Our strategy

Our strategy has evolved since last year. The three main pillars are broadly the same but we've placed more emphasis on the overall customer experience (rather than just on customer service). Following the acquisition of EE, our investment areas have evolved to focus on having the best network in the UK and being a fully converged service provider.

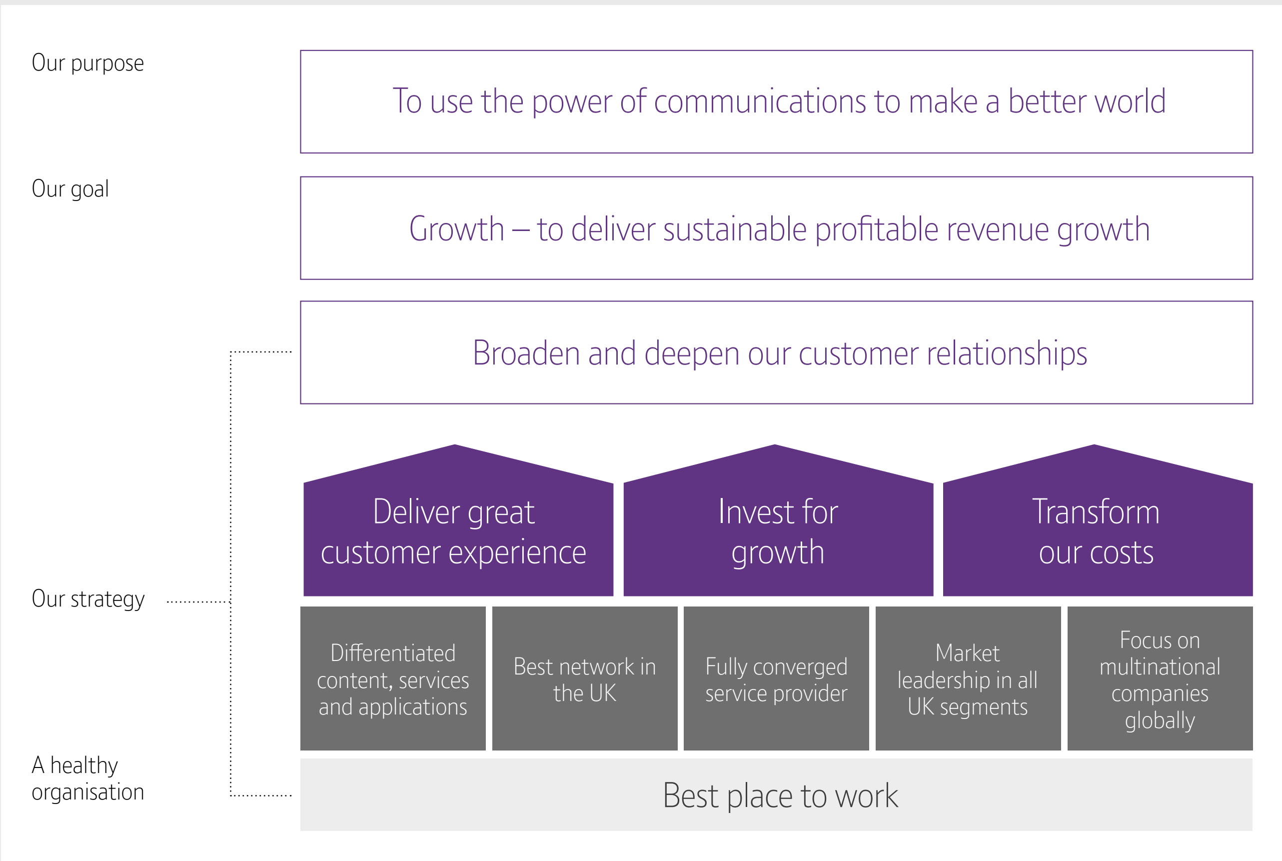
In order to achieve our purpose and reach our goal we've adopted a strategy based on broadening and deepening our customer relationships.

To create sustainable profitable revenue growth, we need stronger relationships with our customers.

