**Goodwill Amortisation**
The total Group goodwill amortisation charge for the year decreased to £433 million (2001 £673 million) of which £350 million was incurred in the first half and £83 million in the second half. This decrease is a result of the reduced carrying value of goodwill following the exceptional goodwill impairment discussed under "Operating Exceptionals" above. The £877 million of Group goodwill remaining on the balance sheet after the exceptional write-down will be amortised over an average period of 7 years.

**Earnings Per Share**
Basic and diluted loss per share was 210.6 pence (2001 10.4 pence). The loss per share excluding exceptional items and goodwill amortisation was 23.2 pence compared to earnings per share of 15.1 pence last year.

## Balance Sheet

As at 31 March 2002, on a consolidated basis, the Group had net current liabilities of £662 million, including drawings of approximately £2.2 billion under the Group's bank credit facility which has been placed on demand in the context of the Group's ongoing restructuring discussions discussed above, and around £260 million drawn under bilateral and debenture arrangements.

As at 31 March 2002, net liabilities before net retirement benefit deficits stood at £1,420 million compared to net assets before net retirement benefit surpluses of £4,834 million at 31 March 2001. The main contributing factor to this decrease is the write-down of goodwill and other operating and non-operating exceptionals offset by the release of provisions for shares to be issued and the gains on disposals of businesses, investments, land, property and other assets; these items are discussed above. Other contributing factors include the Group's operating loss, interest costs and currency movements.

As at 31 March 2002, the Company has net assets of £671 million.

**Working Capital**
Stocks and contracts in progress reduced by £1 billion during the year to 31 March 2002. Of this reduction, approximately £750 million relates to the Core business and £250 million to disposed businesses. In the Core, stocks and contracts in progress were reduced by approximately £540 million as a result of net provision movements. The balance of the reduction was achieved through normal trading following the Group's improved management of the supply chain process and better integrated planning between sales and operations.

Group debtors decreased by approximately £1.4 billion during the year to 31 March 2002. This reduction is driven equally by reductions in the Core business and as a result of disposals. In the Core business, the main driver of the reduction in debtors is the reduced trading volumes experienced during the year. Net debtor provision movements accounted for approximately £100 million. During the first half of the year, debtor days increased from 95 days net in March 2001 to 112 days net in September 2001. This was mainly the result of difficult trading conditions. During the second half, the Group focused on cash collection and made significant improvements in the management of overdue debts, leading to a reduction in debtor days to 100 days net by March 2002. The increase year on year is due to the negative impact of a higher proportion of Southern European sales where payment terms are typically above average.

Trade, other creditors and accruals have reduced by approximately £1.1 billion during the year. Approximately £750 million of this reduction is a result of disposals. The reduction in the Core of approximately £400 million is mainly due to the reduced trading volumes experienced during the year. Creditor days have reduced to 61 days in March 2002 from 90 days in March 2001. This is mainly due to the increased proportion of out-sourced manufacturing in Europe and North America where payment terms stand at 30 days.

**Provisions**
Provisions for liabilities and charges decreased by £209 million to £505 million during the year.

Of the decrease £263 million relates to movements in share option provisions, £214 million of which is in respect of cash paid to collateralise the Group's obligations under the previously disclosed hedging arrangements and £44 million to the release of provisions, disclosed as a non-operating exceptional item. The balance of the movement relates to £5 million of provisions released against share options issued to employees at the time of previous acquisitions.

Reorganisation and restructuring provisions increased, after amounts spent in the period, by a net £50 million. Other provisions decreased by a net £14 million. The majority of the Group's rationalisation programmes are treated on a cash basis, with costs charged to the profit and loss account as the cost is incurred. However, provisions for restructuring have been created to cover those parts of the Group's rationalisation programme, mainly in Germany and the UK, where as at 31 March 2002, individuals had been identified to leave the Group during the course of the current financial year.

## Cash Flow

Net debt decreased by £302 million during the year to 31 March 2002.

For analytical purposes, the Group defines operating cash flow as operating cash flow before exceptional items and after capital expenditure. After net capital expenditure of £188 million, the Group incurred an operating cash outflow of £178 million for the twelve months to March 2002. This was predominantly driven by the Group's operating loss before goodwill amortisation of £463 million offset by an improvement in working capital of £239 million. Following a £470 million operating cash outflow after capital expenditure during the first half of the year, the Group generated positive operating cash flow of £292 million during the second half, including £116 million proceeds from the sale of properties. This sequential improvement results mainly from the Group's increased focus on cash collection from debtors and improved management of overdue debt as well as from increased utilisation of inventory.

