in respect of our initial estimate of the impact of US tax reforms. This impact has been recognised in Q3, resulting in an effective tax rate on profit before specific items for the quarter of 21.5%.

Reported EPS was 5.0p, up 32%. Adjusted[1] EPS of 6.4p was down 3%. These are based on a weighted average number of shares in issue of 9,904m (Q3 2016/17: 9,943m).

Specific items

Specific items[1] resulted in a net charge after tax of £141m (Q3 2016/17: £281m) and are as follows:

Third quarter to 31 December	**2017** **£m**	2016 £m	Change %
Specific revenue			
Regulatory matters	9	(2)	n/m
Specific revenue	**9**	(2)	n/m
Specific operating costs			
Restructuring charge	68	-	n/m
EE integration costs	9	41	(78)
Regulatory matters	9	81	(89)
Italian business investigation	9	100	(91)
Out of period irrecoverable VAT	-	28	n/m
Profit on disposal of business	-	(2)	n/m
EBITDA	**104**	246	(58)
Interest on out of period irrecoverable VAT	-	1	n/m
Net interest expense on pensions	54	53	2
Tax credit	(17)	(19)	(11)
Net after tax	**141**	281	(50)

Capital expenditure

Capital expenditure was £878m (Q3 2016/17: £852m). This consists of gross expenditure of £886m (Q3 2016/17: £863m) which has been reduced by net grant funding of £8m (Q3 2016/17: £11m) mainly relating to our activity on the Broadband Delivery UK (BDUK) programme. The capital expenditure increase of £26m was primarily a result of increased investment in our fixed and mobile networks which was up £45m at £465m. Other capital expenditure components were down £19m with £232m spent on customer driven investments and £157m on systems and IT.

[1] See Glossary on page 2

Our base-case assumption for take-up in BDUK areas has increased to 40% of total homes passed and we will continue to assess this each quarter. Under the terms of the BDUK programme, we have an obligation to repay or re-invest grant funding depending on factors including the level of customer take-up achieved. While we have recognised gross grant funding of £58m (Q3 2016/17: £45m) in line with network build in the quarter, we have also deferred £50m (Q3 2016/17: £34m) of the total grant funding to reflect higher take-up levels on a number of contracts. To date we have deferred £527m (Q3 2016/17: £325m).

Free cash flow

Net cash inflow from operating activities was up £81m at £1,596m. Normalised free cash flow[1] was up £96m at £702m. The increase is mainly due to working capital phasing. A reconciliation to our free cash flow is shown in Additional Information on page 24.

The net cash cost of specific items was £120m (Q3 2016/17: £32m). This includes regulatory payments of £45m (Q3 2016/17: £nil) restructuring payments of £34m (Q3 2016/17: £10m) and EE integration cost payments of £18m (Q3 2016/17: £18m). After specific items and a £34m (Q3 2016/17: £11m) cash tax benefit from pension deficit payments, free cash was an inflow of £616m (Q3 2016/17: £585m).

Net debt and liquidity

Net debt[1] was £8,923m at 31 December 2017, £597m lower than at 30 September 2017. The decrease is primarily due to free cash flows of £616m in the quarter.

At 31 December 2017 the group held cash and current investment balances of £4.9bn. We repaid a GBP £0.4bn European Investment Bank loan on 28 December 2017. Short term borrowings of £1.7bn include term debt of £1.0bn repayable during the remainder of 2017/18 and £0.7bn which comprises collateral for open mark to market positions and overdrafts.

On 14 November 2017 we successfully issued term debt of £1,728m (€1,100m and £750m) on the medium-term Euro market. The effective Sterling interest rates on these 7, 14 and 30 year bonds was 2.37%, 3.15% and 3.66%, respectively. These bonds were issued to generate funding for general corporate purposes.

Our £2.1bn facility with 14 high quality syndicate banks (£150m each) remains undrawn at 31 December 2017. This facility matures in September 2021.

Pensions (Note 2 to the condensed consolidated financial statements)

The IAS 19 net pension position at 31 December 2017 was a deficit of £7.9bn net of tax (£9.5bn gross of tax), compared with £7.7bn net of tax (£9.3bn gross of tax) at 30 September 2017. The increase in the deficit mainly reflects an increase in the liabilities (driven by a fall in the real discount rate), partly offset by an increase in the assets.

The triennial valuation is proceeding, constructive discussions continue with the BTPS Trustee and we still expect to complete the valuation in the first half of the 2018 calendar year. We are considering a number of funding options to address the deficit, including arrangements that would give the BTPS a prior claim over certain BT assets.

In its judgment handed down on 19 January 2018, the High Court decided that it is currently not possible to change the index used to calculate pension increases for Section C members of the BTPS. We are disappointed with the decision and are now appealing.

We continue to review the future pension benefits under our main defined benefit and defined contribution schemes in the UK, with the objective of providing fair, flexible and affordable pensions. We have completed a consultation with our affected employees and are considering their feedback.

