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Introduction

British Telecom is one of Europe's leading providers of telecommunication service. Its principal activities include local, national and international telecommunication services; the company provides local and long-distance telephone call products and services, international calls to and from the UK. In addition this company also provide higher-value broadband, and internet products and services and IT solutions. In the UK BT serves over 20 million business and residential customers with more than 29 million exchange lines, as well as providing network services to other network (BT Group PLC annual report). The company which has a motto 'delivering today, investing for tomorrow' is a public limited company registered in England and Wales, with listing on the London and New York stock exchange. In addition according to the BT annual report, BT is the UK's largest communication service provider market share. In addition BT group plc also covers BT Global Service, BT Retail, BT Wholesale, BT Exact and BT Openworld.

Starting in 1981, the postal and telecommunication service of the Post Office become the responsibility of two separates corporation, with British Telecommunications (under the trading name of British Telecom) taking over the telecommunication business. In 1984, as a result of telecommunication act, British Telecommunication plc was incorporated in England and Wales as a public limited company, and wholly owned by the UK government. Afterwards, from 1991 British Telecommunication traded as BT. In 1999, BT acquired full control of Cellnet (now O2UK) by acquiring Securicor's minority holding. Eventually, on November 2001 BT completed the demerger of mmO2 comprising what were BT's wholly-owned mobile assets in Europe. (www.btplc.com)

To analyze this company whether this is under, over or fairly priced, the portfolio will cover the following area, those are analysis of company performance using accounting statements and ratio analysis, sources of long term finance, gearing and shareholders wealth, dividend policy, and mergers, acquisitions and corporate restructuring. The accounting statements that we will be looking are the balance sheet, income statements and cash flow. Next, we will cover the ratio analyses which are the liquidity and control of working capital, long term solvency and long term investment, profitability, returns on capital, investment ratios and trend analysis. Moreover, to analyse this company performance we need to compare with another company in the same industry, which is Deutsche Telecom.

As there are limitations to analyse the company, there are some basic assumptions to cover. There are several basic assumptions that have to be taken into account to analyse the company. Firstly, there is a time constraint in preparing this portfolio; secondly, the analysis is only based on Bloomberg, BT annual report which can be accessed from btplc.com to monitor the progress of the company and Deutsche Telecom annual report. The last one is that writer has no previous experience in the investment world. Moreover, most of the result of that will be analyzed is based on the BT Group plc 31 March 2004 annual report.

Analysis of Company Performance

As it has been mentioned in the previous chapter about how this company is going to be analysed, we will firstly look at the accounting statement at 31 March 2004. Firstly, we will look at the profitability ratios, which are concerned with the effectiveness of the business in generating profit (McLaney, 2003). Those ratios are return on assets (return on capital employed), return on equity (return on shareholders' funds), gross profit margin, and net profit margin.

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1 - Graphs | Downloads | 99 - Definitions | Profitability

BT/A LN BT Group PLC

#'s in %	3/04	3/03	3/02	3/01	3/00	5Y Averg
Gross margin	NA	NA	NA	NA	NA	NA
Sales Yr change	-1.11	1.52	7.62	-8.41	10.39	2.0
Net inc growth	-47.24	169.95	NA	NA	-31.11	NA
Operating margin	15.52	14.73	14.36	17.18	19.99	16.4
Pretax margin	10.52	16.86	-13.88	9.90	15.51	7.8
Eff tax rate	27.67	14.54	-11.68	12.08	29.56	14.4
Profit margin	7.65	14.34	5.39	-10.91	10.98	5.5
Return on assets	5.17	9.61	2.41	-4.05	6.27	3.9
Return on equity	49.41	NA	NA	-13.43	13.37	NA
Return on cap.	12.89	22.10	10.12	-1.38	10.21	10.8

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In the return on assets ratio we are considering the effectiveness of the assets financed both by the shareholders and by long-term creditors. According to the Bloomberg the ratio is 5.17% for this year and 9.61% for last year. The data also shows that ratio drop for almost half from last year, even though it is better than the 5 years average. It can be seen that they did not maintain their profit well in compare to the assets they have, even they have a lot of short-term debt, they should have generate the profit by using the long-term liabilities. But when it comes to the return on equity the data shows a very big percentage of results, which is 49.41%. It is very good from the shareholders point of view, because basically this ratio is similar with the previous one, but considers matters more specifically from the shareholders' point.

