

An introduction from our Chairman

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However, 2017 has presented its challenges. While we have made significant progress in many areas, concluding the Ofcom Openreach review and successfully integrating EE into the BT Group, we have also had to address some significant issues. In particular the fraud in our Italian business, trading in the UK public sector and international corporates, and the fine that we received from Ofcom for historical process failures in Openreach are very disappointing.

This report includes further information on these matters, as well as details of the measures we have put in place to resolve them. The Board takes them very seriously and has extensively investigated the causes to ensure that they cannot happen again.

Changes to the Board

In March, we announced that Jan du Plessis will join the Board on 1 June 2017, before becoming chairman on 1 November 2017, when I retire. I am delighted Jan has been chosen to succeed me as chairman. He brings great experience, having been chairman of British American Tobacco, SABMiller and Rio Tinto. I wish him every success as he leads BT at this important time.

Simon Lowth joined the Board on 12 July 2016 as group finance director. Simon brings a wealth of knowledge having previously been CFO of BG Group, AstraZeneca and ScottishPower.

Investing in the UK's digital future

As we look ahead to the UK's exit from the European Union, it is more important than ever that we have strong British companies investing in our country's future. We invested around £2bn in the UK's fixed and mobile communications networks this year, taking fibre broadband further and vastly expanding 4G mobile network coverage. Looking ahead, we have bold ambitions to reach 12 million premises with ultrafast broadband by the end of 2020, as well as covering 95% of the UK's landmass with 4G.

We also take seriously our responsibility to invest in the UK's workforce. We hired 900 apprentices this year, with plans to increase this to over 2,000 next year. And our investment in people is leading to better outcomes for our customers. We hired 1,500 people into Openreach this year, mostly engineers, helping to halve the number of missed customer appointments in the fourth quarter, year on year. Meanwhile, we have also hired more than 5,000 new people into customer-facing roles at our contact centres in the UK and Ireland, meaning that 100% of EE's contact centre calls are now handled in the UK and Ireland, with considerable onshoring progress also made at Consumer this year.

We are also investing in innovative technologies, continuing BT's proud history in this area. We have been the UK's third largest investor in research and development over the past decade, and this year launched the Tommy Flowers Institute, a new Higher Education ICT training institute at our research laboratories at Adastral Park.

We are also using technology to support communities. This year we helped generate £95m towards good causes. We also continue to train teachers in tech literacy, giving more than a million children the skills they will need for the future, with an aim to reach five million by 2020.

Investigation into BT Italy

Following allegations of inappropriate behaviours in our Italian business, we conducted an investigation, including an independent review by KPMG LLP. I am very disappointed by what we discovered, including extensive improper accounting practices and a complex set of improper sales, purchase, factoring and leasing transactions. These activities led to the overstatement of earnings and assets in our Italian business. We have detailed on page 6 the issues that arose and the steps that we have taken in relation to these matters.

Agreement with Ofcom on Openreach governance

An important step this year was the agreement reached in March with Ofcom on the future governance of Openreach. This agreement comes after two years of discussions, and will see Openreach become a distinct, legally separate company within the BT Group. It will see Openreach assume greater independence under its own board. We appointed Mike McTighe as Openreach chairman in November 2016. Sir Brendan Barber, Edward Astle and Liz Benison then joined the new Openreach board as independent members in early 2017. Clive Selley, the Openreach CEO, will report into Mike McTighe, with accountability to the BT Group, as the CEO of a wholly-owned subsidiary. This includes accountability to the BT Group chief executive with regards to certain legal and fiduciary duties that are consistent with BT's responsibilities as a listed company.

Rewarding our shareholders

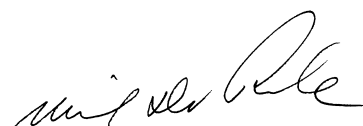
Our goal remains to deliver sustainable, profitable revenue growth. Together with our cost transformation activities, this will support long-term cash flow growth and therefore create value for our shareholders.

The strength of our business means that despite some difficulties this year, we can still fulfil our policy of paying a progressive dividend. The Board is proposing a final dividend of 10.55p, up 10%. This gives a full year dividend of 15.40p, also up 10%. However, given the importance of maintaining flexibility for investment, dividend growth in 2017/18 will be lower than the 10% previously anticipated. The rate of future dividend growth will reflect a number of factors, including underlying medium-term earnings growth, the level of investment spending and other cash commitments. The Board believes that this dividend policy appropriately balances the interests of all stakeholders and provides a solid foundation for future growth, underpinned by an ongoing commitment to investment that delivers sustainable long-term value for customers and shareholders.