[1] See Glossary on page 2

Operating review

BT Consumer

	Third quarter to 31 December				Nine months to 31 December			
	2017	2016	Change		**2017**	2016	Change	
	£m	£m	£m	%	**£m**	£m	£m	%
Revenue	**1,261**	1,262	(1)	-	**3,777**	3,688	89	2
Operating costs	**1,011**	1,002	9	1	**3,049**	2,937	112	4
EBITDA	**250**	260	(10)	(4)	**728**	751	(23)	(3)
Depreciation & amortisation	**52**	52	-	-	**159**	156	3	2
Operating profit	**198**	208	(10)	(5)	**569**	595	(26)	(4)
Capital expenditure	**66**	54	12	22	**199**	165	34	21
Normalised free cash flow	**114**	162	(48)	(30)	**392**	550	(158)	(29)

Revenue was flat year on year driven by ongoing growth of BT Mobile, offset by voice line losses. BT Consumer 12-month rolling ARPU increased 5% to £41.3 per month and revenue generating units[1] per customer grew 3% to 2.02.

Across BT's retail divisions, superfast fibre broadband growth continued with 208,000 net adds, taking our customer base to 5.5m. Of our broadband customers, 59% are now on fibre. We added 35,000 broadband customers this quarter.

We are pleased to note that Ofcom's complaints data shows a reduction of 7% for landlines and 11% for broadband when compared to the previous quarter, with complaints for both products at their lowest rate for more than eight quarters. Average call waiting times are currently 58 seconds which is almost 2 minutes faster than last year and average broadband speeds have increased by 24% to 42Mbps in the last 12 months.

Operating costs increased 1% mainly as a result of increased investment in customer experience and broadband speed upgrades ahead of the price increases that were introduced earlier in January. As a result EBITDA was down 4% in the quarter. Depreciation and amortisation was flat and operating profit was down 5% for the quarter.

Normalised free cash flow in the quarter was down 30% driven by additional capex investment and adverse working capital movements mainly from the timing of supplier payments.

[1] Revenue generating units are voice lines, broadband, TV and mobile

EE

	Third quarter to 31 December				Nine months to 31 December			
	2017	2016	Change		**2017**	2016	Change	
	£m	£m	£m	%	**£m**	£m	£m	%
Revenue	**1,357**	1,311	46	4	**3,974**	3,831	143	4
Operating costs	**1,098**	1,034	64	6	**3,054**	2,991	63	2
EBITDA	**259**	277	(18)	(6)	**920**	840	80	10
Depreciation & amortisation	**197**	203	(6)	(3)	**575**	599	(24)	(4)
Operating profit	**62**	74	(12)	(16)	**345**	241	104	43
Capital expenditure	**122**	153	(31)	(20)	**450**	452	(2)	-
Normalised free cash flow	**128**	141	(13)	(9)	**518**	463	55	12

Revenue was up 4% with a 6% increase in postpaid revenue and a 14% increase in fixed broadband revenues, partially offset by a 15% reduction in prepaid revenue and a 10% reduction in equipment revenue. This is the fifth consecutive quarter of revenue growth, and first full quarter of Emergency Services Network revenues.

At the end of the quarter, the total BT Group mobile base was 29.8m. We added 235,000 postpaid mobile customers, taking the postpaid base to 17.5m. Group postpaid churn was 1.2% reflecting a continuing high level of customer loyalty. Our prepaid customers fell by 299,000, in line with industry trends, taking the base to 6.0m. Our 4G customer base reached 19.6m. Monthly mobile ARPU was £26.2 for postpaid customers and £4.9 for prepaid customers across the Group.

Our 4G geographic coverage now reaches 90% of the UK's landmass and we continue to work towards our 95% coverage ambition by the end of December 2020.

Operating costs were £1,098m in the quarter, resulting in EBITDA of £259m. As expected EBITDA was down 6%, driven by high customer investment costs in the quarter, following the launch of new, premium smartphones and watches. We expect EBITDA to recover strongly in Q4 as seasonal customer behaviour reduces customer investment costs. Depreciation and amortisation was £197m and operating profit was £62m for the quarter.

Capital expenditure was £122m in the quarter down 20% following the achievement of a major Emergency Services Network milestone in Q2. Normalised free cash flow was £13m lower, reflecting the decrease in EBITDA and increased working capital partially offset by the lower capex spend.

Business and Public Sector

	Third quarter to 31 December				Nine months to 31 December			
	2017	2016	Change		**2017**	2016	Change	
	£m	£m	£m	%	**£m**	£m	£m	%
Revenue	**1,125**	1,190	(65)	(5)	**3,406**	3,536	(130)	(4)
- underlying excluding transit				(6)				(3)
Operating costs	**763**	797	(34)	(4)	**2,350**	2,399	(49)	(2)
EBITDA	**362**	393	(31)	(8)	**1,056**	1,137	(81)	(7)
Depreciation & amortisation	**87**	88	(1)	(1)	**272**	264	8	3
Operating profit	**275**	305	(30)	(10)	**784**	873	(89)	(10)
Capital expenditure	**69**	74	(5)	(7)	**221**	186	35	19
Normalised free cash flow	**317**	302	15	5	**796**	860	(64)	(7)

Revenue decreased 5% and underlying revenue excluding transit was down 6%. This was due to the ongoing decline in fixed voice as the market shifts to data and IP, and lower equipment sales resulting from our decision to move away from lower margin business, but was partially offset by continued growth in mobile and networking. This resulted in SME revenue down 3%, Corporate revenue down 7% and Public Sector and Major Business revenue decreasing 6%.