Financial investments represented a cash outflow of £8 million and included £214 million of collateral payments paid under the Group's share option related hedging arrangements, £24 million purchase of shares to satisfy the Group's obligations under option schemes relating to various previously acquired companies, and other fixed asset investments of approximately £70 million including the Group's investment in Confirmant, a venture with Oxford GlycoSciences. This was offset by some £320 million proceeds from the sale of the Group's remaining share in Alstom and other smaller financial investments including Lagardère and Lottomatica.

Cash flows relating to acquisitions and disposals amounted to a positive £1,025 million. This comprises approximately £1.4 billion net cash proceeds from the disposal of businesses including Medical, Commerce and Data Systems and the Group's 50 per cent stake in GDA, which were offset by cash outflows relating to the demerger of ipsaris into Easynet, the creation of Ultramast, a joint venture with Railtrack and other smaller acquisitions.

The Group incurred exceptional operating cash costs of £368 million during the year relating mainly to restructuring and rationalisation including costs associated with the Group's manufacturing outsourcing programme, and the implementation of a new information technology system. As previously announced, management has decided to cease further spend on this implementation project. Further exceptional cash costs will be incurred during the current financial year as the Group continues to implement its cost reduction programmes.

Other cash flows relate primarily to interest, dividends and tax.

## Group Financial Management

The Group funded its activities through cash generated from its operational activities, the proceeds of disposals, bank borrowings and the debt capital markets.

The Group's gross borrowings as at 31 March 2002 were £4,239 million (31 March 2001 £3,677 million) and reflected operating cash outflows and financing transactions in the first half of the year, offset by debt reductions from disposal proceeds.

Marconi's net debt amounted to £2,865 million at 31 March 2002, and decreased from £3,167 million at 31 March 2001.

At 31 March 2002, the Group's cash and liquid resources totalled £1,374 million, of which £278 million was denominated in sterling, £738 million in US dollars, £239 million in euro and the balance of £119 million in other currencies.

At 31 March 2001, Marconi had €7.0 billion of bank facilities, €4.5 billion maturing in March 2003 and €2.5 billion maturing in June 2002. In May 2001, the €2.5 billion facility was replaced by a new €3.0 billion facility, with the total facility outstanding rising to €7.5 billion.

Discussions commenced in October 2001 with the Group's syndicate banks on replacing the existing facilities with a new facility, which would mature in June 2005. The intention of the Group was to secure the medium-term financing required beyond the current market downturn.

On 22 March 2002, Marconi announced that in the light of the Group's revised market outlook, it had decided not to proceed with the new bank facility it had been negotiating

with its lending banks to refinance its two existing syndicated loan facilities. The Group further announced that as a result of this decision, it had agreed to cancel the undrawn commitments under these facilities and to place on demand the drawn portion of the €4.5 billion facility, which matures in March 2003. The Group now has a single facility with total commitment of €3.6 billion and this was fully drawn as at 31 March 2002.

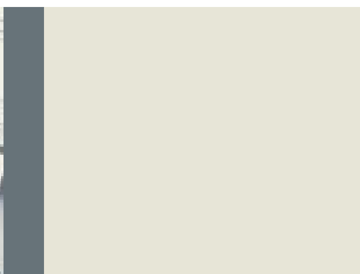
In recent weeks, Marconi has developed a revised business plan which has been presented to representatives of the Group's lending banks and bondholders. The plan, currently being reviewed by independent accountants, demonstrates a sustainable Core business which generates operating cash flow and returns to operating profit in the early stages of the 5-year plan. In parallel, Marconi continues discussions with representatives of its syndicated lending banks and bondholders in order to reach an agreement, as rapidly as possible, on a financial restructuring proposal that is acceptable to all stakeholders. As part of this process, the Marconi Board has agreed that it will accept certain restrictions on financial and corporate activities while it continues its restructuring negotiations with the bank syndicate and bondholders. On 25 April 2002, the Group agreed that certain restrictions will apply to £850 million of its cash and liquid resources balances which will continue to be held with banks independent of the bank syndicate. Currently, these restrictions will expire on 27 May 2002, after which date, the cash can be utilised with five businesses days' notice. In addition, the Group has agreed to increase the margin above LIBOR on its syndicated loan facility to 225 basis points per annum with effect from 1 April 2002. If the current levels of drawings were outstanding for the current financial year, the interest charge would increase by £46 million.

In December 2001 and January 2002, Marconi reduced the total bond debt outstanding through the repurchase by Ancrane Limited of sterling equivalent of £375 million of principal of bonds at 53 per cent of face value, plus fees and accrued interest, funded from the Group's cash resources.