The three pillars of our strategy help us build these relationships, providing great customer experience, transforming our costs and enabling us to invest for growth in the process. They work together: the better our customers' experience, the more we'll sell and the less time and money we'll spend putting things right. And the better we manage our costs, the more we can invest in improving our customers' experience and in products and services that will create growth.

Our strategy in a nutshell

The diagram below shows the main elements of our strategy and how they work together to support our purpose and goal. More details on our purpose and goal, in the context of our business model, can be found on page 24.



How we're doing

1

Delivering great customer experience

Everything we do influences our customers' opinion of BT. Whether it's fixing a fault, marketing a new product or fulfilling a new contract, it's the total customer experience that matters. That's why it's so important we work together across our entire business to improve our customers' experience. As a result our strategy now emphasises the importance of improving every aspect of the customer experience.

Customer service is at the heart of this goal. We've really improved our service levels this year, but we can do more. Our focus on customer experience means that everyone in BT, from marketing to contact centre, and front-line engineer to senior executive, has a role to play – and this includes the digital experience offered by online, apps and social media.

We believe that improving our customers' experience will create more growth. That's why it's such an important part of how we judge the group's performance. Our key measures of customer experience include customer perception (based mainly on the industry standard of Net Promoter Score) and getting things done Right First Time.

How we did in the year

We've seen a steady improvement in our customers' perception of us, increasing by five points since last year, with improvements across all lines of business.

Our Right First Time performance has also improved, by 6.4% compared to -3.0% last year. EE and our corporate businesses performed particularly well and we've prepared and responded much better to difficult weather conditions in the UK.

What difference did our customers see?

Customers judge us on their day-to-day interaction with BT. They want a consistent, reliable service, a network that offers a great experience and products that improve their lives. It's in these three areas – service, network and products – where we can most clearly see the progress we're making, progress we're committed to continuing over the coming year.

Deliver a consistent and reliable service

- All our Consumer customers have been given an improved level of care and on average, have landline faults fixed 24 hours quicker than last year.
- Consumer has created more than 2,200 new roles to help answer 90% of customer calls in the UK and Ireland by Spring of 2017. They are on track to meet this target, with around 86% of calls now answered in the UK and Ireland.
- EE now handles 100% of its customer service calls in the UK and Ireland.
- Openreach achieved or is on track to achieve all of Ofcom's copper Minimum Service Levels (MSLs).
- There's been a material improvement in how we deliver Ethernet with Openreach achieving five of the six Ofcom MSL targets.
- Openreach has recruited over 1,500 people, mostly engineers. It also halved its number of missed customer appointments by the end of the financial year.
- We've made it even easier to interact with us online, for example 9m customers have signed up to 'My EE' via the app or online.

A great customer experience from our network

- We've improved the weather proofing of our networks. This year we've halted the growth in network faults following six consecutive years of increasing faults.
- Global Services is enabling better monitoring of network, IT and applications.
- Openreach is offering to connect fibre-to-the-premises for free to all developments of new sites with over 30 plots[a].

Products that improve customer experience

- Consumer upgraded all its superfast broadband (Infinity 1) customers from 38Mbps to 52Mbps where available.
- Business and Public Sector upgraded over 80,000 UK Business Fibre broadband customers from up to 38Mbps to speeds of up to 76Mbps.
- We launched BT Call Protect to divert nuisance and unwanted calls to junk voicemail. It's free to all our customers.

Our top priorities

Looking ahead, we're focused on:

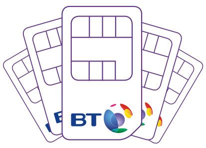
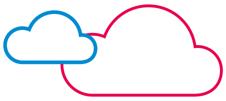
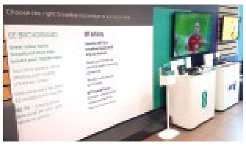
- improving every interaction between our contact centre advisers and customers, with further investment in skills and tools;
- developing all our digital channels to enable more customers to adopt online as the best method of interacting with us;
- extending the reach of our fibre and mobile networks, and reducing network faults;
- improving our Ethernet delivery processes, enhancing the experience for our business and corporate customers; and
- enabling all our people to put customers' needs at the heart of their decision making.