From the next ratio which is gross profit margin, it can be see that the profit they have is only 10.52% from the sales and it drop about 6% from last year. Of course to analyse this ratio we have to refer to the nature of this company, there are some company which have the strategy to attract the investors by charging a very high price so they will have a very high percentage of this ratio. On the other hand, there are some company with the strategy to charge the consumers a very low price so they will have a high turnover. If we look at the net profit margin, it shows the same pattern with gross profit margin. The difference between profit margin and gross profit margin is the tax and interest they have to pay in that period of time. By looking at the net income growth data, we could assume that they have a lower number of all the ratio compare to last year's performance is because of the declining of the profit. They did not show a positive growth on their profit. By significant data above they do maintain their effectiveness of the assets they have, but this company did not maintain their profit properly.

The second ratio we are going to analyse is the activity ratios, which are cover the net asset turnover, return on net assets, stockholding period, debtors' collection period and creditors' payment period. According to McLaney (2003), the activity ratios are used to assess the effectiveness of a business in using its assets. In this case we are not going to analyse all of the ratios because this company is not a manufacturing company but rather a company that provides service. Therefore the ratios we are going to analyse are only the net asset turnover and return on net assets.

According to the audited BT annual report 2004, the sales figure for that period are £18.519m and the total assets after excluding the current liabilities are £18.070m. Considering the amount of sales and total assets after excluding the current liabilities, the net asset turnover for BT for 2004 is 1.02 times. Additionally, to get the percentage of the return on assets ratio is by multiplying the net profit margin and net asset turnover, and the result is 7.803. Those figures measures the effectiveness with which assets are being used to generate sales, because the result of net asset turnover is not big it reflects the business strategy they used is by charging the consumers a very low price that generates a high turnover. In some investors opinion to invest in a company that have a huge turnover is better than investing in a company who have a high profit margin, because it shows that the company may be sustainable into the future. As it can be seen that BT has a small net asset turnover ratio and also has a small figure of net profit margin we can examine that this company is using their assets not effectively.

The third ratio is the liquidity ratio which will include current ratio and acid test ratio. These ratio is to measure how was the business manage its working capital. The current ratio is usually expressed by stating the amount of current assets per £1 of current liabilities, and the acid test ratio is addresses to answer a direct question; if short-term creditors were demand payment of their claims immediately, would there be sufficient liquid assets to meet them? Usually business seek to have neither current ratio or acid test ratio higher than 1:1, because it shows that the company can provide those short term liabilities by having sufficient liquid assets (McLaney, 2003).

From the data below, this company has a figure of current assets £9378m for the end of this period and the figure of their current liabilities is £8548m. By assuming that this company is not in a supermarket industry, so the stocks or inventory is not included in the liquid assets, referring to the assumption, the liquid asset for the period end 31 March 2004 is £9289m. The current ratio for this company is 1.09 : 1 and the acid test ratio is 1.08 : 1. By knowing this number, it can be seen that the business capable to pay meet the liabilities and showing to the creditors that this business have a sufficient amount of current assets to cover the creditors claim and by showing this figure, it also increase the confidence level to give a short-term loans. In addition, after deducting the stocks from the current assets, the acid test ratio also shows that this business is good in managing their working capital.

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1 - Graphs | Downloads | 99 - Definitions | Assets

BT/A LN BT Group PLC Currency: GBP

Millions	3/04	3/03	3/02	3/01	3/00	5Y GeoGr
Cash & near cash	109.0	91.0	158.0	412.0	253.0	1.3
ST investments	5163.0	6340.0	4581.0	2557.0	2051.0	9.5
Trade debtors	2126.0	2240.0	2393.0	3379.0	2487.0	-.6
Stocks <inventory>	89.0	82.0	111.0	361.0	225.0	-11.0
Other cur assets	1891.0	2173.0	2879.0	2881.0	2754.0	.9
Current assets	9378.0	10926.0	10122.0	9590.0	7770.0	4.5
Gross fixed assets	37393.0	36304.0	34966.0	40966.0	35729.0	1.8
Accum depreciation	21906.0	20416.0	18888.0	19341.0	17566.0	6.1
Net fixed assets	15487.0	15888.0	16078.0	21625.0	18163.0	-2.8
LT inv't & LT rec	256.0	322.0	94.0	588.0	414.0	-4.0
Other assets	1497.0	1081.0	1379.0	22996.0	11241.0	-7.9
Total assets	26618.0	28217.0	27673.0	54799.0	37588.0	-1.0

