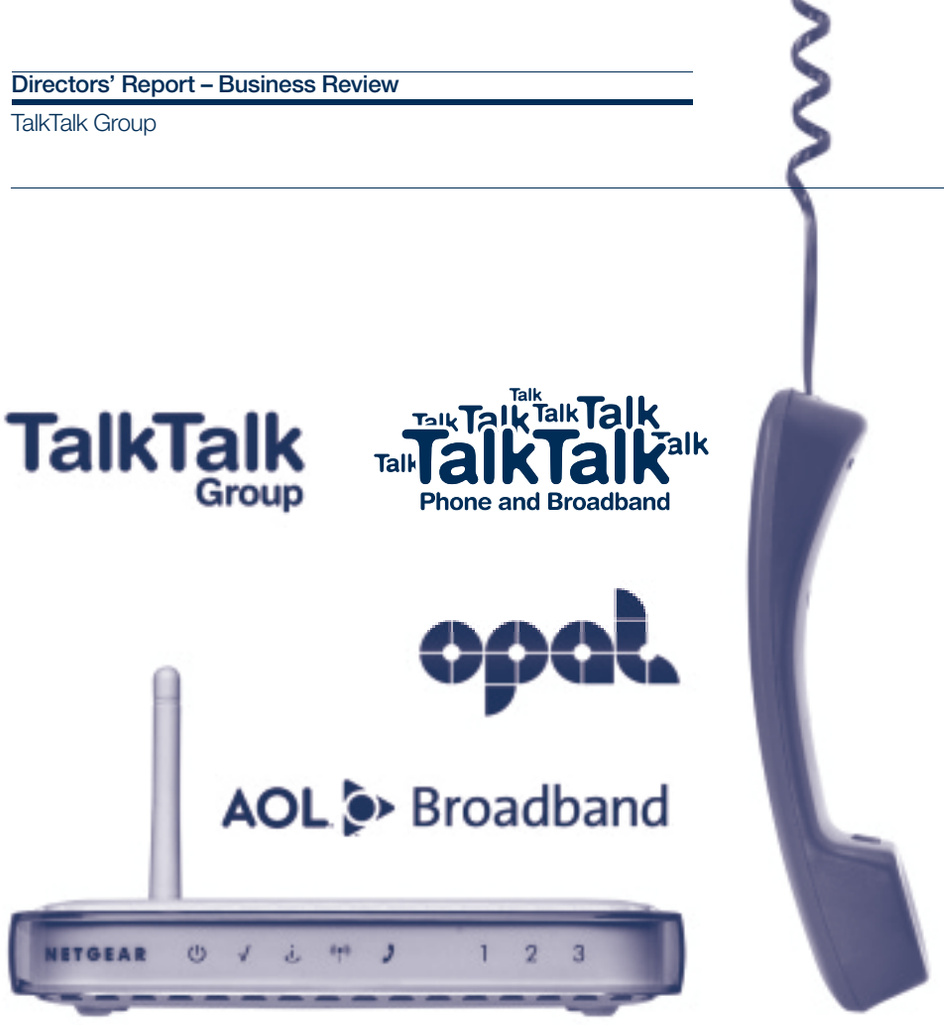


TalkTalk Group

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

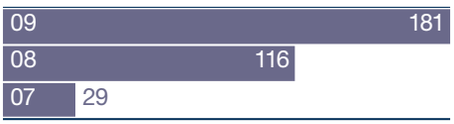
Broadband customer base (m)

2.8m



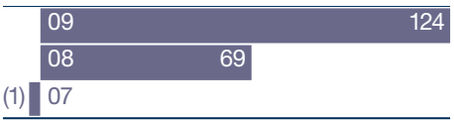
Headline EBITDA (£m)

£181m



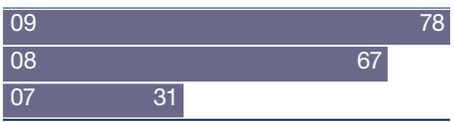
Headline EBIT (£m)

£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.

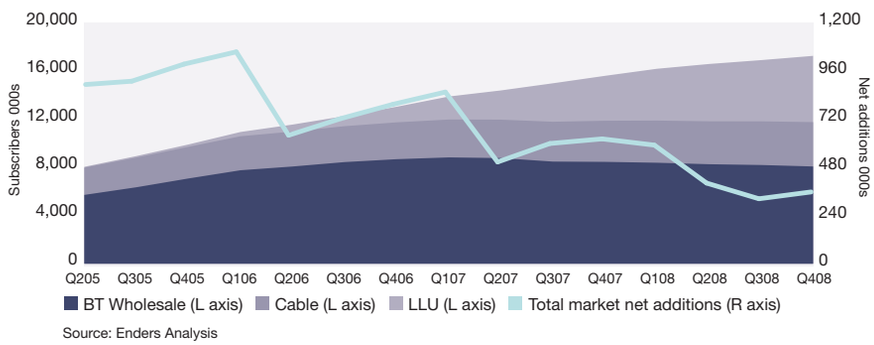
Targeting strong cash generation

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

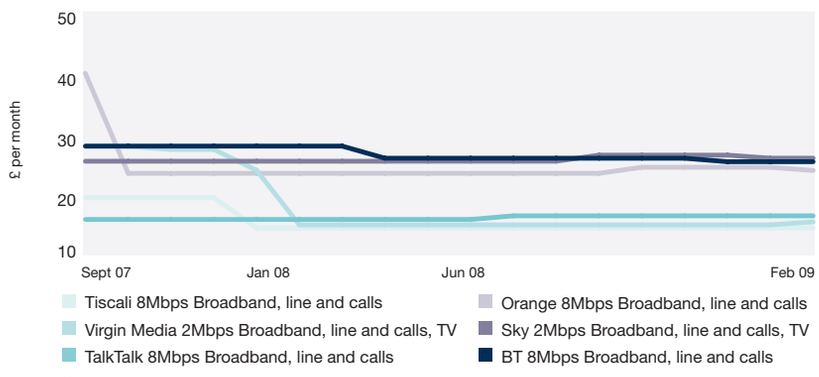
Growth in the UK broadband market slowed sharply during 2008, principally as a result of the decline in housing transactions. Penetration has reached over 65%, and despite the slowing growth we expect the market to eventually reach 80% penetration in the next 3-4 years.



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 f nancial resources and may choose to use broadband as a loss-leader for other products
- Regulation may curb our access to f bre 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.