Foreign exchange movements had a £2m positive impact on Republic of Ireland revenue, where underlying revenue excluding transit was down 10% due to the impact of churn on traditional lines and lower equipment sales.

Order intake decreased 22% to £0.7bn and was up 12% to £3.6bn on a rolling 12-month basis, due to the signing of a large wholesale contract in Republic of Ireland in Q1.

Operating costs were 4% lower driven mainly by lower voice product input and legacy contract costs. EBITDA declined 8% following the reduction in revenue and against a strong prior year comparator. Depreciation and amortisation was 1% lower and operating profit was 10% lower.

Capital expenditure decreased £5m and normalised free cash flow was £15m higher reflecting the timing of working capital inflows and lower capital expenditure, partly offset by the £31m decrease in EBITDA.

Global Services

	Third quarter to 31 December				Nine months to 31 December			
	2017	2016	Change		**2017**	2016	Change	
	£m	£m	£m	%	**£m**	£m	£m	%
Revenue	**1,266**	1,398	(132)	(9)	**3,772**	4,057	(285)	(7)
- underlying excluding transit				(6)				(8)
Operating costs	**1,123**	1,358	(235)	(17)	**3,475**	3,766	(291)	(8)
EBITDA	**143**	40	103	258	**297**	291	6	2
Depreciation & amortisation	**98**	117	(19)	(16)	**319**	331	(12)	(4)
Operating profit (loss)	**45**	(77)	122	158	**(22)**	(40)	18	45
Capital expenditure	**64**	69	(5)	(7)	**192**	260	(68)	(26)
Normalised free cash flow	**30**	(115)	145	126	**(102)**	(340)	238	70

Revenue for the quarter was down 9% including a £18m negative impact from foreign exchange movements and a £42m decline in transit revenue. Underlying revenue excluding transit was down 6%. This decline reflected lower IP Exchange volumes in the UK and Continental Europe in line with our strategy to reduce low margin business, the ongoing impact of a major customer insourcing services in the US, a large contract in Brazil that has now completed and lower general trading across all of our regions.

Underlying revenue excluding transit was down 8% in the UK and down 1% in Continental Europe. Underlying revenue was down 9% in the Americas[1] and down 6% in AMEA[2].

Our total order intake was £1.1bn in the quarter, down 11% and on a rolling 12-month basis was £3.7bn, down 25% year on year, mainly reflecting ongoing challenging market conditions.

As part of our Cloud of Clouds portfolio strategy we announced a strategic collaboration with Amazon Web Services (AWS) with focus on networking, security and managed services to transform the way organisations around the world deploy cloud solutions.

Operating costs were down 17% mainly reflecting the impact of our investigation into our Italian business in the prior year and lower IP Exchange volumes. EBITDA was up £103m for the quarter reflecting the impact of our Italian business in the prior year and certain one off benefits in this quarter including pension plan changes in Continental Europe. Excluding these one off items and the results of our Italian business, EBITDA was broadly in line with the comparable EBITDA for last year of around £120m. Depreciation and amortisation was down 16% due to the timing of recognition on certain projects in the prior year. Operating profit for the quarter was £45m.

Capital expenditure was down 7%. Normalised free cash flow was an inflow of £30m for the quarter, up £145m mainly due to the prior year impact of unwinding improper working capital transactions in our Italian business.

[1] United States & Canada and Latin America (Americas)
[2] Asia Pacific, the Middle East and Africa (AMEA)

Wholesale and Ventures

	Third quarter to 31 December				Nine months to 31 December			
	2017	2016	Change		**2017**	2016	Change	
	£m	£m	£m	%	**£m**	£m	£m	%
Revenue	**506**	528	(22)	(4)	**1,503**	1,568	(65)	(4)
- underlying excluding transit				(4)				(4)
Operating costs	**317**	317	-	-	**953**	954	(1)	-
EBITDA	**189**	211	(22)	(10)	**550**	614	(64)	(10)
Depreciation & amortisation	**79**	76	3	4	**233**	227	6	3
Operating profit	**110**	135	(25)	(19)	**317**	387	(70)	(18)
Capital expenditure	**54**	53	1	2	**160**	154	6	4
Normalised free cash flow	**138**	151	(13)	(9)	**358**	440	(82)	(19)

Revenue was down 4% with underlying revenue excluding transit also down 4%. Managed solutions revenue was down 8% primarily due to continued lower revenue from our Mobile Ethernet Access Services contracts, reflecting the maturity of mobile network operator 4G build programmes.

Data and Broadband revenue was down 8% due to the continuing decline in legacy Partial Private Circuits and intensifying price competition in the wholesale broadband market. Voice revenue was down 3%.

Our Ventures businesses performed well with revenue growing 9% to £84m. This was driven by growth in bulk messaging services and Fleet Solutions. We continue to rollout InLinkUK across London, and also launched in Leeds, and there were 86 live units as at the end of the quarter. Mobile generated revenue of £55m, down 5% after last year benefitted from the recognition of some specific contractual customer commitments.

