MARCONI PLC
Form 6-K
March 18, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the Month of March 18 2003

Commission file number: 0-30924

MARCONI PLC

(Exact name of Registrant as specified in its Charter)

4th Floor
Regents Place
338 Euston Road
London
NW1 3BT
(Address of principal executive offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.)

Form 20-F X   Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes   No X

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

In order to utilize the "Safe Harbor" provisions of the United States Private Securities Litigation Reform Act of 1995 (the "Reform Act"), Marconi plc (the "Company") is providing the following cautionary statement. Except for historical information contained herein, statements contained in this Report on Form 6-K may constitute "forward-looking statements" within the meaning of the Reform Act. The words "believe", "anticipate", "expect", "intend", "estimate", "plan", "assume", "positioned", "will", "may", "risk" and other similar expressions which are predictions of or indicate future events and future trends which do not relate to historical matters identify forward-looking statements.

Reliance should not be placed on such statements because they involve known and unknown risks, uncertainties and other factors which are in some cases beyond the control of the Company, together with its subsidiaries (the "Group"), and may cause the actual results, performance or achievements of the Group to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements (and from past results, performance or achievement). Certain factors that may cause such differences include but are not limited to the following: (1) any major disruption in production at our key facilities; (2) changes in the environmental, tax and other laws and regulations, which, among other things, could cause us to incur substantial additional capital expenditures and operation and maintenance costs; and (3) adverse changes in the markets for our products, including as a result of increased competition in the highly competitive international markets for such products. These and other risks, uncertainties and factors are discussed in the Company's Registration Statement on Form F-1 and other filings with the Securities and Exchange Commission, including this Form 6-K. Shareholders and prospective investors are cautioned not to place undue reliance on these forward-looking statements which speak only as to the Company's judgment as of the date hereof. Any such forward-looking statements are not intended to give any assurance as to future results. The Company undertakes no obligation to publicly update or revise any of these forward-looking statements, whether to reflect new information or future events or circumstances or otherwise.

MARCONI QUARTERLY REPORT

for the three months ended 31 December 2002

- Significant progress on cost reduction and cash generation despite continued tough market conditions
- Direct cost savings more than offset lower Core sales volumes driving improvement in Core gross margin before exceptional items: 22.1 per cent of sales (Q3 FY02 19.3 per cent; Q2 FY03 21.6 per cent before impact of GBP25 million stock provisions) (see Core Gross Profit / Margin below)
- Core operating cost annual run-rate (before goodwill amortisation and exceptional items) reduced to around GBP550 million by 31 December 2002 (approximately GBP1 billion at 31 December 2001); on track to achieve target run-rate of GBP520 million by the end of the financial year (see Core Operating Expenses below)
- Substantial reduction in Core operating loss (before goodwill amortisation and exceptional items) to GBP41 million from GBP128 million in Q3 last year and from GBP90 million in the previous quarter this year; further progress towards EBITDA breakeven (GBP15 million adjusted Q3 EBITDA loss before exceptional items in the Core) (see Core Adjusted Operating Profit/(Loss) below)
- Reduced operating loss (before goodwill amortisation and exceptional items) and significant progress in working capital drive GBP66 million positive operating cash flow (net of capital expenditure and before exceptional cash flows) in the Core during Q3 (Q3 2002 GBP25 million outflow; Q2 FY03 GBP43 million outflow); (see Operating Cash Flow below)
- Group operating loss reduced to GBP130 million (Q3 2002: GBP256 million); Increased loss on ordinary activities before taxation of GBP198 million (Q3 2002: profit before tax GBP76 million) due to non-operating gains of GBP341 million in prior year
- Outlook: seasonal Q4 sales uplift not expected; further sales declines likely during the year ending 31 March 2004; appropriate cost actions will be taken to further reduce breakeven level of Core sales to around GBP1.7 billion (see Outlook below)
- Major milestone in financial restructuring achieved with filing of scheme documents with court on 17 March 2003 (see Financial Restructuring below and separate announcement dated 18 March 2003)

- First European sale of BXR 48000 and first commercial sale of Marconi Softswitch to Jersey Telecom during Q3; recent major order wins include Access Hub and MSH2K optical backbone network for Telecom Italia; new 3-year frame contract with TATA India for SDH equipment;
- Strong product pipeline; recent product launches include next generation SDH equipment (Series 4); new release of Access Hub platform incorporating voice over DSL, new Gigabit Ethernet and multicasting for video functionality; enhanced features to ServiceOn network management portfolio; integrated video application into next generation interactive kiosks; further enhancements to BXR-48000 to enable 10Gbps secure encrypted data transmissions; virtual presence desktop (Vipr) video conferencing platform launched.