Whilst we have undoubtedly faced challenges this year, we must not lose sight of the people, infrastructure and services that make BT a great company, with an important role to play in the future of how people in the UK and around the world live their lives.

As I leave BT I would like to thank my colleagues on the Board, Gavin Patterson, our CEO and the management team whose support I have valued highly over the years.

In my first chairman's message ten years ago, I closed by saying there was every reason for optimism. Looking forward, I have great confidence that remains the case today.



Sir Michael Rake
Chairman
11 May 2017

A message from our Chief Executive

Whilst we've continued to bring new services to our customers, invested in our digital infrastructure and made significant improvements to the customer experience, I'd be the first to say that 2016/17 has been a challenging year, and one that has been humbling for us all at BT.



The behaviours and practices we found in our Italian business, as well as Ofcom's findings around Openreach's use of the Deemed Consent process a number of years ago, have no place in BT. We take these extremely seriously and have reviewed all aspects of our governance, putting in place new measures and controls to prevent them from happening again. In addition, we've also faced difficult market conditions in both the UK public sector and international corporate markets.

Despite these challenges though, I believe we've made good progress in many areas across the business.

After a two-year negotiation, we reached a comprehensive and enduring agreement with Ofcom on the long-term governance of Openreach. This brings to a close a period of uncertainty; protects the interests of millions of UK households, businesses and service providers who rely on our infrastructure, and it's good news for pensioners and colleagues too.

We've continued to invest in the UK's digital future. We've now passed over 26.5 million premises with our superfast fibre broadband network. Our ultrafast deployment, which provides speeds of 100Mbps and above, is also making great progress, with 500,000 homes and businesses now passed – using a mix of fibre-to-the-premises and G.fast technologies.

Our mobile investment is also performing strongly. Our 4G coverage now reaches 80% of the UK's geographical coverage, the largest of any UK operator. And we're on track to reach 92% by September 2017. The integration of EE into the BT family continues to go well, and we have delivered cost synergies earlier than originally planned in our first year.

We believe online usage through mobile devices is set to increase in the future. And we also believe that everyone in the UK should be able to access superfast broadband, wherever they are and as fast as it can be. That's why in May 2016 we committed to invest £6bn in our wireless

and fixed networks over the next three years. This investment will enable the UK to make social and economic progress, consolidate our position as the UK's digital champion and create growth over the long-term for our stakeholders.

This year, through our continued innovation, we've also launched a range of new products, services and content.

Our new BT Call Protect service is proving popular, helping two million customers avoid nuisance calls.

We've secured exclusive rights to the UEFA Champions League and UEFA Europa League until the end of the 2020/21 season, covering double-header nights during the group stages and free-to-air broadcast. These rights are in addition to FA Cup and Premier League football, live rugby, cricket, UFC and now boxing. And we've brought BT Sport content to millions of additional sport fans through digital channels such as BT Sport's YouTube channel, where we will show this year's UEFA Champions League

and UEFA Europa League finals. We're also pleased to be the first operator to offer Dolby Atmos sound.

We're working with local authorities to launch our next generation of payphone kiosks, which you'll start to see shortly.

And we've built a unique security platform that integrates best-in-class technology from our partners, with our own award-winning innovation – to protect our multinational customers and the UK's critical national infrastructure.

Customer experience remains our top priority. We've listened to criticism and have a well-developed improvement plan in place. Our efforts are starting to bear fruit and customers are benefiting – with significantly more calls answered onshore, shorter call waiting times, faster repair times, fewer missed appointments, and our best Right First Time performance this decade. All of this is showing in our Group Customer Perception Score, the way we measure customer experience, which has improved for the last ten consecutive months. While we're making progress, we know our service must continue to get better and our focus will remain on delivering further improvements in the coming year.

We've also significantly invested in our people – recruiting thousands into engineering and customer-facing roles, and providing thousands of hours of training and development. We've also created more than 1,700 new apprenticeship and graduate jobs and provided 2,000 vocational training and work experience placements, mainly for out-of-work youngsters. For so many people, BT is a source of pride and honour and we want that to always be the case.

We remain committed to our strategy of broadening and deepening customer relationships and to using the power of communications to make a better world.

This year has presented us with challenges and we've learnt from them. I know we have the ability to emerge stronger and better, whatever challenge we face.

We take our role as the leading investor in the UK's digital infrastructure very seriously. I'm determined to make sure that we remain at the heart of what's to come and that we continue to add value for our customers and employees and for shareholders and society as a whole.

We're excited about the opportunities we'll create to use our unique set of assets and capabilities; the innovative new products and services we'll bring to customers and the new skills and career possibilities we'll provide for our people.



Gavin Patterson
Chief Executive
11 May 2017