TalkTalk Group

TalkTalk Group is our UK fixed line telecoms division, serving over 3.9m fixed line customers comprising 2.8m broadband and 1.1m voice-only and narrowband customers. It is currently the number 3 player in the UK broadband market, with by far the most extensive unbundled network in the UK, which supports a low-cost operating model that enables strong profitability even on market-leading tariffs. Its B2B operation, branded Opal, is a major player in the small business market.

Over the last 12 months we have successfully completed the integration of the AOL broadband business and continued to grow the business organically. The bulk of our network investment is now complete and the business is set to be strongly cash generative going forward.

Financial Performance

- Revenue down 3% to £1,385m, reflecting a growing broadband base offset by declines in our narrowband and voice-only bases
- Headline EBITDA up 56% to £181m, driven by the increasing proportion of on-net customers
- Headline EBIT up 80% to £124m, reflecting EBITDA growth partially offset by higher depreciation and amortisation charges
- Capex of £106m, down 38% year-on-year after the substantial completion of our network build-out

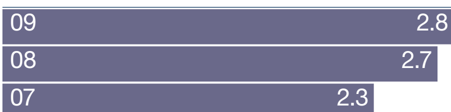
Operational Highlights

- Completed integration of AOL broadband business
- Continued migration of customers onto our own network, with 78% of all broadband customers now on-net
- 186,000 broadband net adds, before 93,000 AOL base clean-up, taking the total base to 2.8m
- Broadband monthly ARPU up 3% to £22.65
- Major improvements in customer service, resulting in reduced churn and much more positive customer perception

Key Performance Indicators

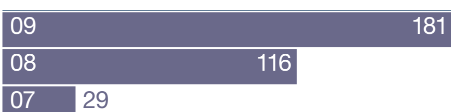
Broadband customer base (m)

2.8m



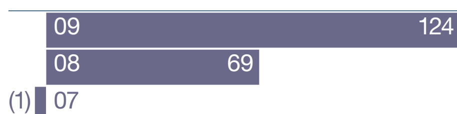
Headline EBITDA (£m)

£181m



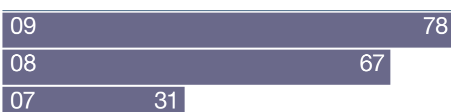
Headline EBIT (£m)

£124m



% on-net

78%



Strategy

The TalkTalk Group is clearly positioned as the best value provider in the UK residential broadband market. We do not believe that low cost should equate to low service, so we are absolutely focused on maintaining and improving our network quality, developing innovative products and delivering a positive experience to customers.

Maintaining and growing our broadband market share

Our market share has been steady at around the 16% mark for the last two years. We believe that, as our service levels have improved, some of our direct competitors have weakened and as consumers look for value, we are well placed to grow our share. With strong margins and low churn, each marginal new customer generates a very high net present value for the division. In addition, increasing scale enables us to spread fixed network costs across a wider base.

Focusing on value and simplicity

Our customer research tells us that people are fed up of paying over the odds for a bundle which includes services they don't want. Our proposition is clear: we are the best value provider of a combined package of calls, line rental and broadband, with no expensive extras. However, we have developed a range of "Boosts", which allow customers to sign up for higher speeds, greater download capacity and other features, whenever they like without being contractually committed to them.

Continuing to improve network performance and reliability

As broadband becomes more ubiquitous and customers find more and more things to do on the internet, usage is increasing significantly. We have anticipated this trend and have been developing our network to manage the huge increases in demand expected over the next three years. The investments we have made will allow us to do this while protecting our margin structure.

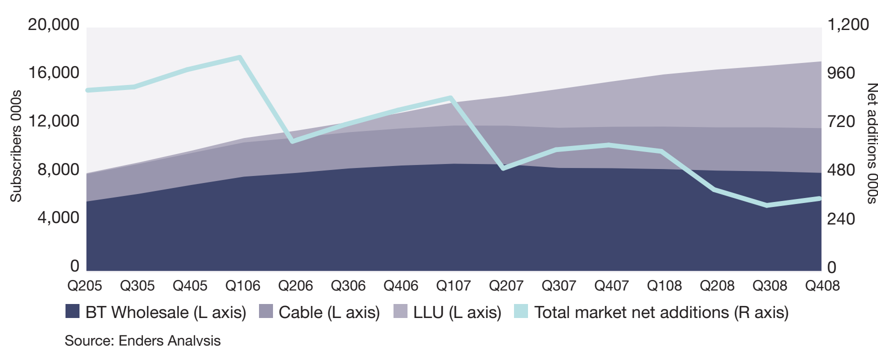
Targeting strong cash generation

The Group has invested over £900m into the TalkTalk Group over the last six years. That period of investment is now over: capex is declining sharply, and the customer base we have built up is highly cash generative. We have set a target of over £100m operating free cash flow from the division in 2009-10.