A more detailed discussion on the Group's financial management, including treasury policies, is included in pages 35 and 36 of this Annual Report and Accounts.

**Going Concern**

As discussed in Group Financial Management above, Marconi is discussing its appropriate capital structure with its lending banks and representatives of its bondholders. There is no guarantee that these negotiations will reach a satisfactory conclusion. However, in the light of the information currently available to them, the Directors believe that the Group's banks and bondholders will support it in achieving an appropriate capital structure. On this basis, the Directors consider it appropriate to prepare the accounts on a going concern basis. Should the Group's banks and bondholders not support the Group in this respect, adjustments would be necessary to record additional liabilities and to write down assets to their recoverable amount. Furthermore, contingent liabilities would crystallise, resulting in additional liabilities in the Company balance sheet. It is not practicable to quantify these possible adjustments.



In September 2001, as a result of the Group's Operational Review, Marconi reorganised its operations into two main reporting divisions. All businesses relating to the Group's network communications business remained in the Core whilst non-core activities were transferred to Capital. The Group manages the businesses in its Capital division for value and ultimately disposal.

This Review of Operations concentrates on a discussion of the Group's Core business. A discussion on Capital and the disposals completed during the year is contained in the Financial Review on page 6 of this Annual Report and Accounts.

## Core Business Review

**Core - Order Backlog, Orders Received and Sales**

The Order Backlog in the Core business fell from approximately £2.1 billion at March 2001 to approximately £1.7 billion at March 2002 as the level of sales recorded during the period was higher than the level of new orders, a reflection of the difficult market conditions. At March 2002, Network Services accounted for over 40 per cent of the order backlog, Network Equipment for approximately 24 per cent and the balance related to Mobile. The decline in order backlog for Network Equipment was more marked than the decline in Network Services which remains more resilient as a result of its long-term maintenance and turnkey project contracts. The order backlog in Mobile remained stable year on year.

Orders received by the Core business totalled £2,833 million (2001 £4,452 million), an overall decrease of 36 per cent whilst sales were £3,100 million (2001 £4,665 million), an overall decrease of 34 per cent. The comparable declines in orders received and sales respectively reflects a general reduction in the sales cycle (time from customer order to shipment) in the telecoms industry as operators focus on short payback on investments. In Optical Networks in particular, the sales cycle has reduced significantly due to the absence of orders for major new network build projects and the increased proportion of short-term network in-fill orders. As a result of the reduced sales cycle, the overall decline in trading volumes and the subsequent consumption of the order backlog, the book to bill ratio in the Core remained below one throughout most of the year.

The level of decline broadly reflects the overall reduction of capital expenditure in the telecoms industry during the period as well as other factors that have contributed to the industry-wide market downturn, namely the decline of many CLEC and Pan-European service providers. The percentage decrease in Network Equipment sales was greater than in Network Services, the latter benefiting from areas where demand has remained more resilient including maintenance activities as well as wireless and managed services. Network Equipment was worst affected in its largest market, the United Kingdom, mainly as a result of substantial reductions in capital expenditure by many of the UK second operators and lower sales to BT.

Major new Network Equipment orders awarded to Marconi during the year include DWDM contracts with BT, Telecom Italia, Fibernet (Germany), Omnitel-Vodafone (Italy) and China Railcom, the Group's first contract for its new Ultra Long Haul DWDM equipment with Amcom (Australia), High Density DSLAM contracts with Telecom Italia, Telkom South Africa and Wind (Italy) and continued orders for broadband ATM switches from the US Federal Government.

The Core business serves a strong global customer base of predominantly incumbent operators. The ten largest customers of Network Equipment and Network Services during the year were BT (UK), Bell South (USA), Metro City Carriers (Germany), Qwest (USA), SBC (USA), Sprint (USA), Telecom Italia (Italy), UK Ministry of Defence (UK), Verizon (USA), Vodafone (UK - Germany – Italy). This group of customers accounted for 33 per cent of Core sales in 2001/02. BT remains the Group's largest customer and accounted for 13 per cent of Core sales in 2001/02 (2001 18 per cent).

On a geographic basis, EMEA (Europe, Middle East and Africa) and North America (NAM) are the Group's main markets. The majority of the Group's product sales in the EMEA region relate to Optical Networks. In NAM, product sales are driven by Access (including Outside Plant and Power) and Broadband Switching. Marconi offers network services to its customers world-wide. EMEA accounts for over 50 per cent of Network Services sales with NAM representing about one-third of Network Services sales.