Order intake of £372m was in line with Q2 but down 61% year-on-year as last year benefitted from the five-year wholesale mobile network services deal with Virgin Media and the 10-year InLinkUK advertising contract. On a rolling 12-month basis order intake is £1.3bn, down 38% year on year.

Operating costs were broadly flat and EBITDA decreased 10% reflecting the revenue decline, particularly in higher margin legacy services. Depreciation and amortisation was up 4%, and operating profit decreased 19%.

Capital expenditure was up 2%. Normalised free cash flow was £138m, down 9% on last year primarily reflecting lower EBITDA.

Openreach

	Third quarter to 31 December				Nine months to 31 December			
	2017	2016	Change		**2017**	2016	Change	
	£m	£m	£m	%	**£m**	£m	£m	%
Revenue	**1,286**	1,284	2	-	**3,834**	3,809	25	1
Operating costs	**645**	608	37	6	**1,955**	1,871	84	4
EBITDA	**641**	676	(35)	(5)	**1,879**	1,938	(59)	(3)
Depreciation & amortisation	**336**	349	(13)	(4)	**1,026**	1,014	12	1
Operating profit	**305**	327	(22)	(7)	**853**	924	(71)	(8)
Capital expenditure	**477**	409	68	17	**1,264**	1,103	161	15
Normalised free cash flow	**332**	362	(30)	(8)	**819**	1,053	(234)	(22)

Revenue was flat with growth of 23% in fibre broadband being offset by lower copper line rental. This also includes regulatory and commercial price changes which had a negative impact of £14m and £21m respectively.

We continue to extend the reach of fibre broadband which is now available to more than 27.4m premises passed by our superfast fibre broadband network. 886,000 of those premises are able to connect to an ultrafast (100Mbps+) service using FTTP or Gfast technology. We achieved a record high 600,000 fibre broadband net connections during the quarter and now have around 9.2m customers connected to fibre (Q3 2016/17: 7.2m).

As a result of strong seasonal offers in the market by our Communications Provider customers we saw higher demand for our FTTC products in the quarter that helped increase our physical line base by around 42,000.

We continue to focus on improving the experience of our customers. So far this year we are ahead on all 60 copper minimum service levels set by Ofcom and we have seen a 4.1% reduction in our copper network faults compared to the same period last year. We continue to engage with Ofcom on the new Ethernet minimum service level measures that apply from December 2017 to March 2019.

Operating costs were 6% higher mainly driven by an increase in business rates charged on network assets and higher pension charges. EBITDA was down 5% and depreciation and amortisation was down 4% with operating profit down 7%.

Capital expenditure was £477m, up £68m or 17%, reflecting our ongoing investment in fibre broadband speed and coverage which contributed to the Government's achievement to provide superfast broadband coverage to 95% of the UK by December 2017. Capital expenditure was after gross grant funding of £55m (Q3 2016/17: £45m) directly related to our activity on the BDUK programme build which was offset by an increase in our grant funding deferral of £50m (Q3 2016/17: £32m).

Normalised free cash flow was down 8% due to the increased operating costs and capital expenditure partly offset by the timing of customer receipts due in Q2.

Condensed consolidated financial statements

Group income statement

For the third quarter to 31 December 2017

	Before specific items	Specific items	Total
	£m	£m	£m
Revenue	5,979	(9)	**5,970**
Operating costs	(5,021)	(95)	**(5,116)**
Operating profit	958	(104)	**854**
Finance expense	(143)	(54)	**(197)**
Finance income	4	-	**4**
Net finance expense	(139)	(54)	**(193)**
Share of post tax loss of associates and joint ventures	(1)	-	**(1)**
Profit before tax	818	(158)	**660**
Tax	(176)	17	**(159)**
Profit for the period	642	(141)	**501**
Earnings per share			
- basic	6.4 p		**5.0 p**
- diluted	6.4 p		**5.0 p**

Group income statement

For the third quarter to 31 December 2016

	Before specific items	Specific items	Total
	£m	£m	£m
Revenue	6,126	2	6,128
Operating costs	(5,151)	(248)	(5,399)
Operating profit	975	(246)	729
Finance expense	(151)	(54)	(205)
Finance income	2	-	2
Net finance expense	(149)	(54)	(203)
Share of post tax profit (loss) of associates and joint ventures	-	-	-
Profit before tax	826	(300)	526
Tax	(171)	19	(152)
Profit for the period	655	(281)	374
Earnings per share			
- basic	6.6p		3.8p
- diluted	6.5p		3.7p

Group income statement

For the nine months to 31 December 2017

	Before specific items	Specific items	Total
	£m	£m	£m
Revenue	17,779	(23)	**17,756**
Operating costs	(14,982)	(468)	**(15,450)**
Operating profit	2,797	(491)	**2,306**
Finance expense	(406)	(163)	**(569)**
Finance income	8	-	**8**
Net finance expense	(398)	(163)	**(561)**
Share of post tax loss of associates and joint ventures	(1)	-	**(1)**
Profit before tax	2,398	(654)	**1,744**
Tax	(497)	63	**(434)**
Profit for the period	1,901	(591)	**1,310**
Earnings per share			
- basic	19.1 p		**13.2 p**
- diluted	19.1 p		**13.2 p**

