Networks and Broadband Switching, reflecting the development and launch of key products during the year including our Ultra Long Haul and Metropolitan DWDM ranges and our new multi-service core switch, the BXR 48000. Balanced against this increase, we scaled back investment on Access products as we shift our focus away from older legacy technology and onto the higher margin products in our portfolio such as our Access Hub, and Fixed Wireless Access platforms.

In both Sales and Marketing and General and Administration, on the other hand, we achieved substantial cost reductions during the year mainly as a result of reducing the number of employees.

In addition to reducing operating costs, we have taken significant actions during the year to reduce our cost of goods sold, which includes the costs of production and distribution. The steps we have taken during the year include completing the outsourcing of four major facilities and transferring 1,900 employees to Jabil Circuit, rationalising facilities in the global supply chain and the Outside Plant and Power business, reducing product costs by taking advantage of lower market prices for components and more efficiently utilising our field service teams. While many of these actions were well underway by the end of last year, much of the financial benefit will only begin to appear in the current year.

Overall, despite the significant operating loss reported for the year as a whole, I am able to report that we have made substantial progress in restoring the Company's operational performance since 4 September, and that we achieved both of the main objectives announced on that date.

Business Plan and Debt Restructuring Discussions

In November, as a complement to our Operational Review, we engaged LEK, an independent strategic consulting firm, to undertake an extensive strategic review of the business in the light of the changed market circumstances. This additional strategic analysis was completed in April 2002 and forms the strategic backdrop to the new business plan, which we have developed in recent weeks in light of our revised view of an extended market downturn. The plan aims to ensure that the business will be robust in a continuing period of constrained demand for telecoms equipment through calendar year 2002 and into 2003 and demonstrates that our Core business can generate operating cash flow (after capital expenditure) in each of the 5 years of the plan and return to operating profit (before exceptionals and goodwill amortisation) in the early stages. This plan, which is currently under review by independent accountants forms the basis of the ongoing discussions with our banks and representatives of our bondholders, which the Board expect will lead to a successful financial restructuring.

Customers

Our ten largest customers accounted for one-third of Core sales with BT representing 13 per cent, down from 18 per cent in the previous year. For Marconi, this group represents a strong and well diversified incumbent customer base, with five North American companies and five European. The list includes leading telecoms operators such as BT, Bell South, Qwest, SBC, Sprint, Verizon, Telecom Italia and Vodafone. We have been well supported by our customers during a very difficult year and independent industry analysis shows that, in our main field of Optical Networks in Europe, we have maintained our market share position.

Employees

This has been a traumatic year for Marconi employees. To achieve the necessary cost reductions we have had to take the regrettable action to substantially reduce the size of our workforce. Where possible, we have done this through voluntary redundancies and offered leavers outplacement support and counselling. However, reducing our workforce has caused great uncertainty for the people who remain part of Marconi, and I am grateful for their continued dedication to our customers and our business in such trying circumstances.

Mike Parton
Chief Executive

Introduction

Management has prepared this Financial Review to be read in conjunction with the Group's financial statements and notes for the year ended 31 March 2002.

Unless otherwise stated, references to "Group" in the trading section of this Financial Review refer to the Marconi Group including its share of joint ventures, but excluding its share of results of associates.

All prior year comparatives have been restated to include the impact of the Group's adoption of FRS17 for pension accounting as if the standard had always been adopted by the Group.

Full disclosure of changes to accounting policies can be found in note 3 to the accounts on page 46 of this Annual Report and Accounts.

Group Sales

Group sales for the twelve months to 31 March amounted to £4,567 million, representing a decrease of 34 per cent (2001 £6,942 million). This decrease, observed across all major geographic zones, was mainly a result of reduced demand in the global market for telecommunications equipment and services resulting in lower sales in Marconi's Core business and the disposal of Marconi's Medical Systems business and the majority of businesses in the Group's Capital division during the year.

Group Gross Profit and Operating Profit/(Loss)

Gross profit before exceptional items at Group level was £1,124 million, representing a gross margin of 25 per cent (2001 36 per cent). This decrease was primarily due to the reduction in sales volumes in the Core business and the resulting under-utilisation of resources in the services activity and supply chain. The disposal of Capital businesses during the year also contributed to the decrease in gross profit.

This decline in gross profit was partially offset by reductions in operating expenses achieved during the year. Nevertheless, the Group reported an operating loss before goodwill amortisation and exceptional items of £463 million. This compares to an operating profit before goodwill amortisation and exceptional items of £754 million in the corresponding period last year.

Divisional Analysis

Core

A full discussion on the operating performance of the Group's Core business can be found under Review of Operations on page 12 of this Annual Report and Accounts.

Medical and Capital

The Group completed a number of significant disposals during 2001/02 including the sale of its Medical Systems business and the majority of the non-core businesses managed within Capital.

As a result of these disposals, Medical Systems, Commerce Systems and Data Systems are reported as discontinued activities in the Group's statutory accounts. However, for the purposes of this management commentary and to ensure consistency with previous management reports, the results of Commerce Systems and Data Systems have been identified within Capital until disposal. Also, for the purposes of this report, the results of the Group's 50 per cent stake in General Domestic Appliances have been included in Capital until the date of disposal. However, in the statutory P&L account, these results are included under the Group's share of joint ventures.