[a] New sites with over 30 plots registered from 10 November 2016.

2

Investing for growth

We're putting money and resources in five strategic areas that we believe will deliver sustainable, profitable revenue growth. They underpin our strategy and our operational and financial performance, which in turn contribute to our KPIs (on page 20).

Differentiated content, services and applications	**Best network in the UK**	**Fully converged service provider**	**Market leadership in all UK segments**	**Focus on multinational companies globally**
Launch of BT Smart Hub 	26.5m premises passed with fibre PG88	£150m cost synergies in the first year of EE integration PG93	37% retail broadband share PG56	180 countries PG70
Launch of BT Family SIM 	G.fast pilots in 17 locations PG88	BT Sport made available to EE customers	29% mobile market share PG62	Cloud of Clouds  PG71
BT Sport daily viewing up 12% 	80% of UK landmass now covered by 4G PG63	£1.6bn target Net Present Value of revenue synergies from EE acquisition	W&V W&V named Best Wholesale Operator[a] PG76	NFV Network Function Virtualisation PG71
My BT, My EE app improvements 	5G research with a range of partners PG33	Trial of selling BT products in EE shops 	3.8m mobile customers of Mobile Virtual Network Operators we support PG75	SDN Software Defined Networking PG71

[a] MVNO World Congress 2016.

3

Transforming our costs

Our approach to cost transformation

Operating as cost efficiently as possible is at the heart of our strategy. We've honed our approach and methodology over the past decade. It's focused on simultaneously driving customer experience improvement and cost transformation, and it's underpinned by rigorous analysis, operating management leadership and strong governance.

We still benchmark our cost of doing business against other companies inside and outside our sector to see where we can do even better.

Our largest programmes span multiple lines of business or complex changes within a single line of business. Continuous Improvement (CI) provides a complementary 'bottom-up' approach, empowering our people to make small but significant changes to how we do things every day. The result improves customer service and employee engagement while reducing the cost of failure.

Training is an important part of our approach, led by our in-house Cost Transformation Faculty, part of the BT Academy (page 53). The faculty is responsible for the continued development of both our change methodology and our 'change professionals'.

This year alone we trained and coached more than 1,000 people. BT is the only UK organisation licensed by the British Quality Foundation to certify qualifications on such a scale at the most advanced levels in Lean[a], Six Sigma[b] and Change & Project Management methodologies. We're now sharing our approach with other organisations.

How we did in the year

We've continued to pursue opportunities to further transform our costs. Despite this, our underlying operating costs excluding transit were up 1%, reflecting our investments in mobile, BT Sport and customer experience.

You can read about cost transformation within Our lines of business from **page 56**, and the group's operating costs on **page 94**.

We've insourced engineering roles in IT and networks

Programmes this year included:

- realising the cost synergies created by bringing together BT and EE, including buying synergies, rationalising our property estate, insourcing roles in both IT and networks, and creating a shared call centre planning function for the group;
- re-engineering important processes to improve our delivery of Ethernet, which has led to shorter lead times, higher output and improved quality of delivery;
- reducing our network costs in the UK and overseas by consolidating our technical facilities and deploying tools to better manage third-party costs; and
- reviewing the operating model for main areas of our business, see pages 70 and 93.

Our top priorities

Looking ahead, we're focused on:

- establishing a new unit that brings together our customer experience and our group transformation teams. The new unit will enable us to make investments and take decisions about business performance that are more clearly aligned with our customer experience and productivity priorities;
- continuing to create synergies from the integration of BT and EE by sharing best practice on cost transformation;
- gaining greater efficiency from our shared service functions and operating model in the UK and internationally; and
- addressing the customer experience and cost of failure impacts in our consumer and business products.