Marketplace Trends

UK broadband market

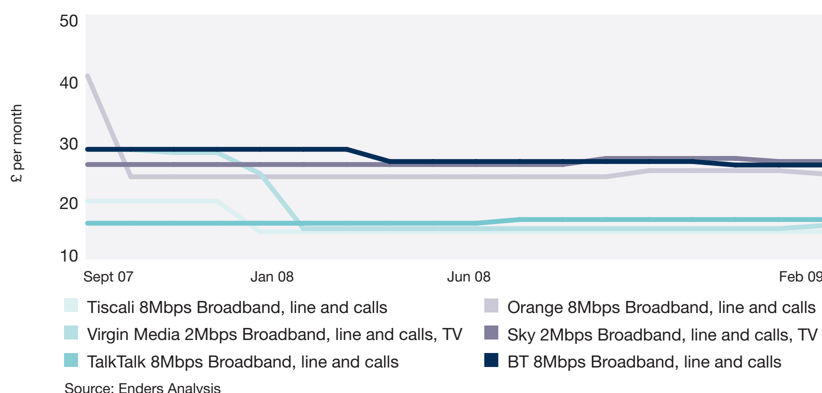
Growth in the UK broadband market slowed sharply during 2008, principally as a result of the decline in housing transactions. Penetration has reached over 65%, and despite the slowing growth we expect the market to eventually reach 80% penetration in the next 3-4 years.



Source: Enders Analysis

Broadband tariffs

Broadband and bundled pricing has been remarkably stable overall for the last three years, since we came in and repriced the market in April 2006. Competition is rational, with financially weaker players now marketing less aggressively, and there have even been signs of price rises in recent months. Over time we expect pricing changes to be driven by speed and metered access.



Source: Enders Analysis

Headline Financials

	2009 £m	2008 £m
Revenue	**1,385**	1,424
Residential*	**1,089**	1,112
Business	**296**	312
EBITDA pre-SAC and marketing	**307**	280
SAC and marketing	**(126)**	(164)
EBITDA	**181**	116
Depreciation and amortisation	**(57)**	(47)
EBIT	**124**	69
EBIT %	**9.0%**	4.8%

* Comprises residential customers and small business customers with similar profiles.

Short-Term Risks and Challenges

- A weak consumer environment could affect market growth and increase the level of bad debts
- We may not be able to pass on in full the copper price increases allowed by OFCOM to our customers
- Struggling competitors may behave irrationally and undercut the market

Longer-Term Risks and Challenges

- Some of our competitors have much greater financial resources and may choose to use broadband as a loss-leader for other products
- Regulation may curb our access to fibre infrastructure at fair prices, thus preventing us from delivering higher speeds to customers
- Network or customer service may deteriorate, increasing our churn rate

TalkTalk Group delivered another good performance last year, growing its customer base, increasing the proportion of its customers on its unbundled network from 67% to 78% and achieving a substantial reduction in its churn rate. Despite the unexpected slow-down in the rate of growth in the broadband market, TalkTalk Group still increased in profitability, with Headline EBIT growing by 80% to £124m and Headline EBIT margins almost doubling from 4.8% to 9.0%. TalkTalk Group has also started to deliver strong cash flows, and has significantly increased visibility of these cash flows going forward.

Residential revenues were down marginally in the last financial year, falling 2% to £1,089m (2008: £1,112m).

Blended broadband monthly ARPU rose by 3% to £22.65. The increase was driven by the greater proportion of higher ARPU TalkTalk customers within the base. Non-broadband ARPU rose 18% to £20.93, reflecting price increases in line with BT's voice price increases during the year.

B2B revenues declined by 5% to £296m (2008: £312m). Opal continued to improve its revenue mix, with an ongoing trend towards higher value services offsetting falling premium rate traffic. In the second half, the business launched its new suite of data products for the small business market, which is expected to drive moderate revenue growth in 2009-10.

During the year underlying growth in the broadband base was 186,000 customers, but as part of the AOL integration process, we identified a discrepancy of 93,000 customers and reduced the base accordingly at the half year. This delivered a net increase of 93,000 customers to 2.8m.

Our base of non-broadband customers, encompassing customers taking our voice-only service or narrowband package, continued to decline in line with our expectations, ending the year at 1.1m customers. A large number of these customers are signing up to our own bundled broadband services.

The TalkTalk broadband base made further excellent progress during the year, increasing by 339,000 customers or 27%. The customer service issues of previous years are now behind us and our simple value proposition continues to gain traction in the market. Growth picked up noticeably towards the end of the financial year, reflecting what is seasonally our strongest quarter for broadband growth but also underlining the brand's value credentials as customers increasingly look to save money in the current economic climate.

Trends in churn at TalkTalk were also very encouraging, with annualised churn falling materially year-on-year as customers became increasingly satisfied with our service levels, and the housing market became more subdued. With our highly efficient, fully-unbundled network,

we are able to generate strong cash margins while maintaining the most competitive telecoms bundles in the market. With customer lifetimes lengthening and acquisition costs stable, we believe the net present value of the base is increasing all the time.

