

January 22, 2009

**Research Update:**

**BT Group PLC And Subsidiaries  
'BBB+' L-T Ratings On CreditWatch  
Negative On Trading Review; 'A-2'  
S-T Ratings Affirmed**

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## Research Update:

# BT Group PLC And Subsidiaries 'BBB+' L-T Ratings On CreditWatch Negative On Trading Review; 'A-2' S-T Ratings Affirmed

## Rationale

On Jan. 22, 2009, Standard & Poor's Ratings Services placed its 'BBB+' long-term corporate credit ratings on leading U.K. telecommunications provider BT Group PLC (BT) and wholly owned subsidiary British Telecommunications PLC on CreditWatch with negative implications. This action follows the release of BT's update on reviews being carried out in its BT Global Services division, along with details of trading in the third quarter of financial 2009 (ending March 31, 2009). At the same time, the 'A-2' short-term ratings on BT and British Telecommunications were affirmed.

The CreditWatch placement reflects our near-term concerns for the weaker-than-expected EBITDA and profit margin performance at BT's Global Services division for the second quarter running. This follows an earlier trading update issued on Oct. 31, 2008. The reassessment of contract values and challenges related to obtaining cost efficiencies, and the costs associated with achieving a steadier state for this division, could adversely affect our assessment of BT's overall business risk profile. This is because the projected growth in cash flow generation at BT Global Services--which so far has faced falling EBITDA for the first nine months of financial 2009 of about 43%--represents an important support to BT's ratings in the future. Potential cash outgoings for the restructuring of BT Global Services and, importantly, any additional outgoings arising from an unfavorable outcome from BT's upcoming triennial pensions review, could result in additional funding requirements, as in previous years. These elements could lead us to lower the rating by one notch.

The ratings continue to be supported by the group's substantial market positions in the U.K. fixed-line and broadband markets, and by its ongoing focus on operating efficiency. These strengths underpin substantial free operating cash flow (FOCF) generation, albeit that this likely to be lower in financial 2009 versus the prior year. Such strengths are set against intense competitive pressures, including pricing and product convergence, as well as moderate margins.

Adjusted debt was £16.1 billion at Sept. 30, 2008. Current credit metrics, including adjusted debt to EBITDA at 2.8x and FOCF to adjusted debt at 9.8% for the 12 months to Sept. 30, 2008, are weaker than our long-term expectations for the ratings and do not provide rating headroom for further deterioration.

## Short-term credit factors

The short-term rating on BT is 'A-2'. This reflects our expectation that the group will maintain substantial cash generation, meaningful cash balances, and good access to external sources of liquidity, which has been the case to date. Capital expenditures and dividends should be financed from internally generated funds, as in financial 2008 when large working capital inflows in the fourth quarter offset previous adverse working capital movements and pension contributions.

The short-term rating is bolstered by the group's:

- Cash of £915 million at Sept. 30, 2008.
- Historically good access to the capital markets.
- Commercial paper programs at wholly owned subsidiary British

Telecommunications. These have a notional limit of \$35.0 billion, backed up by a £1.5 billion five-year committed credit facility. BT raised £851 million of net proceeds from commercial paper in the quarter ended Sept. 30, 2008. Its ability to source funds via commercial paper is subject to market conditions, however.

- Committed facilities of £900 million (up to March 2009, with a one-year term-out option) and £10 million in additional short-term facilities.
- Expected continued near-term cash generation that should not meaningfully deviate from annual FOCF of more than £1.5 billion, although this will now likely be lower in financial 2009.

These items are expected to be sufficient to refinance or repay £1.9 billion of short-term debt at Sept. 30, 2008, and interim dividends totaling approximately £420 million, to be paid in February 2009.

## CreditWatch

To resolve the CreditWatch, we will factor in the group's business plan, operating performance, and financial strategy for financial 2010 and beyond. We expect the latter to include developments related to the pensions review, capital expenditure plans, and the stance of the BT board on dividends. To this end, we will hold further discussions with BT's management in the short-term.

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
BT Group PLC		
Long-Term Corporate Credit Rating	BBB+/Watch Neg	BBB+/Negative
Short-Term Corporate Credit Rating	A-2	A-2
British Telecommunications PLC		
Long-Term Corporate Credit Rating	BBB+/Watch Neg	BBB+/Negative
Short-Term Corporate Credit Rating	A-2	A-2

*Research Update: BT Group PLC And Subsidiaries 'BBB+' L-T Ratings On CreditWatch Negative On Trading Review; 'A-2' S-T Ratings Affirmed*

Senior Unsecured Debt Rating	BBB+/Watch Neg	BBB+
Commercial Paper Rating	A-2	A-2

Esat Group Ltd.

Corporate Credit Rating	BBB+/Watch Neg/--	BBB+/Negative/--
Senior Unsecured Debt Rating	BBB+/Watch Neg	BBB+

BT Finance B.V. (Netherlands)

Senior Unsecured Debt Rating*	BBB+/Watch Neg	BBB+
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\*Guaranteed by British Telecommunications PLC.

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