Restructuring

We are also expanding and accelerating areas of our cost transformation programme. We are simplifying our central Group Functions and our internal service unit, Technology, Service & Operations to improve the effectiveness and efficiency of the services and infrastructure delivered to our lines of business. We are also restructuring the Global Services organisation and accelerating ongoing transformation programmes in other lines of business. We anticipate that these transformation programmes will save in total around £300m over two years, with a restructuring charge of around £300m over the next two years, with most of this being incurred in 2017/18. This restructuring cost will be treated as a specific item. These changes will clarify accountabilities, remove duplication and improve efficiencies, removing around 4,000 roles mainly from managerial and back-office areas. The cost savings will provide headroom to offset market and regulatory pressures and support increased investment in delivering great customer experience and leading networks.

[a] Lean is a methodology for achieving small, incremental changes in processes in order to eliminate waste and improve efficiency and quality.
[b] Six Sigma is a data-driven methodology for eliminating defects in processes.

Key performance indicators

We've achieved our customer service performance goal for the year, but need to do better. We hit our revised financial guidance set in January 2017, but fell short of our financial targets set at the start of the year due to the issues in our Italian business and headwinds in UK public sector and international corporate markets.

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

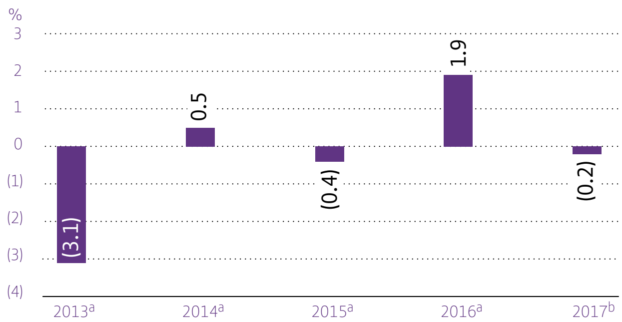
Our KPIs are chosen because they reflect the key elements of our strategy. We use these to measure the variable elements of our senior executives' pay each year, as we've explained in the Report on Directors' Remuneration (see page 122).

We've outlined our performance against each KPI here, together with an explanation 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 252 to 254.

Our key measure of the group's revenue trend, underlying revenue excluding transit adjusted for the acquisition of EE, was down 0.2% (2015/16: up 1.9%[c]) which is broadly consistent with our revised outlook.

Trend in underlying revenue excluding transit
Year ended 31 March

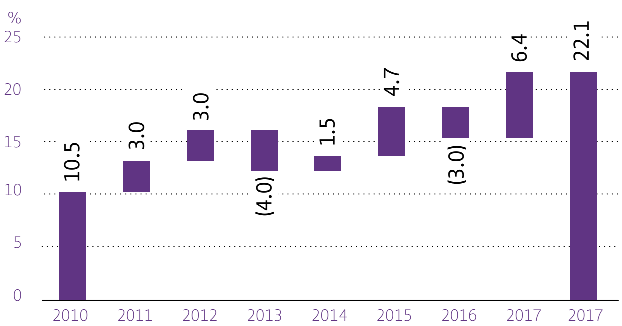


Performance
Our revenue performance has been heavily impacted by the challenging conditions we've seen in the UK public sector and international corporate markets. This was offset by strong performance in our customer-facing lines of business driven by EE and Consumer. We explain more about the performance of our lines of business from page 56.

Definition
Underlying revenue reflects the overall performance of the group that will contribute to sustainable profitable revenue growth. We exclude the impact of specific items, foreign exchange movements and disposals and from 2016/17 this measure is calculated as though EE had been part of the group from 1 April 2015. This differs from how we usually adjust for acquisitions as explained on page 252. We focus on the trend in underlying revenue excluding transit because transit traffic is low margin and is affected by reductions in mobile termination rates, which are outside our control.

Our customer service measure Right First Time was up 6.4% compared with down 3.0% last year.

Customer service improvement
At 31 March



Cumulative improvement from 1 April 2009.

Performance
Improving the service we deliver is key. Our Right First Time measure was up 6.4% (2015/16: down 3.0%). We're making good progress in some areas. Openreach achieved or is on track for all 60 of the minimum service levels (MSLs) set by Ofcom for copper, but disappointingly we missed one of the six MSLs for Ethernet. 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 17.

Definition
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, completing orders when we agreed or fixing faults within an agreed period. As well as improving service and the customer experience, keeping our promises should mean that there is less work to do to correct our mistakes, and so reduces our costs.