As expected, the AOL Broadband base fell by just under 245,000 customers, reflecting the 93,000 adjustment noted above and customers switching from the higher broadband tariffs to which AOL customers were historically signed up. We focused our retention programmes on customers living within our unbundled exchange footprint, where we can offer lower tariffs reflecting our lower cost base in those areas. As a result, AOL churn rates reduced towards the end of the year. We also completed the integration of AOL during 2008, combining the businesses under a single UK residential management team.

We made further substantial progress on the footprint, capacity and resilience of our telecoms network during the year. We unbundled a further 326 exchanges, taking our fully-unbundled network to 1,705 exchanges and our partially-unbundled network to 1,251 exchanges. Together this gives us approximately 80% coverage of the UK population. We unbundled 372,000 customers during the year, taking the total unbundled base to 2.2m customers or 78% of the total broadband base, in line with our goal. We remain the largest unbundler in the UK, representing 39% of all unbundled lines. Importantly, we are still the only broadband provider that has succeeded in making full unbundling work. This is testament to the skill of our engineers and our strong supplier partnerships, and enables us to provide packaged broadband and voice services at a much lower cost than our partially-unbundled competitors.

At the year end we changed the way we account for subscriber acquisition costs ("SAC"). Historically we have capitalised SAC and amortised it over a customer's minimum contract term – typically 18 months. We are now expensing SAC as incurred, bringing our policy in line with the majority of other telecoms companies and more closely aligning our profit and loss performance with our cash flow.

Cash flow

	2009 £m	2008 £m
Headline EBITDA	**181**	116
Working capital	**(35)**	12
Capex	**(106)**	(172)
Operating free cash flow (pre-exceptionals)	**40**	(44)

TalkTalk Group generated operating free cash flow of £40m (2008: outflow of £44m). Strong EBITDA growth was partially offset by an outflow on working capital, which was caused by timing issues due to a change to calendar month ends; there was no deterioration in underlying working capital. Capex reduced from £172m to £106m, reflecting high levels of network investment in the prior year.

The major elements of the capital expenditure on the network in 2008-09 were the additional exchanges unbundled, increased capacity in existing exchanges, and the continuation of our project to increase backhaul capacity within the network. By the end of the year we had substantially completed our new CRM and billing platform investment and have commenced migrations, which should enable us to provide an enhanced service to customers in the years ahead.

Outlook

The prospects for the coming year are good. After many years of investment, we expect TalkTalk Group to deliver significant free cash flow and consolidate its position in the marketplace. While we remain mindful of the tough times many of our customers are enduring, we believe that residential broadband and telephony are must-have services that customers are unwilling to forego. At the same time, as a clear value player with no unwanted services within the bundle, we expect to benefit from customers seeking to save on monthly outgoings by moving to TalkTalk.

We expect to achieve 125,000-175,000 broadband net adds next year, reflecting stable market share in a maturing market. ARPU growth is expected to be marginal, with some beneficial mix effects and the sale of additional value-added services likely to be cancelled out by a slight decline in voice traffic.

The non-broadband base is likely to continue to decline but at a slower rate than this year, with ARPUs again broadly stable.

Within the B2B operation, we are budgeting for revenue growth of 3-5%, driven by the launch of new data services and a renewed strategic focus. EBITDA margins in both businesses are expected to be flat to slightly up, driven by operating efficiency and scale benefits.

While overall EBIT growth is likely to be limited, we are targeting significant free cash flow generation. We are planning for neutral working capital and a further reduction in capex, to £80m in the coming year. This allows us to target operating free cash flow of over £100m, a figure which we believe is sustainable in the medium term.

Longer term we are bullish about the outlook for broadband. The market appears to be consolidating around four major players, of which we are clearly differentiated as offering transparent value and simplicity. Across both our divisions, we are guided by our view of the connected world – that customers will increasingly use mobile and fixed broadband connectivity wherever they are, to integrate their entertainment, domestic and business needs seamlessly. This makes the broadband connection in the home one of great strategic importance and value.

However, we remain conscious of the role of the regulator in ensuring that where significant investment has been made, it is suitably protected. Fibre networks will come, although we do not believe they will reach the mass market for five years. When they do, we are confident that we will be able to access that infrastructure at fair rates determined by natural market forces.

Best Buy Europe

Best Buy Europe, in which the Group has had a 50% share since 1 July 2008, encompasses our retail operations across Europe and our share of profits in Best Buy Mobile in the US.

During the year we have made significant progress in evolving our existing customer proposition and product mix beyond mobile phones to include mobile broadband, laptops and other connected devices. We have not only broadened the offer in our small stores but also introduced a slightly larger format, "Wireless World", which embraces gaming and an extended laptop offer, as well as a Geek Squad technology support presence.

We have also laid the foundations for our Big Box consumer electronics format, which we plan to launch in the UK in spring 2010.