London - 18 March 2003: Marconi (MONI) today announced unaudited non-statutory financial results for the three months ended 31 December 2002.

Commenting on the results, Mike Parton, Chief Executive, said "We are making real progress towards our operational goals. Core gross margin improved by almost three points over the same period a year ago despite lower volumes. Our Core operating cost run rate was reduced by almost half over the same period. While our markets remain difficult, we are continuing to improve our operating performance."

This news release should be read in conjunction with Marconi's unaudited non-statutory financial results and the Operational and Financial Review for the three months ended 31 December 2002.

Conference Call Details

Management will host a conference call and audiocast for analysts and investors today (Tuesday 18 March) at 4 pm UK time to discuss the Group's Q3 results and details of its financial restructuring announced in a separate press release this morning.

The call can be accessed on Marconi's web-site or by dialling +44 (0) 20 8996 3900 from Europe or 800 241 5872 (toll-free) or +1 617 847 8701 from US and quoting "Marconi".

An instant replay will be available for fourteen days by dialling +44 (0) 1296 618700, pass code 563002 from Europe or 888 286 8010, passcode 48156936 from US.

Materials to accompany the call will be available on Marconi's website www.marconi.com.

ENDS/...

About Marconi plc

Marconi plc is a global telecommunications equipment and solutions company headquartered in London. The company's core business is the provision of innovative and reliable optical networks, broadband routing and switching and broadband access technologies and services. The company's aim is to help fixed and mobile telecommunications operators worldwide reduce costs and increase revenues.

The company's customer base includes many of the world's largest telecommunications operators. The company is listed on the London Stock Exchange under the symbol MONI. Additional information about Marconi can be found at www.marconi.com.

This press release contains forward-looking statements with respect to products, partners, customers, future growth and other matters. Please refer to the Form

20-F report and Form 6-K reports filed by Marconi plc with the United States Securities and Exchange Commission for a discussion of risks that could cause actual results to differ materially from such statements.

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MARCONI PLC

OPERATIONAL AND FINANCIAL REVIEW

for the three months ended 31 December 2002

FORWARD-LOOKING STATEMENTS

This Operational and Financial Review contains certain statements that are or may be forward-looking. These statements typically contain words such as "intends", "expects", "anticipates", "estimates" and words of similar import. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances which may occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by such forward-looking statements. These factors include, but are not limited to future revenues being lower than expected; increasing competitive pressures within the industry; general economic conditions or conditions affecting the relevant industries, both domestically and internationally, being less favourable than expected. These factors and other factors that could effect these forward-looking statements are described in the Company's Form 20-F report and Form 6-K reports filed with the US Securities and Exchange Commission. The Company disclaims any obligation to publicly update or revise these forward-looking statements, whether to reflect new information or future events or circumstances or otherwise.

OVERVIEW

Overall conditions in the telecommunications market remained tough during the third quarter. Trading levels in EMEA in the third quarter remained stable despite the continuing difficult market environment. Marconi is now beginning to observe some slowing of business in the Middle East as a result of the current political environment. The North American market continues to be characterised by further tightening of capital expenditure by a number of large telecom operators, particularly towards the end of their financial years in December. In Central and Latin America (CALA), the market was relatively stable during the quarter although capital expenditure amongst major operators in the region remained at a low level. In Asia-Pacific (APAC), while the market remains buoyant in Australia, conditions in the Chinese market are more difficult as a result of delays in capital expenditure due to the re-organisation of key customers, delays to the roll-out of certain network build projects and increased pricing pressure on new business.

Despite the difficult market environment, the Group continued to make significant progress during the quarter towards its targets to improve operating performance in the Core business. In particular compared to the previous quarter, further cost savings achieved during the period led to an approximate 0.5 percentage point increase in Core gross margin (before exceptional items) to 22.1 per cent and an approximate GBP85 million reduction in Core operating cost run-rate (before goodwill amortisation and exceptional items) to GBP550 million at 31 December 2002. Headcount reductions are a major driver of the Group's cost reduction initiatives. At 31 December 2002, the Group employed just over 16,000 employees in its Core business, down from just over 19,000 at 30 September 2002.