[a] Calculated as though EE was not part of the group until 1 April 2016.
[b] Calculated as through EE had been part of the group from 1 April 2015.
[c] Certain prior year results have been revised to reflect the outcome of the investigation into our Italian business. See note 1 to the consolidated financial statements.

Outlook for 2017/18

For 2017/18, we continue to expect underlying revenue excluding transit to be broadly flat year on year. Adjusted EBITDA is expected to be £7.5bn – £7.6bn.

Our outlook for normalised free cash flow over the cumulative two-year period 2016/17 and 2017/18 remains broadly unchanged. However, normalised free cash flow in 2016/17 of £2,782m was almost £300m above our outlook of around £2.5bn, due to early customer collections that will reverse in 2017/18. As such, normalised free cash flow in 2017/18 is now expected to be £2.7bn – £2.9bn, from £3.0bn – £3.2bn previously.

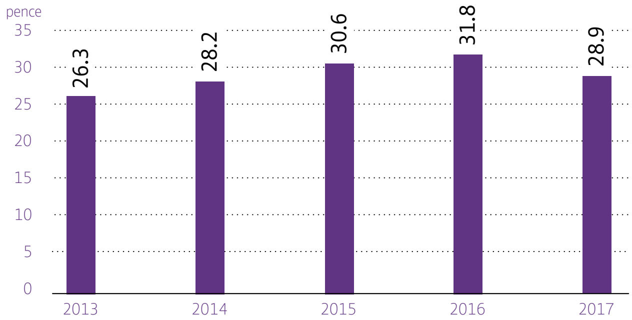
This outlook is provided on the basis of our existing investment plans. However, we continue to evaluate a range of additional investment opportunities. Our decision on whether to move forward with these will be affected by a number of factors, including the outcome of Ofcom's Wholesale Local Access Market Review, responses to Openreach's consultations and the results of any future spectrum auctions.

Our underlying dividend policy remains unchanged: to deliver progressive dividends while balancing the need to invest in the business, support the pension fund and maintain a strong balance sheet. The Board has concluded that a dividend increase of 10% in 2016/17 remains appropriate. However, given the importance of maintaining flexibility for additional investment and the range of potential outcomes, 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.

We expect to buy back around £100m of shares in 2017/18 to help counteract the dilutive effect of all-employee share option plans maturing in the year. This is below the £206m buyback we completed in 2016/17 reflecting the lower number of shares that are expected to be required for our share option plans.

Adjusted earnings per share decreased 9% to 28.9p.

Adjusted earnings per share
Year ended 31 March



Performance

Adjusted profit after tax grew 5% to £2,869m this year reflecting the impact of the acquisition of EE.

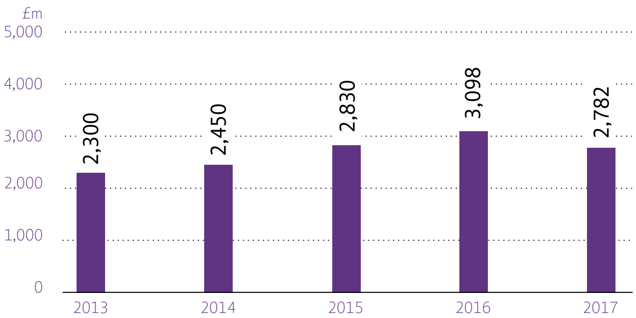
Adjusted earnings per share decreased 9% to 28.9p. The weighted average number of shares in the market increased 15%.

Definition

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.

We generated normalised free cash flow of £2,782m. This was down £316m compared with last year, but is above our revised outlook of around £2.5bn due to earlier than expected customer collections which will reverse next year.

Normalised free cash flow
Year ended 31 March



Performance

The decrease of £316m or 10% in our normalised free cash flow primarily reflects the impact of cash outflows in our Italian business as we unwound the effects of inappropriate working capital practices, as well as higher capital expenditure in relation to Emergency Services Network (ESN) and EE integration, partially offset by the benefit of an additional ten months of EE.

Definition

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.