Group income statement

For the nine months to 31 December 2016

	Before specific items	Specific items	Total
	£m	£m	£m
Revenue	17,954	(14)	17,940
Operating costs	(14,997)	(414)	(15,411)
Operating profit	2,957	(428)	2,529
Finance expense	(459)	(159)	(618)
Finance income	10	-	10
Net finance expense	(449)	(159)	(608)
Share of post tax loss of associates and joint ventures	(7)	-	(7)
Profit before tax	2,501	(587)	1,914
Tax	(471)	85	(386)
Profit for the period	2,030	(502)	1,528
Earnings per share			
- basic	20.4p		15.4p
- diluted	20.3p		15.3p

Group balance sheet

	31 December 2017	31 December 2016[1]	31 March 2017
	£m	£m	£m
Non-current assets			
Intangible assets	14,574	15,188	15,029
Property, plant and equipment	16,875	16,256	16,498
Derivative financial instruments	1,631	2,256	1,818
Investments	51	42	44
Associates and joint ventures	37	26	31
Trade and other receivables	261	248	360
Deferred tax assets	1,784	1,937	1,717
	35,213	35,953	35,497
Current assets			
Programme rights	448	437	264
Inventories	267	236	227
Trade and other receivables	3,827	3,995	3,835
Current tax receivable	57	65	73
Derivative financial instruments	395	217	428
Investments	3,977	2,359	1,520
Cash and cash equivalents	948	435	528
	9,919	7,744	6,875
Current liabilities			
Loans and other borrowings	2,194	2,655	2,632
Derivative financial instruments	25	11	34
Trade and other payables	7,206	7,460	7,437
Current tax liabilities	206	252	197
Provisions	462	280	625
	10,093	10,658	10,925
Total assets less current liabilities	**35,039**	33,039	31,447
Non-current liabilities			
Loans and other borrowings	13,268	11,016	10,081
Derivative financial instruments	837	858	869
Retirement benefit obligations	9,530	11,083	9,088
Other payables	1,412	1,197	1,298
Deferred tax liabilities	1,322	1,198	1,240
Provisions	500	560	536
	26,869	25,912	23,112
Equity			
Ordinary shares	499	499	499
Share premium	1,051	1,051	1,051
Own shares	(189)	(104)	(96)
Merger reserve	6,647	6,647	6,647
Other reserves	693	986	884
Retained loss	(531)	(1,952)	(650)
Total equity	**8,170**	7,127	8,335
	35,039	33,039	31,447

[1] Revised. See note 1 to the condensed consolidated financial statements

Group cash flow statement

For the third quarter and nine months to 31 December

	Third quarter to 31 December		Nine months to 31 December	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Cash flow from operating activities				
Profit before tax	660	526	1,744	1,914
Share-based payments	23	17	63	50
Profit on disposal of subsidiaries and interest in associates	-	(2)	(1)	(16)
Share of post tax losses of associates and joint ventures	1	-	1	7
Net finance expense	193	203	561	608
Depreciation and amortisation	868	895	2,625	2,619
(Increase) decrease in working capital	77	(95)	(333)	(303)
Provisions, pensions and other non-cash movements[1]	(83)	135	(155)	86
Cash inflow from operating activities[2]	**1,739**	1,679	**4,505**	4,965
Tax paid	(143)	(164)	(324)	(382)
Net cash inflow from operating activities	**1,596**	1,515	**4,181**	4,583
Cash flow from investing activities				
Interest received	1	1	3	6
Dividends received from associates and joint ventures	-	2	-	2
Net (acquisition) disposal of subsidiaries[3], associates and joint ventures	(3)	(3)	(21)	54
Purchases of property, plant and equipment and software	(845)	(759)	(2,510)	(2,222)
Proceeds on disposal of property, plant and equipment	2	8	13	9
Purchase of non-current asset investments	-	(1)	-	(22)
Purchases of current financial assets	(4,055)	(2,369)	(9,947)	(6,934)
Proceeds on disposal of current financial assets	2,652	2,379	7,505	7,518
Net cash outflow from investing activities	**(2,248)**	(742)	**(4,957)**	(1,589)
Cash flow from financing activities				
Interest paid	(144)	(187)	(403)	(474)
Equity dividends paid	(6)	(4)	(1,044)	(955)
Proceeds from bank loans and bonds	1,728	1	3,757	3
Repayment of borrowings[4]	(352)	(680)	(854)	(1,072)
Cash flows from derivatives related to net debt	64	(70)	(68)	127
Net repayment on facility loans	-	1	-	(618)
Proceeds from issue of own shares	3	6	49	66
Repurchase of ordinary share capital	-	-	(221)	(206)
Net cash inflow (outflow) from financing activities	**1,293**	(933)	**1,216**	(3,129)
Net increase (decrease) in cash and cash equivalents	**641**	(160)	**440**	(135)
Opening cash and cash equivalents	291	514	511	459
Net increase (decrease) in cash and cash equivalents	641	(160)	440	(135)
Effect of exchange rate changes	-	6	(19)	36
Closing cash and cash equivalents[5]	**932**	360	**932**	360