The Group's improved operating performance combined with further progress in all areas of working capital management, led to a significant improvement in adjusted operating cash flow, with the Group recording an operating cash inflow (before exceptional items) of GBP72 million during the quarter. Non-operating and exceptional cash outflows (excluding tax) of GBP88 million relating mainly to the Group's ongoing operational and financial restructuring processes and interest paid were partially offset by a net GBP45 million tax repayment received during the period. In total during the third quarter, the Group generated cash of GBP29 million before use of liquid resources and financing.

The Group was awarded a number of important business wins during the period. These included the first European sale of the Group's BXR 48000 multi-service switch-router to a large financial institution and the first sale of the Group's recently launched Softswitch to Jersey Telecom. In addition, since the beginning of calendar year 2003, the Group has announced two major new business wins from Telecom Italia: a Euro 80 million (approximately GBP50 million) frame contract for the supply of the Access Hub and a new 2-year frame contract estimated at approximately Euro 15 million (approximately GBP10 million) to build an optical backbone network architecture based on the Group's recently launched next generation digital cross-connect, the MSH2K.

Board

During the third quarter and more recently, Marconi has announced a number of changes to its Board of Directors as a result of which, the Board now comprises:

Executive Directors	Mike Parton	Chief Executive Officer
	Mike Donovan	Chief Operating Officer
	Chris Holden	Interim Chief Financial Officer
Non-Executive Directors	John Devaney	Chairman
	Kent Atkinson	Chairman of Audit Committee
	Derek Bonham*	

Ian Clubb	Chairman of Remuneration Committee
Kathleen Flaherty	
Werner Koepf	

* Member of the Board of Marconi plc only; all other Executive and Non-Executive Directors are members of the Boards of both Marconi plc and Marconi Corporation plc.

Please refer to the Group's announcements dated 14 November 2002, 16 December 2002 and 14 March 2003 for full details of these board changes.

Financial Restructuring

On 29 August 2002, Marconi announced that it had concluded non-binding indicative heads of terms (the "Heads of Terms") for the financial restructuring of Marconi plc and its wholly owned subsidiary Marconi Corporation plc (the "Restructuring").

On 13 September 2002, Marconi announced that, in accordance with the Heads of Terms, interim security over the balance of the lockbox accounts established in April 2002 had been granted in favour of the Group's Syndicate Banks, bondholders (including the bond trustees) and certain ESOP derivative providers.

On 16 December 2002, Marconi concluded modifications to the Heads of Terms. The terms of the Restructuring as updated by these modifications were in most respects, including the initial cash distribution, the same as those announced by Marconi on 29 August 2002.

On 7 February 2003, Marconi announced that Marconi plc and Marconi Corporation plc had reached agreement in principle with the Group's ESOP derivative banks for a settlement of their ESOP derivative related claims against the Group. Documentation reflecting this settlement has now been concluded. As a result of this settlement, the initial cash distribution to be made as part of the Restructuring is to be increased by GBP135 million, in return for a GBP123 million reduction in the face value of the Junior Notes to be issued as part of the Restructuring (ie equivalent to redemption at 110 per cent of face value).

In the 7 February 2003 announcement, Marconi also indicated that the initial cash distribution was to be increased by an additional GBP20 million (to a total of GBP320 million) in replacement of the surplus cash element of the excess cash mechanism outlined in the Group's announcement of 16 December 2002. This GBP320 million figure is in addition to GBP95 million which, as previously announced, has already been paid on interest accrued on Marconi Corporation financial debt in the period to 15 October 2002.

Further proposed changes to the Restructuring were announced on 18 March 2003. In particular, Marconi announced proposed modifications to the scheme consideration including an increase in the face value of the Junior Notes to the sum of US$ 300 million and the US dollar equivalent of approximately GBP117 million and a proposal that the Limited Recourse Notes no longer be issued, as well as a further increase to the initial cash distribution of an additional GBP20 million (to a total GBP340 million). The Group further announced that documentation for the proposed schemes of arrangement has been filed with the High Court of England and Wales and that scheme documentation is expected to be posted to creditors by 31 March 2003, with Restructuring targeted to be completed by 31 May 2003.

Please refer to these announcements for further details on the Restructuring.

RECENT DEVELOPMENTS

On 24 February 2003, Marconi announced that, following approval from the High

Court in the United Kingdom, Marconi Corporation plc had completed a return of capital from Ultramast Limited (a joint venture with Railtrack Telecom Services Limited and settled all outstanding litigation relating to the joint venture company set up in December 2000 with RT Group plc. As a result of the transaction, Marconi received cash proceeds of approximately GBP41 million (GBP20 million of which Marconi Corporation plc had previously paid into court).