Financial Performance

- Revenue up 15% to £3,563m, driven by market share gains and currency movements
- Headline EBIT down 33% to £101m, reflecting the tough economic environment and our pursuit of market share gains
- £7m of opex relating to the Big Box project
- First-time contribution of £8m from Best Buy Mobile, a year ahead of plan

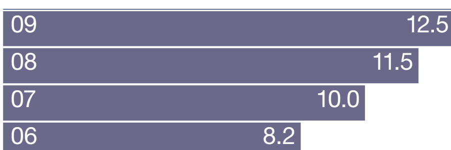
Operational Highlights

- Roll-out of laptop proposition to all UK stores and the majority of European stores
- Estimated 5% UK laptop share from a standing start
- Strong growth in handset market share
- Very strong growth in strategically important products such as mobile broadband and smartphones
- First new format mid-sized stores opened, with a further 30-40 to follow this year

Key Performance Indicators

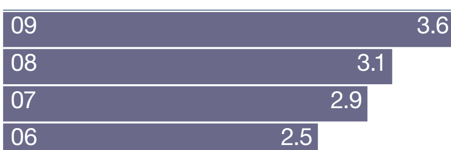
Connections (m)

12.5m



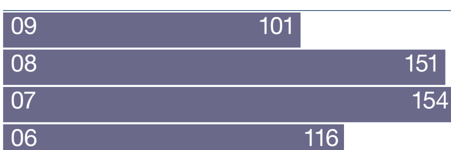
Revenues (£bn)

£3.6bn



Headline EBIT (£m)

£101m



Strategy

The Carphone Warehouse has survived and thrived in a highly competitive mobile industry by constantly identifying changes in consumer behaviour which present opportunities if we address them and threats if we do not. Over the last two years we have been undergoing our biggest evolution yet, as we address the opportunity presented by the "Connected World" – and this governs the main elements of our divisional strategy.

Evolving the retail proposition to embrace a broader array of connectivity services

We have been very successful in developing our existing store proposition to offer a wider range of connected devices, to reflect new services available in the market and customers' changing technology needs. Mobile broadband, laptops and smartphones have been significant contributors to top line growth this year. Looking ahead, this is set to continue as we refine the small store offer and roll out 30-40 of our new, mid-sized stores.

Growing our market share of mobile connections

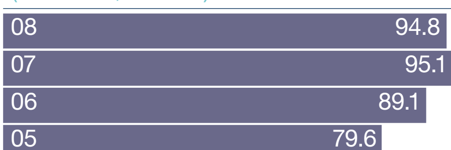
Market share has long been a key element of our strategy. Significant share makes us an important partner to network operators and handset manufacturers alike. The opportunity for market share growth is greater in a weak handset market, as more marginal players struggle to compete with our proposition. We estimate that our market share improved significantly year-on-year and we aim to deliver further strong gains over the next 12 months.

Launching a multi-channel consumer electronics business

With our partners Best Buy, the acknowledged global champions of Big Box consumer electronics retailing, we are planning to launch a major assault on the UK electricals market. Our first out-of-town stores are scheduled to open in spring 2010 and, if successful, we will roll out a presence across the UK supported by a full multi-channel service offering. We are confident that the planned investments will generate a new and material leg of growth for the business.

Marketplace Trends

Handset sales Western Europe*
(units sold, millions)



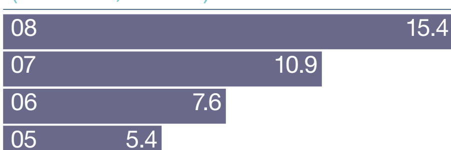
Source: GFK

* For the nine markets in which Best Buy Europe operates.

European handset market

After five years of strong and consistent growth, 2008 witnessed a slight fall in the European handset market. A combination of market saturation, the macroeconomic environment and a lack of new products in the mid-tier all contributed to this decline. At this stage we expect a similar trend in 2009, followed by stabilisation in 2010.

Laptop sales Western Europe*
(units sold, millions)



Source: GFK

* For the nine markets in which Best Buy Europe operates.

Laptop sales and penetration

The laptop market is set for continued strong unit growth as prices fall, hardware becomes subsidised with mobile broadband, and smaller, "netbook" type products proliferate. The market in Western Europe was up 41% in 2008 but is still only a fraction of the size of the mobile phone market.

Headline Financials (100% basis)

	2009 £m	2008 £m
Revenue	**3,563**	3,091
Gross margin	**1,033**	940
SG&A	**(845)**	(723)
EBITDA	**188**	217
Depreciation and amortisation	**(87)**	(65)
Joint ventures	**–**	(1)
EBIT	**101**	151
EBIT %	**2.8%**	4.9%

Short-Term Risks and Challenges

- A weak consumer environment and an uncertain outlook mean that the business needs to remain flexible in its financial planning
- The launch of the Big Box consumer electronics proposition requires significant upfront investment and a major commitment of resource on which we may not achieve a satisfactory return
- Currency movements could have a negative impact on handset prices and erode margins
- Failure to improve working capital management could increase financing costs

Longer-Term Risks and Challenges

- Mobile networks may continue to invest in their own distribution platforms and seek to deal directly with their customers
- The rate of technological change may slow, reducing the need for customers to upgrade their handsets
- We may experience significant price competition in the consumer electronics market, damaging the economics of our business plan
- Competition between network operators may subside, reducing incentives to customers

Best Buy Europe's revenues grew 15% to £3,563m, with 9% growth coming from the strength of the Euro year-on-year. Headline EBIT fell 33% to £101m (2008: £151m). Although profitability fell year-on-year, we made significant progress in the development of the business and are well positioned in terms of market share, product diversification, an efficient cost base and the strength of our relationships with both vendors and mobile network partners.