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1 - Graphs | Downloads | 99 - Definitions | Liabilities

BT/A LN BT Group PLC Currency: GBP

Millions	3/04	3/03	3/02	3/01	3/00	5Y GeoGr
Trade creditors	2307.0	2772.0	2396.0	3287.0	2416.0	-.3
ST borrowings	1271.0	2548.0	2195.0	12136.0	5650.0	6.1
Other ST creditors	4970.0	4360.0	4799.0	5310.0	6819.0	1.0
Cur liabilities	8548.0	9680.0	9390.0	20733.0	14885.0	1.3
LT borrowings	12426.0	13456.0	16245.0	18775.0	5354.0	29.7
Other LT liab	2504.0	2376.0	2324.0	2738.0	1056.0	12.5
Total liabilities	23478.0	25512.0	27959.0	42246.0	21295.0	12.9
Preferred equity	.0	.0	.0	.0	.0	NA
Minority interest	46.0	63.0	72.0	499.0	498.0	-26.6
Total common equity	3094.0	2642.0	-358.0	12054.0	15795.0	-27.0
Shareholder equity	3140.0	2705.0	-286.0	12553.0	16293.0	-27.0
Tot liab & equity	26618.0	28217.0	27673.0	54799.0	37588.0	-1.0

The last part to be analysed by using accounting statements is by analysing the cash flow of this company. From the cash flow statement, it can be analysed the real inflow and outflow of the cash in the company during the period. According to McLaney (2003), cash tends to be at the heart of most aspects of business and a business's ability to prosper and survive is likely depending on its ability to generate cash. There are three parts in the cash flow statement; those are the cash flow from operating, cash flow from financing and cash flow from investing.

Menu P182 Equity **FA**

1 - Graphs | Downloads | 99 - Definitions | Cash Flow From Operations

Currency: GBP

BT/A LN BT Group PLC

In Millions	3/04	3/03	3/02	3/01	3/00	5Y GeoGr
Operating profit (l	2880.00	2770.00	2650.00	2994.00	3709.00	-5.47
Deprec & amort	2936.00	3035.00	4046.00	3431.00	2841.00	2.61
Other non-cash adj	-611.00	-2217.00	-3995.00	-1628.00	-1929.00	NM
Chg in non-cash wc	-657.00	501.00	301.00	-296.00	-241.00	NM
Cashflow-operating	4548.00	4089.00	3002.00	4501.00	4380.00	-2.18
FCF/share	.22	.18	-.13	-.04	.11	NM
Cash Flow/Basic shr	.53	.47	.36	.62	.61	-5.71

From the data above, it can be seen that the cash flow from operating £4548m from its trading activity. That is to say that not only in this period even from the previous period, the business generated huge net cash inflow, it can also be said that the main transaction of this company generated a big sum of cash, as for this business is categorised as a service provider. While in a company that provide goods, the cash they got is not as big a service provider because most of the transaction they made could be generated the trade debtors account. Not to be forgotten, the profit they have make is even less than the real cash inflow.

Later on, the cash inflow they were making could be use to finance the company or to pay dividends, which can be seen from the cash flow from financing and investing. The cash flow from investing shows that the business has to deduct their cash from operating activities, which is in this case it is a normal conditions, because of the negative signs in capital expenditure and the business did not spent their cash to buy any assets. Moreover, the cash flow from their financing activities it shows a negative figure as well, because of the changes in their long-term borrowing and the sum of the changes shows a positive figure which means they pay some of their debt in this period. Furthermore they paid dividend to their shareholders for £645m.