On 5 March 2003, Marconi announced that it had completed, in separate transactions, the disposal of two of the businesses from its Capital portfolio. First, the disposal of the Group's Private Mobile Networks division (also known as TETRA) to Finmeccanica SpA for approximately GBP2 million in cash, approximately GBP4.8 million in assumed financial debt and approximately GBP8.2 million in assumed debt to suppliers, and second, the disposal of Marconi Online to Coca Cola Amatil (N.Z.) Limited for approximately GBP1 million.

OUTLOOK

The market for telecommunications equipment and services remains difficult.

During the first three quarters of the current financial year the annualised rate of Core sales has declined by around 10 per cent from approximately GBP2 billion in the first quarter to approximately GBP1.8 billion in the third quarter.

The Directors do not expect that the Group will benefit from a seasonal uplift in Core sales during the fourth quarter of the financial year compared to the level recorded in the third quarter (GBP456 million), contrary to the seasonal pattern of customer demand in previous years.

Furthermore, the Directors believe that market volumes are likely to contract further during the next financial year and do not expect to benefit from significant market share gains. As a result, the Group believes that Core sales could decline by up to a further 5 per cent during the next financial year compared to the annualised third quarter trading levels (GBP1.8 billion).

In December 2002, the Group outlined its Core operating model and confirms its targets to achieve a gross margin run-rate in the range of at least 24 to 27 per cent of Core sales and an operating expenditure run-rate in the range of 21 to 24 per cent of Core sales during the next financial year ending 31 March 2004. The Group now believes that it will be able to reduce the Core operating cost base to an annual run rate below GBP450 million during the next financial year and thereby reduce its targeted breakeven level of sales to below GBP1.7 billion.

BASIS OF PREPARATION

The non-statutory and unaudited financial statements that accompany this Review have been prepared on a consistent basis with the Group's accounting policies as stated as at 31 March 2002. However, as these accounts are not statutory financial statements, the Group has not applied all of the requirements of the Companies Act 1985 or of accounting standards in relation to items of disclosure including, but not limited to retirement benefits, financial instruments and directors' emoluments. The last actuarial assessment of the Group's defined benefit pension scheme liabilities and valuation of pension assets was performed at 30 September 2002 and has not been updated for the quarter ended 31 December 2002. Consequently, no amounts have been recognised in the Statement of Total Recognised Gains and Losses for movements in the actuarial position of plan assets and plan liabilities.

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. The Group currently consists of Marconi plc and its subsidiaries, including Marconi Corporation plc. After completion of the proposed financial restructuring (see Financial Restructuring above), Marconi Corporation plc will replace Marconi plc as the parent company of the Group. The major profit and loss differences between the unaudited consolidated results of Marconi plc and Marconi Corporation plc for the third quarter ended 31 December 2002 were:

- Marconi plc's share of the fees paid to advisers in connection with the restructuring which have been charged to operating exceptional items (GBP8 million); and

- interest payable of GBP1 million on the bonds issued by Marconi Corporation plc held by Ancrane Limited, a subsidiary of Marconi plc that does not form part of the Marconi Corporation plc group;

The major balance sheet differences between the unaudited consolidated financial position of Marconi plc and Marconi Corporation plc as at 31 December 2002 were:

- cash of GBP1 million held by Marconi plc; and

- net balances of GBP660 million being Marconi Corporation plc bonds and other balances held by members of the Marconi plc group that are not members of the Marconi Corporation plc group with members of the Marconi Corporation plc group.

Throughout this Operational and Financial Review, the term:

- "adjusted gross profit" refers to gross profit before an exceptional credit of GBP7 million (Q3 2002: GBP19 million exceptional charge) as disclosed in Note 5a;

- "adjusted operating profit/(loss)" refers to operating profit/(loss) before exceptional charges of GBP54 million (Q3 2002: GBP94 million) as disclosed in Note 5a and goodwill amortisation of GBP28 million (Q3 2002: GBP46 million) as disclosed in note 4;

- "adjusted operating cost run-rates" and "adjusted operating expenses" refer to operating cost run rates and operating expenses before exceptional charges of GBP60 million (Q3 2002: GBP75 million) as disclosed in note 5a and goodwill amortisation of GBP28 million (Q3 2002: GBP46 million) as disclosed in note 4;

- "adjusted operating cash flows" refers to operating cash flows before exceptional cash outflows of GBP82 million (Q3 2002: GBP107 million) and after net capital expenditure of GBP3 million inflow (Q3 2002: GBP29 million inflow).