During the year, we achieved total connections of 12.5m, up 8% year-on-year (2008: 11.5m), despite what we estimate to be a year-on-year decline in the European handset market. As a result we estimate that our market share has grown significantly, reinforcing our belief in the value of our independent model in the eyes of the consumer.

Subscription connections were also up 8% to 4.8m (2008: 4.5m). Growth in subscription sales was driven by high-end, internet-enabled handsets, and by mobile broadband connections. It is clear that mobile data, whether via laptops or handsets, using 3G networks or WiFi, is really taking off. We have positioned ourselves well to capture this rapid growth, as the connections figures demonstrate. In contrast, the market for mid-tier handsets, the historical "bread and butter" of the subscriptions market, was in decline throughout the year. There are now signs however, that the features available in high-end devices are now cascading into the more mass market mid-tier ranges, and this segment of the handset market is beginning to show signs of improving.

Pre-pay connections were up 9% to 7.0m. After a slow second quarter, pre-pay sales picked up in the second half of the financial year as we took significant market share from general retailers. Although we initially thought that the pre-pay business would be more at risk from a more cautious consumer environment, any effects were more than offset by our own strong market share gains.

Like-for-like revenue, stripping out the impact of new space, was up 7.9% and at constant currencies, like-for-like revenue was up 1.1%.

Divisional gross margin fell 140 basis points year-on-year, from 30.4% to 29.0%. This decline reflected both a more aggressive trading stance, as we sought to use our scale and strong financial position to grow our market share, and the impact in our product mix of lower margin mobile broadband connections and our drive into the laptop market place.

We opened 180 stores during the year, and closed or relocated 132, giving net store additions of 48. The total store base was 2,459 at the year end (2008: 2,411), including 219 franchise stores (2008: 236). Total average selling space excluding franchises was up 8% to 122,470 sqm (2008: 113,438 sqm). Including franchises, total average selling space was up 7% to 131,137 sqm (2008: 122,976 sqm).

During the year we reduced our plans for fresh store openings based on our traditional store format after several years of rapid expansion. We focused instead on the most significant change

to the in-store proposition achieved in the business's history, which included the introduction of a full laptop offer across a significant proportion of the portfolio. In October, we opened the first of our new, mid-sized stores, which are up to 300 sqm, compared to our normal small store size of around 60 sqm. These mid-sized stores offer not only a much wider range of laptops, but also areas dedicated to gaming, wireless TV and music services, all backed up by an in-store Geek Squad presence. These stores have performed very strongly, with excellent customer feedback, and we will be introducing a further 30-40 over the coming year, through a mix of new stores and refits.

During the year we also trialled a major change to how our sales consultants are remunerated, with the introduction of higher base salaries and bonuses, to replace the traditional mix of lower salaries and sales-based commissions. Under the trial, bonuses are based on a store's Net Promoter Score, which is a measure of the difference between positive and negative customer feedback. The trial was a success and we are now progressively introducing this structure across the whole of the UK business. There has been no deterioration in sales performance as a result, and we believe that, over time, it will create even greater trust in the brand in the eyes of customers.

White City, London
We opened four new mid sized store formats last year show casing a much wider range of laptops and connected devices alongside the core mobile propositions.

In the US, Best Buy Mobile had an outstanding year. This business, in which Best Buy Europe have a profit-sharing agreement, was launched two years ago to reposition Best Buy's mobile retailing operations with the assistance of Carphone Warehouse. Over the course of the year its in-store presence has been introduced across all of Best Buy's Big Box stores in the US, delivering near triple-digit rates of like-for-like growth and significant market share gains as a result. In addition, Best Buy have opened 33 standalone stores, taking the total to 39. Our share of profits for the year was £8m and is expected to grow significantly in the year ahead.

Best Buy Mobile, USA
Best Buy Mobile had an outstanding performance this year. We have opened 33 standalone stores this year, taking the total to 39. Best Buy Mobile's in store presence is now in every Best Buy Big Box store in the US.

Since the deal with Best Buy, which completed at the end of June, we have committed significant resource to the Big Box consumer electronics retail launch, planned for spring 2010. We had originally scheduled the first store openings for the second half of 2009, but the highly favourable property environment has presented us with increasingly attractive opportunities, both in terms of locations and lease terms. As a result, we have chosen not to rush, but to take our pick of the opportunities and ensure that our launch has the most material impact. We incurred approximately £7m of costs relating to the launch during the year.

Best Buy Europe's Insurance business continues to be an important contributor to the profitability of the business. Customers value the protection it gives when they commit to a high value contract and receive a heavily subsidised, valuable mobile phone. Although performance earlier in the year was relatively subdued, business picked up in the second half. We benefited from the introduction of the laptop proposition into the stores, and also from the development of a combined insurance and Geek Squad assurance policy, giving customers not only protection against loss, but also access to technology assistance from the Geek Squad.