[1] Includes pension deficit payments of £6m for the quarter (Q3 2016/17: £6m) and £16m for the nine months to 31 December 2017 (31 December 2016: £19m)
[2] Includes cash flows relating to TV programme rights
[3] Prior year includes a true up of consideration following the audit of the completion balance sheet relating to the acquisition of EE
[4] Repayment of borrowings includes the impact of hedging and repayment of lease liabilities
[5] Net of bank overdrafts of £16m at 31 December 2017 (31 December 2016: £75m)

Notes to the condensed consolidated financial statements

1 Basis of preparation and accounting policies

These condensed consolidated financial statements ('the financial statements') comprise the financial results of BT Group plc for the quarters and nine months to 31 December 2017 and 2016 together with the audited balance sheet at 31 March 2017.

Except as described below and other than income taxes which are accrued using the tax rate that is expected to be applicable for the full financial year, the financial statements have been prepared in accordance with the accounting policies as set out in the financial statements for the year to 31 March 2017 and have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative financial instruments) at fair value.

These financial statements do not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006 and have not been audited or reviewed by the independent auditors. Statutory accounts for the year to 31 March 2017 were approved by the Board of Directors on 11 May 2017, published on 25 May 2017, and delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified and did not contain any statement under Section 498 of the Companies Act 2006. These financial statements should be read in conjunction with the annual financial statements for the year to 31 March 2017.

Revision on prior year financial statements

The effect of the prior year revision on the balance sheet as at 31 December 2016 is set out below.

Acquisition of EE

IFRS 3 'Business Combinations' requires us to recognise provisional fair values if the initial accounting for the business combination is incomplete. In the period ended 31 March 2016, we reported that the fair values recognised for our 29 January 2016 acquisition of EE were provisional. During 2016/17, we finalised this assessment and also received a purchase consideration refund from the previous owners of £20m following the finalisation of the audit of the completion balance sheet. This resulted in a revision to previously recognised brand and customer relationship assets which decreased by £15m. Our reassessment also led to a £14m decrease in receivables and an increase in provisions related to unfavourable contracts in the amount of £20m. The net impact of the adjustments including the deferred tax effect resulted in an increase in goodwill of £49m as of 31 December 2016. These had no material impact on the income statement.

Revision of prior period statements

Group balance sheet

At 31 December 2016

	As published	EE purchase price accounting finalisation adjustment[1,2]	Revised
	£m	£m	£m
Non-current assets			
Intangible assets	15,154	34	15,188
Property, plant and equipment	16,256	-	16,256
Trade and other receivables	248	-	248
Other non-current assets	4,261	-	4,261
	35,919	**34**	**35,953**
Current assets			
Trade and other receivables	4,009	(14)	3,995
Cash and cash equivalents	435	-	435
Other current assets	3,314	-	3,314
	7,758	**(14)**	**7,744**
Current liabilities			
Loans and other borrowings	2,655	-	2,655
Trade and other payables	7,460	-	7,460
Other current liabilities	536	7	543
	10,651	**7**	**10,658**
Total assets less current liabilities	**33,026**	**13**	**33,039**
Non-current liabilities			
Loans and other borrowings	11,016	-	11,016
Retirement benefit obligations	11,083	-	11,083
Other non-current liabilities	3,800	13	3,813
	25,899	**13**	**25,912**
Equity			
Ordinary shares	499	-	499
Other reserves	8,580	-	8,580
Retained loss	(1,952)	-	(1,952)
Total equity	**7,127**	**-**	**7,127**
	33,026	**13**	**33,039**

[1] Revised to reflect EE purchase price accounting finalisation

[2] The above adjustments differ from those disclosed in the Annual Report & Form 20-F 2017 to reflect the true up of consideration initially recorded in the 30 September 2016 balance sheet and subsequently reflected in our purchase price accounting in Q4 2016/17

2 Pensions

	31 December 2017	30 September 2017	31 March 2017
	£bn	£bn	£bn
IAS 19 liabilities – BTPS	**(58.9)**	(57.5)	(58.6)
Assets – BTPS	**49.9**	48.7	50.0
Other schemes	**(0.5)**	(0.5)	(0.5)
Total IAS 19 deficit, gross of tax	**(9.5)**	(9.3)	(9.1)
Total IAS 19 deficit, net of tax	**(7.9)**	(7.7)	(7.6)
Discount rate (nominal)	**2.35%**	2.50%	2.40%
Discount rate (real)	**(0.82)%**	(0.68)%	(0.78)%
RPI inflation	**3.20%**	3.20%	3.20%
CPI inflation	**0.9% below RPI until 31 March 2021 and 1.2% below RPI thereafter**	0.7% below RPI until 31 March 2019 and 1.2% below RPI thereafter	0.7% below RPI until 31 March 2019 and 1.2% below RPI thereafter

3 Contingent liabilities

Legal Proceedings: save for the updates provided below, there have been no material updates relating to the Legal Proceedings as disclosed in the Annual Report & Form 20-F 2017.