Sources of Long Term Finance and Shareholders Wealth

There are three sources for company to finance its investment, one example is through debt financing, the second one is through equity financing and the last one is the cash generated from the previous operation which can be seen from the cash flow statement of a company. Bank loans are example of managing investment through debt financing, in which the company has to pay a certain amount of interest. From a risk point of view this is disadvantageous for the company since it has to bear the risk burden itself, i.e. the company has an obligation to pay interests to the bank, even when the company is not doing well. When a company raises equity, they agreed to share part of its ownership to its shareholders. When an ownership is split, it can be assumed that shareholders are aware of the risk they are undertaken. This implies that in times where company's performance is not doing well, they are under no obligation to pay interests in the form of dividends.

It can be seen from the previous chapter that they have £4548m from the operating activities, and it is one of the sources they get to either invested in net working capital and fixed assets or it is paid out to shareholders as dividend. Another source of long term finance it can be seen in the BT annual report, they issued new loans of £1326m at that period, the new loans included a US$172 million 0.75% exchangeable bond due in 2008, exchangeable into ordinary shares of LG telecom, BT's Korean based associate and a sale and leaseback of circuit switches which had no effect on net debt but increased gross debt and cash by around £1 billion. In addition, there are also £440m was received from mmO2, as part of the demerger.

After knowing the sources of long term finance, the next step is to look at from the investors' point of view. Even though there are some ratios that already been measure in the previous chapter that can be taken into account to measure the liquidity of their assets they are getting, the productivity of the company use its assets and the profitability of the funds they have got from the investors. However, there is also some ratio which is more suitable to put in this chapter; those are the debt to equity ratio and some of investors' which are earnings per share, price earnings ratio, and dividend yield.

As it can be seen from Bloomberg, this business has a fully diluted Earning Per Share for £0.16, it means that this amount of money is the profit attributable to each share, even though it is not the dividend paid, the shareholders should bear in mind that its belong to them whether the business give it or not. In addition, this company is fluctuating for the last 5 years, by comparing EPS. But if we saw from the different point of view, this company seems quite consistent to pay the dividends to their shareholders, by looking at the previous 5 years data of this company.

Additionally, the price/earnings ratio for the period ended 31 March 2004 is 11.60. The price-earnings ratio combines accounting and stock market data, by comparing the stock price and earnings per share. The figure of price-earnings ratio is quite a big number; it measures the price that the investors are prepared to pay for each pound sterling of earnings, the numbers may also indicates that investors think the firm has good growth opportunities or that is earnings are safe and therefore it is more valuable. It is subjective by mentioning that the price-earnings ratio is quite a big number, it is because the limitation to do more research about the competitors. Furthermore, the dividend yield for this company is 4.86%, because the percentage is not big, we can indicate that investors are not expecting a high rate of return, or they are expecting a rapid dividend growth with consequent capital gains.

According to the BT annual report, BT paid interim dividends annually in February and final dividends in September. However, as part of BT's debt reduction and restructuring plans, neither a final dividend for the year ended 31 March 2001 nor an interim dividend for the year ended 31 March 2001. For the shareholders that not a resident in the UK, dividends will be translated from pounds sterling into US dollars using exchange rate prevailing on the date the ordinary dividends were paid.

Conclusion

In conclusion, to analyse this company there are many ratios that has been calculated above, even though analysing a company is not just by doing all the ratios but also looking at all the news about the company and knowing the history of the company itself. By doing part of the analysis, it can also be measure whether the company is under, fairly or over performance. Especially because of the ratio has been done above is from the financial statement which is the most important aspects in the company, moreover financial statements typically contain large amounts of data. So therefore we have to choose which one is the most important, especially when there is a limit to analyse a company.

From the profitability ratios, it can be analysed that this business is not effective to generate profit. As it can be seen that they did not maintain their profit well in compare to the assets they have. They should have generated the profit by using the long-term liabilities. But when it comes to the return on equity the data shows a very good result, and it is very good from the shareholders point of view. From other ratio it can be seen that the business capable to pay meet the liabilities and showing to the creditors that this business have a sufficient amount of current assets to cover the creditors claim and by showing this figure, it also increase the confidence level to give a short-term loans. Moreover, the other ratio shows that this business is good in managing their working capital.

To sum up, if we are looking from the profitability of the company, this company is not really stable this time, sometimes it shows a good profit margin and suddenly drops in the following period. By looking from the investors' point of view, this business is not highly valued by investors, but in some investors opinion this company might a save way to invest your money on, because this business always pays dividend an try to maximise the long term investors even they not making a profit at that period.

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