Cash flow (100% basis)

	2009 £m	2008 £m
Headline EBITDA	**188**	217
Working capital	**(160)**	(4)
Capex	**(115)**	(107)
Operating free cash flow (pre-exceptionals)	**(87)**	106

Best Buy Europe saw an outflow on operating free cash flow of £87m (2008: inflow of £106m). The adverse movement was largely due to working capital, particularly in the first half of the year. Our working capital position reflected an increasing alignment of our interests with our network partners, with commission being deferred over the contract life rather than paid up front. Whilst not affecting revenue recognition, this had an adverse impact on working capital. We have been working with the networks and other key suppliers to limit further absorption of working capital, experiencing minimal absorption in the second half of the year, and expect much-improved cash generation in 2009-10.

Mobile Life Report 2008
We established Mobile Life in 2006 to better understand the impact of mobile phones on our customers' daily lives. Mobile Life provides our business with invaluable insights which enable us to respond better to our customers' needs across the business, to deliver better product solutions, to improve advice, and to provide superior customer care.

For the full document visit: www.cpwplc.com

Outlook

The short-term outlook for Best Buy Europe is inevitably uncertain. Economies across Europe are set to be in recession throughout 2009, and we do not expect the handset market to be immune to these wider pressures. We have set our budgets for the year with this in mind.

Overall we expect revenues to be broadly flat in 2009-10, excluding currency effects. We estimate that the handset market will fall slightly but that we will continue to make market share gains, with connections approximately flat. In addition, the evolution of the retail proposition should see an increasing proportion of non-connection related revenue within the mix, with the result that from the following year, connections will become a less reliable proxy for revenue growth.

We expect gross margin to decline by 25-50 basis points. This reflects a continuation of our trading strategy and further increases of hardware sales within the revenue mix. However, the cost saving programme which we have undertaken during 2008-09 is expected to offset the impact of the gross margin deterioration at the EBITDA level.

We are planning for a minimal increase in the overall store count. Our focus will be on further developing the retail proposition and opening 30-40 of our new, mid-sized format stores. This should result in around 1-2% growth in average space for the year.

Our plans for the Big Box store openings will accelerate through the year and will result in start-up costs of approximately £30m, in line with the figure we indicated in October 2008. This primarily reflects the costs of the team, research and consultancy fees and the pre-opening rents on the new stores.

Best Buy Mobile is set to grow profits strongly in the coming year, enjoying a full year's trading out of all Big Box stores and further standalone store openings. Best Buy Europe's share of profits is expected to rise to £20-25m.

The impact of all of these effects is expected to result in an EBIT margin of 2.5-3.0%. The Group's share of the taxed profits of the division is anticipated to be in the £30-40m range.

Cash flow for the division will be a major focus for the year and we are targeting an operating free cash flow figure of £50m, after Big Box investments and start-up costs. Capex for the core business is set to fall with the decline in new store openings, and we aim to reduce working capital outflow materially year-on-year.

Longer term, the outlook is very positive. Tough trading conditions are effective at taking out spare capacity and our competitive position is improving. We have made significant progress in developing our retail model, and see good prospects of material profits growth from Best Buy Mobile and Best Buy Big Box stores in the UK over the next five years.

Whilst profitability has suffered against the economic environment, we have areas of substantial progress for the Group to report.

Roger Taylor, Chief Financial Officer

Joint ventures and associates

Alongside the results of Best Buy Europe since the transaction with Best Buy, the Group's share of results of joint ventures and associates in the income statement includes our share of post-tax losses from Virgin Mobile, our French MVNO.

Virgin Mobile had a second successful year of customer growth, adding over 300,000 customers and bringing its base to over 1.1m customers, of whom 44% are subscription. Our share of losses for the year was £8m. The business continued to invest significantly in brand-building and customer recruitment, and while it will record further losses in 2009-10, broadly in line with 2008-09 levels, as it continues to invest in growth, we expect it to move to profitability at the EBITDA level on a monthly basis in the second half of this year.

Exceptional items

The disposal of 50% of the Group's retail and distribution business gave rise to a net gain after tax of £608m, which is reflected in the results of discontinued operations. Indirect costs of £6m after tax also arose as a result of the transaction. Further to the new partnership, Best Buy Europe commenced the disposal of approximately 100 stores, and accelerated a shift in its range of retail stock away from mobile phones towards laptops and other products, resulting in an exceptional charge. Exceptional costs associated with these programmes are reflected in a post-tax charge of £11m through the results of joint ventures.

Prior to the transaction with Best Buy, the Group conducted a review of its central support structures, particularly in relation to its retail and distribution business, to achieve greater divisional autonomy and efficiency. This review resulted in a reorganisation programme that is expected to yield savings of £7m per annum. Redundancy and other restructuring costs that have arisen as a result of the programme are reflected in a post-tax charge of £9m in discontinued operations.