Italian business – US securities class action complaints

The lead plaintiff has been appointed in the purported US securities class action filed in the District of New Jersey. On 21 November 2017, lead plaintiff in the New Jersey action filed an amended complaint brought on behalf of purchasers of BT Group ADRs between May 2013 and January 2017 (the "class period"), regarding allegations that the company made materially false and/or misleading statements during the class period, including, but not limited to, with regard to its internal controls. On 22 January 2018 we filed our motion to dismiss the amended complaint. The two New York actions have been voluntarily dismissed by the plaintiffs in those actions.

Phones 4U

In December 2016, the administrators of Phones 4U Limited (P4U) started legal proceedings in the High Court in the United Kingdom against EE, claiming £66m under a retail trading agreement for sums then due in respect of revenues (net of costs) from certain customers prior to P4U entering administration. This sharing of revenue under the retail trading agreement is due to continue until September 2019, with related payments continuing until April 2021. We are contesting these claims and brought counter-claims against P4U, including damages arising from P4U ceasing trading. The High Court dismissed most of these counter-claims on 16 January 2018, and we are considering appealing the judgment. We consider that we have adequate provisions in relation to this matter to cover any potential payments ultimately required by EE.

Hutchinson 3G Limited

The parties have resolved this matter to their mutual satisfaction and have discontinued the High Court proceedings.

Brazilian tax claims

We currently have 35 ICMS cases with a current potential value of £226m. The eight ICMS tax cases, worth approximately £40m, that are pending appeal before the Sao Paulo Court of Appeal are due to be heard in February 2018.

Additional Information

Notes

1) Our commentary focuses on the trading results on an adjusted basis, which is a non-GAAP measure, being before specific items. Unless otherwise stated, revenue, operating costs, earnings before interest, tax, depreciation and amortisation (EBITDA), operating profit, profit before tax, net finance expense, earnings per share (EPS) and normalised free cash flow are measured before specific items. This is consistent with the way that financial performance is measured by management and reported to the Board and the Executive Committee and assists in providing a meaningful analysis of the trading results of the group. The directors believe that presentation of the group's results in this way is relevant to the understanding of the group's financial performance as specific items are those that in management's judgement need to be disclosed by virtue of their size, nature or incidence. Reported revenue, reported operating costs, reported operating profit, reported profit before tax, reported net finance expense and reported EPS are the equivalent unadjusted or statutory measures. Reconciliations of reported to adjusted revenue, operating costs, operating profit, profit before tax and EPS are set out in the Group income statement. Reconciliations of underlying revenue excluding transit, EBITDA, net debt and free cash flow to the nearest measures prepared in accordance with IFRS are provided in this Additional Information.

2) Trend in underlying revenue excluding transit is a non-GAAP measure which seeks to reflect the underlying performance of the group that will contribute to long-term sustainable growth and as such excludes the impact of acquisitions and disposals, foreign exchange movements and any specific items. We exclude transit from the trend as transit traffic is low-margin and is affected by reductions in mobile termination rates.

Reconciliation of earnings before interest, tax, depreciation and amortisation

Earnings before interest, tax, depreciation and amortisation (EBITDA) is not a measure defined under IFRS, but is a key indicator used by management to assess operational performance. A reconciliation of reported profit before tax to adjusted EBITDA is provided below.

	Third quarter to 31 December		**Nine months to 31 December**	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Reported profit before tax	**660**	526	**1,744**	1,914
Share of post tax loss of associates and joint ventures	**1**	-	**1**	7
Net finance expense	**193**	203	**561**	608
Operating profit	**854**	729	**2,306**	2,529
Depreciation and amortisation	**868**	895	**2,625**	2,619
EBITDA	**1,722**	1,624	**4,931**	5,148
EBITDA specific items	**104**	246	**491**	428
Adjusted[1] EBITDA	**1,826**	1,870	**5,422**	5,576

[1] See Glossary on page 2

Free cash flow

Free cash flow and normalised free cash flow are not measures defined under IFRS but are key indicators used by management to assess operational performance. A reconciliation from cash generated from operations, the most directly comparable IFRS measure, to free cash flow and normalised free cash flow, is set out below.

	Third quarter to 31 December		Nine months to 31 December	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Cash generated from operations	**1,739**	1,679	**4,505**	4,965
Tax paid	**(143)**	(164)	**(324)**	(382)
Net cash inflows from operating activities	**1,596**	1,515	**4,181**	4,583
Add back pension deficit payments	**6**	6	**16**	19
Included in cash flows from investing activities				
Net purchase of property, plant and equipment and software	**(843)**	(751)	**(2,497)**	(2,213)
Interest received	**1**	1	**3**	6
Net purchase of non-current asset investments	**-**	(1)	**-**	(22)
Dividends received from associates and joint ventures	**-**	2	**-**	2
Included in cash flows from financing activities				
Interest paid	**(144)**	(187)	**(403)**	(474)
Free cash flow[1]	**616**	585	**1,300**	1,901
Net cash flow from specific items	**120**	32	**709**	146
Cash tax benefit of pension deficit payments	**(34)**	(11)	**(62)**	(99)
Normalised free cash flow[1]	**702**	606	**1,947**	1,948

Net debt

Net debt is not a measure defined under IFRS but is a key indicator used by management to assess operational performance. A reconciliation from loans and other borrowings, cash and cash equivalents, and current asset investments, the most directly comparable IFRS measures, to net debt, is set out below.