Capital contributed sales of £908 million during the year, a 25 per cent decrease compared to last year (2001 £1,204 million). This comprises £504 million of discontinued activities (2001 £649 million) and £404 million of sales (2001 £555 million) relating to GDA, Marconi Optical Components and the continuing Capital businesses. The main reason for this decline is the impact of disposals completed during 2000/01 including Avery Berkel, Woods and Marconi's share in Comstar. Medical Systems contributed sales of £584 million (2001 £1,112 million) and an operating profit of £19 million (2001 £95 million).

Other Financial Items

Exceptional Items

The Group recorded substantial exceptional operating costs during the year, totalling £5,216 million. These were partially off-set by exceptional non-operating income of £667 million.

Operating Exceptionals

In line with its accounting policies, the Group reassessed the carrying values of goodwill, fixed assets, inventory and debtors. As a consequence of the more uncertain sales outlook and more conservative assessment of future growth prospects of acquired businesses, the Group has recorded an exceptional charge of £3,831 million to write down goodwill and tangible fixed assets. The goodwill impairment relates primarily to Fore Systems, Reltec Corporation, Metapath Software International (MSI), Mariposa Technology, ipsaris (formerly Fibreway), Systems Management Specialists (SMS) and Albany Partnership (APT).

The Group also incurred exceptional charges of £150 million to increase doubtful debt provisions and recorded a £672 million increase in provisions for slow moving and obsolete inventory and related charges. Other exceptional charges totalled £563 million and related primarily to the Group's reorganisation and ongoing rationalisation.

Disposals

Business	Net Proceeds £m	Acquired by	Completed
Medical Systems	729	Royal Philips Electronics	October 2001
Commerce Systems	225	Danaher Corp.	February 2002
Data Systems	283	Danaher Corp.	February 2002
GDA (50%)	113	Merloni	March 2002
Surplus Properties	116	Various	Various
Other Non-Core Assets	93	Various	Various
Total Cash Disposals	**1,559**		
ipsaris	71.9% stake in Easynet (49.9% voting rights)	Easynet Group	July 2001
Marconi Optical Components	9.9% stake in Bookham Technology	Bookham Technology	March 2002

Net Debt Composition

£billion	31.03.02
Bonds (€ and US$ maturing 2005, 2010, 2030)	(1.77)
Syndicate Bank Credit (€4.5 billion facility[1])	(2.21)
Bilateral Bank Credit and Debentures	(0.26)
Gross Debt	**(4.24)**
Cash and Liquid Resources	1.37
Net Debt	**(2.87)**

1) Headroom under £4.5 billion facility and entire £3 billion facility cancelled
Outstanding syndicate drawings placed on demand
2) Certain restrictions apply to £850 million of £1.4 billion cash as part of restructuring process

Non-operating Exceptionals
The non-operating exceptional income of £667 million related mainly to gains on disposal of subsidiaries and other fixed assets (£576 million) and the release of provisions relating to share options (£291 million). The £576 million gain on disposals was partially off-set by a £200 million write down of the value of some of the Group's investments.

Capital Expenditure and Financial Investment
Net capital expenditure and financial investment amounted to £196 million (2001 £34 million).

In line with the Group's previously stated target spend of £360 million, capital expenditure amounted to £361 million. Asset sales generated £173 million including the sale of the Group's car fleet, certain manufacturing facilities and other properties. As a result, net capital expenditure reduced to £188 million (2001 £561 million), representing 4 per cent of sales (2001 8 per cent).

Capital expenditure in the Core business amounted to £217 million or £47 million net of the sale of assets. This was a significant reduction compared to the previous year (2001 £328 million, net) and was well below the level of depreciation in the Core of approximately £200 million. This represents under 2 per cent of Core sales (2001 7 per cent) and includes equipment for participation in technology trials with key customers and test equipment which supports on-going research and development activity, the purchase of software licences as part of the Group's implementation of a new information system and spend related to site and facility developments.

Net capital expenditure in Capital increased to £134 million largely as a result of fixed asset investment in ipsaris and Marconi Optical Components in the first half of the year prior to disposal. Net capital expenditure in Medical amounted to £7 million.

Net financial investments during the year amounted to £8 million.

Net Interest Payable and Finance Income
In the twelve months to 31 March 2002, the Group's net interest charge to the Profit and Loss Account, was £238 million (2001 £150 million). The interest charge increased as a function of the Group's higher net debt position.

Net finance income of £200 million (2001 £41 million) includes the exceptional gain of £166 million, which relates to the total of the Group's bond repurchases completed during the year.

Following the Group's adoption of accounting standard FRS17 "Retirement benefits", net finance income has been introduced as a separate category from net interest payable. This item includes the expected returns on pension scheme assets partially off-set by an expense in relation to the discounting of scheme liabilities.

Taxation
The tax credit on loss from ordinary activities was £21 million in the reporting period compared with a charge of £195 million in the corresponding period last year. The net tax charge on exceptional items was £231 million.

The Group paid £13 million in relation to tax, after hedging. This comprised £110 million net tax repayments offset by payments of £123 million related to tax on foreign exchange rate movements. For the year ended 31 March 2001 the comparable amounts were £137 million of tax payments and £33 million of receipts related to tax on foreign exchange rate movements.

During the year, the Group adopted accounting standard FRS19 "Deferred taxation". This change in policy does not have a material effect on our financial position and no prior period adjustment is necessary.

Deferred tax assets of £596 million (2001 £147 million) have not been recognised in respect of operating losses, pension scheme deficits and exceptional expenditure as the Group is not sufficiently certain that it will be able to recover those assets within a relatively short period of time.

Additional disclosure is provided in Note 9 to the Accounts.