Further to the divisionalisation process, both TalkTalk Group and Best Buy Europe have undertaken comprehensive reorganisation programmes in the second half of the year. The TalkTalk Group programme is expected to generate annualised savings of approximately £10m per annum, and has resulted in redundancy and other restructuring costs of £10m, which are reflected in exceptional operating expenses. The Best Buy Europe reorganisation is expected to yield annualised savings for the joint venture of up to £50m per annum, and has resulted in a post-tax charge through the results of joint ventures of £7m. TalkTalk Group also completed the transfer of its AOL network operations, hosting, billing and customer management from a transitional platform provided by AOL Time Warner onto the Group's own systems, at a cost of £16m, shown within exceptional operating expenses.

Additionally, an exceptional foreign exchange loss of £85m has arisen in the year following a change in the functional currency of the Group's brand company from Swiss Francs to Sterling. The transaction with Best Buy necessitated a change in the operations of the brand company, which in turn made Sterling the appropriate functional currency. As a result of the change, movements on the brand company's Swiss Franc borrowings, which would have previously been recognised through reserves, were thereafter reflected in the income statement. These borrowings were converted into Sterling before 31 March 2009. A tax credit of £24m has been recognised in respect of this loss.

The Group no longer has any material exposure to movements in the Swiss Franc.

Finally, the Group fully impaired its legacy wireless internet investments, resulting in a non-cash charge of £5m through exceptional operating expenses.

Amortisation of acquisition intangibles

The amortisation charge in respect of acquisition intangibles amounted to £71m (2008: £75m), primarily in relation to AOL.

Interest and taxation

Net interest of £4m was payable during the year, a substantial reduction in the charge for 2007-08 of £45m, as a result of the proceeds from the transaction with Best Buy. The effective tax rate on Headline profits from continuing operations excluding joint ventures was 17% (2008: 50%). The tax rate benefited from the recognition of previously unrecognised tax assets.

Earnings per share ("EPS")

Headline EPS was 12.6p, a reduction of 18% year-on-year (2008: 15.2p). Statutory EPS was 61.6p (2008: 8.1p), reflecting the gain on the transaction with Best Buy.

Group cash flow

	2009 £m	2008 £m
TalkTalk Group	**40**	(44)
Best Buy Europe		
Gross disposal proceeds	**1,041**	–
Other cash movements	**(106)**	140
Exceptionals (cash element)	**(20)**	(15)
Acquisitions (net)	**(76)**	(68)
Tax and interest	**(4)**	(45)
Dividends and shares	**(89)**	(17)
Other	**(16)**	(20)
Net cash flow	**770**	(69)
Opening net debt	**(843)**	(618)
Foreign exchange	**(86)**	(156)
Closing underlying net debt	**(159)**	(843)

The Group had underlying net debt at the year-end of £159m. In addition, the Group had used its committed facilities to provide funding of £293m to Best Buy Europe at the end of March, and total net debt including Group borrowings to fund these loans was therefore £452m. The loans were provided under a £475m revolving credit facility, half of which is guaranteed by Best Buy Co., Inc.

Best Buy Europe had net debt of £47m at the end of the year, comprising loans from the Group of £293m and net cash and other borrowings of £246m; Best Buy Europe's net cash and other borrowings are not consolidated into our Group results. The Group's effective net debt, including the Group's share of Best Buy Europe net debt, was therefore £182m.

The principal components of TalkTalk Group's operating cash flows are detailed above.

The Group received gross proceeds of £1,041m from the transaction with Best Buy. Other cash movements reflect operating cash flows prior to the transaction (shown in the Group cash flow as discontinued operations), the removal from Group debt of Best Buy Europe's cash and debt, and share capital invested in the business since June. In the prior year, other cash movements reflect Best Buy Europe's operating free cash flow, together with net disposal proceeds of £34m.

The principal acquisition cost in the year was the final deferred consideration payment of £70m for the AOL acquisition.

Tax and interest reflects a sharp reduction in year-on-year interest costs, and continuing minimal tax payments, reflecting the substantial tax losses available to TalkTalk Group.

Dividends and shares include the acquisition of 24m Group shares into our Employee Benefit Trust earlier in the year to avoid future dilution from the exercise of share options, at a cost of £53m.

Dividends

We are proposing a final dividend of 3.00p per share (2008: 3.00p), taking the total dividend for the year to 4.35p, which represents an increase of 2% on last year, and which against Headline earnings provides dividend cover of 2.9 (2008: 3.7).

Balance sheet

The transaction with Best Buy has resulted in the deconsolidation of the Best Buy Europe balance sheet and the Group's share of Best Buy Europe is now shown in interests in joint ventures and associates.

Group net assets have increased from £651m to £1,116m. Goodwill, other intangible assets, property plant and equipment, current assets and current liabilities have all reduced significantly year-on-year as a result of the deconsolidation. Loans to Best Buy Europe are shown separately in the balance sheet.

Foreign exchange

A large proportion of the Group's borrowings at the start of the year were held in Euros and Swiss Francs, as a hedge against non-Sterling assets. The part-disposal of the Euro-denominated businesses within Best Buy Europe has substantially reduced the Group's requirement for Euro hedges, although some hedges remain in respect of the Group's investment in and funding to Virgin Mobile France and on cash flow hedges for TalkTalk Group.