	31 December 2017	31 December 2016	31 March 2017
	£m	£m	£m
Loans and other borrowings	**15,462**	13,671	12,713
Cash and cash equivalents	**(948)**	(435)	(528)
Current asset investments	**(3,977)**	(2,359)	(1,520)
	10,537	10,877	10,665
Adjustments:			
To re-translate currency denominated balances at swapped rates when hedged[2]	**(1,327)**	(1,564)	(1,419)
To remove fair value adjustments and accrued interest applied to reflect the effective interest method[3]	**(287)**	(332)	(314)
Net debt[1]	**8,923**	8,981	8,932

[1] See Glossary on page 2
[2] The translation difference between spot rate and hedged rate of loans and borrowings denominated in foreign currency
[3] Includes remaining fair value adjustments made on certain loans and other borrowings and accrued interest at the balance sheet date

Reconciliation of year on year trend in underlying revenue excluding transit

Year on year trend in underlying revenue excluding transit is a measure which seeks to reflect the underlying performance that will contribute to long-term profitable growth. A reconciliation from the trend in reported revenue, the most directly comparable IFRS measure, to the trend in underlying revenue excluding transit, is set out below.

	Third quarter to 31 December 2017	Nine months to 31 December 2017
	%	%
Decrease in reported revenue	**(2.6)**	**(1.0)**
Specific items	0.2	-
Decrease in adjusted[1] revenue	**(2.4)**	**(1.0)**
Transit revenue	0.7	0.5
Acquisitions and disposals	-	0.1
Foreign exchange movements	0.2	(0.5)
Decrease in underlying[1] revenue excluding transit	**(1.5)**	**(0.9)**

Reconciliation of adjusted operating costs before depreciation and amortisation

	Third quarter to 31 December 2017	Nine months to 31 December 2017
	%	%
(Decrease) increase in reported operating costs	**(5)**	**-**
Depreciation and amortisation	-	-
(Decrease) increase in reported operating costs[2]	**(5)**	**-**
Specific items	3	-
Decrease in adjusted[1] operating costs[2]	**(2)**	**-**

[1] See Glossary on page 2
[2] Before depreciation and amortisation

Forward-looking statements – caution advised

Certain statements in this results release are forward-looking and are made in reliance on the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. These statements include, without limitation, those concerning: our outlook for 2017/18 including revenue, EBITDA, free cash flow and progressive dividends; Openreach's acceleration of its FTTP programme; and our investment in the roll out of 4G.

Although BT believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to have been correct. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements.

Factors that could cause differences between actual results and those implied by the forward-looking statements include, but are not limited to: material adverse changes in economic conditions in the markets served by BT whether as a result of the uncertainties arising from the UK's exit from the EU or otherwise; future regulatory and legal actions, decisions, outcomes of appeal and conditions or requirements in BT's operating areas, including the outcome of Ofcom's strategic review of digital communications in the UK, and the implementation of the DCR commitments, as well as competition from others; consultations and market reviews including the outcome of Ofcom's reviews of the Wholesale Local Access, Wholesale Broadband Access and Business Connectivity markets and forthcoming spectrum auctions; selection by BT and its customer facing units of the appropriate trading and marketing models for its products and services; fluctuations in foreign currency exchange rates and interest rates; technological innovations, including the cost of developing new products, networks and solutions and the need to increase expenditures for improving the quality of service; prolonged adverse weather conditions resulting in a material increase in overtime, staff or other costs, or impact on customer service; developments in the convergence of technologies; external threats to cyber security, data or resilience; political and geo-political risks; the anticipated benefits and advantages of new technologies, products and services not being realised, including the proposed investment in our FTTP broadband network; the timing of entry and profitability of BT in certain markets; significant changes in market shares for BT and its principal products and services; the underlying assumptions and estimates made in respect of major customer contracts proving unreliable; the anticipated benefits, synergies and cost savings of the EE integration not being delivered; the improvements to the control environment proposed following the investigations into BT's Italian business not being implemented successfully, effectively or timeously across the Group; the outcome of the BTPS triennial valuation and discussions on the pensions review; and general financial market conditions affecting BT's performance and ability to raise finance. BT undertakes no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

About BT

BT's purpose is to use the power of communications to make a better world. It is one of the world's leading providers of communications services and solutions, serving customers in 180 countries. Its principal activities include the provision of networked IT services globally; local, national and international telecommunications services to its customers for use at home, at work and on the move; broadband, TV and internet products and services; and converged fixed-mobile products and services. BT consists of six customer-facing lines of business: BT Consumer, EE, Business and Public Sector, Global Services, Wholesale and Ventures, and Openreach.

British Telecommunications plc (BT) is a wholly-owned subsidiary of BT Group plc and encompasses virtually all businesses and assets of the BT Group. BT Group plc is listed on stock exchanges in London and New York.

For more information, visit www.btplc.com

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We will hold a conference call for analysts and investors in London at 9am today and a simultaneous webcast will be available at www.bt.com/results

We are scheduled to announce our fourth quarter results for 2017/18 on Thursday 10 May 2018.