The further weakening of Sterling during the year caused significant currency outflows in relation to Swiss Francs. However, the change in the functional currency of the Group's brand company from Swiss Francs to Sterling during the year and redenomination of its borrowings have materially eliminated the Group's exposure to Swiss Francs by the end of the year.

Financing and treasury

The Group's operations are financed by committed bank facilities, retained profits and equity. The Group's committed bank facilities are a £550m revolving credit facility ("RCF"), which is used for working capital purposes, and a £375m term loan. The facilities mature in March 2013 and October 2012 respectively. The terms of both facilities are similar and the covenant packages are identical. The Group was in compliance with the covenant conditions of both facilities at the year end.

Most uncommitted money market loans have been terminated as a result of banks' credit constraints, although some overdraft facilities are still in use to provide working capital flexibility.

Funding of our subsidiaries is arranged centrally with an emphasis on tight cash control and efficient cash management. All funding is provided on an arm's length basis and currency risk is ordinarily hedged using foreign exchange swaps or currency borrowings. Other than intercompany loans and capital funding, balance sheet translational risk is not hedged against adverse movements in exchange rates and the results of any such movements are taken to reserves. The Group is exposed to limited cross-border transactional commitments and, where significant, these are hedged at inception using forward currency contracts.

Group committed debt facilities have been used to provide a £475m RCF to Best Buy Europe. This RCF has terms that are broadly similar to the Group's main external facilities, including a debt:EBITDA covenant, and its final maturity date is 13 March 2013. Under this RCF 50% of drawings are guaranteed by Best Buy Co., Inc.

Treasury policy permits the use of long-term derivative treasury products for the management of currency and interest rate risk and the Group's interest rate exposures are monitored regularly. More generally, the Group treasury function seeks to follow treasury best practice as recommended by the Association of Corporate Treasurers and adheres at all times to their Ethical Code. The Group does not trade or speculate in any financial instruments.

Going concern

A review of the Group's business activities, together with the factors likely to affect its future development, performance and position are set out elsewhere within this Business Review, including the Risks and Uncertainties section. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are shown in the balance sheet, cash flow statement and accompanying notes to the financial statements. Further information concerning the Group's financing arrangement and policies are set out in the Financing and treasury section above. Further details of the Group's financial risk management arrangements are provided in note 22 to the financial statements.

The Directors, in their consideration of going concern, have reviewed the Group's future cash forecasts and revenue projections, which they believe are based on prudent assumptions, and based on those forecasts and projections, that it is appropriate to prepare the financial statements of the Group on the going concern basis.

In arriving at this conclusion, they have noted that at 31 March 2009 there was substantial headroom against committed banking facilities and that these facilities do not start to mature until 2012.

Return on capital employed

Total shareholders' funds at March 2009 were £1,116m, compared to £651m at March 2008. After taking into account average net debt, excluding debt used to fund Best Buy Europe, and adjusting for the amortisation of acquisition intangibles and exceptional items, the Group generated a return on capital employed from continuing operations of 8.4% (2008: 2.2%). The return on capital employed from continuing and discontinued operations was 8.4% (2008: 12.0%).

Assuming a weighted average cost of capital for the period of 5.8% (2008: 6.5%), this represents an economic value added in respect of continuing operations of £36m (2008: -£60m) or 2.6% (2008: -4.3%). Economic value added for all operations on the same basis was £36m (2008: £76m) or 2.6% (2008: 5.5%).

Group Risk and Business Assurance functions identify, evaluate and manage the risks the Group faces on an ongoing basis. The table below summarises the more material risks to the Group, and how we seek to mitigate them in the day-to-day running of the business.

Specific risk	Potential impact	Mitigation
Going concern	Insufficient funding affects ability to continue trading.	Banking facilities currently provide substantial headroom, and do not start to mature until 2012, providing significant time before refinancing is necessary.
Competitive environment	Loss of market share and erosion of margins from increased competition.	Our strategy is to reinvest the benefits of scale into our customer proposition – to keep barriers to entry high and to maximise value for our customers. We have continued to see market share gains as a result of this strategy.
TalkTalk brand perception	Weak customer retention as a result of poor customer service.	We have continued to make significant improvements in customer service, and expect our substantial investment in new CRM systems to enhance service further in the year ahead.
Capacity and functionality of network infrastructure	Failure to provide a reliable service causes customer churn.	We focus continuously on improving network resilience and performance, and continue to invest to ensure that we keep pace with customers' growing demands.
Capacity and functionality of I.T. infrastructure	Failure to provide adequate service levels or to manage back office processes.	In addition to our substantial investment in CRM systems for TalkTalk Group, we have continued to invest to improve the functionality and resilience of our other front and back office systems.
Exchange rates	Profits adversely affected by exchange rate movements; value of assets and liabilities similarly affected.	Exchange rate exposures have been reduced significantly in the year: our exposure to Swiss Francs has been materially eliminated following the repatriation of our brand management company; our exposure to other European currencies has also reduced as a result of the sale of half of our non-Sterling businesses to Best Buy.