Going Concern

There is no guarantee that the negotiations relating to the Restructuring (discussed above) will reach a satisfactory conclusion. However, in the light of the information currently available to them, the Directors of Marconi plc and

Marconi Corporation plc believe that the Group's bankers, bondholders and other creditors will support the Group in achieving an appropriate capital structure and that all the conditions for the Restructuring will be satisfied. On this basis, the Directors consider it appropriate to prepare the accounts on a going concern basis. Should the Group's bankers, bondholders and other creditors (or some of them) cease to support the Group before the completion of the Restructuring, or should all of the conditions for the Restructuring not be met, adjustments would be necessary to record additional liabilities and to write down assets to their recoverable amount. It is not practicable to quantify these possible adjustments.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Marconi's non-statutory financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the U.K.. The preparation of these non-statutory financial statements requires the Group to make estimates, judgements, and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Note 2 of the Notes to the accompanying non-statutory financial statements describes the significant accounting policies used in their preparation. The Directors base their estimates on historical experience and various other assumptions that they believe are reasonable under the circumstances, the results of which form the basis for making judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Group believes that the following are some of the more critical judgement areas in the application of its accounting policies that affect the Group's financial position and results of operations.

The development and selection of these critical accounting estimates has been discussed with the Audit Committee and the Audit Committee has reviewed the Group's disclosure relating to it in this Operational and Financial Review.

Revenue Recognition

Revenue is recognised when all of the following conditions are satisfied 1) there is persuasive evidence that an arrangement exists; 2) delivery has occurred or services have been rendered; 3) the fee is fixed or determinable; and 4) it is probable that the debtor will be converted into cash.

It is common for Marconi's sales agreements to cover the delivery of several products and/or services. These range from arrangements where a contract covers the delivery and installation of equipment to more complex arrangements, which also include training of customer personnel, sale of software and other support services. Revenue from contracts with multiple element arrangements, such as those including installation and commissioning services, is recognised as each element is earned based on objective evidence of the relative fair values of each element and when there are no undelivered elements that are essential to the functionality of the delivered elements.

Revenues and estimated profits on long-term contracts are recognised under the percentage-of-completion method of accounting using a cost-to-cost methodology. Significant judgement is required in determining progress toward completion and in estimating revenues and costs. Profit estimates are revised periodically based on changes in facts in the underlying contract. When estimates of total contract revenues and costs indicate a loss, a provision for the entire amount of the contract loss is recognised in the period in which the loss becomes foreseeable. Advance payments received from contracts are recorded as a liability unless there is a right of set-off against the value of work undertaken.

Impairment of Long-Lived Assets

The Group reviews the carrying value of other fixed assets and assets to be disposed of, including other intangible assets, whenever indicators of impairment exist. Indicators of impairment include (but are not limited to):

- a significant adverse change in the extent or manner in which a long-lived asset or asset group is being used or in its physical condition;

- a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset or asset group; and

- a current expectation that, more likely than not, a long-lived asset or asset group will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

These tests for impairment require significant judgements in determining estimates of future cash flows and the resulting value in use of the relevant fixed asset. Estimations of the present value of future cash flows contain inherent uncertainty and include estimates of market size and market share information, growth rates, product demand and technological development, costs of labour and supplier purchases, working capital requirements, and discount rates to be applied to future cash flows.

If the carrying value of a fixed asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the fixed asset exceeds the higher of its net realisable value or its value-in-use. In the three months ended 31 December 2002 and 2001, Marconi recorded impairment charges in relation to tangible fixed assets of GBP9 million and GBPnil million, respectively. In the year ended 31 March 2002, Marconi recorded an impairment charge relative to goodwill of GBP3,677 million. The Group believes that its estimates of future cash flows are reasonable; however, changes in such estimates could affect the determination of the net realisable value or its value-in-use of the relevant fixed asset.

Contingent Liabilities

Marconi is subject to legal proceedings and other claims arising in the ordinary course of business. Various claims and proceedings have been or may be instituted or asserted against Marconi relating to class shareholder actions and the conduct of its business, including those pertaining to patents, environmental, safety and health, employment and contract matters. The Group is required to assess the likelihood of any adverse judgements or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is based on a careful analysis of each individual issue with the assistance of outside legal counsel. Although the outcome of litigation cannot be predicted with certainty and some lawsuits, claims or proceedings may be disposed of unfavourably to Marconi, the Group believes that the ultimate outcome of these matters will not have a material adverse effect on the results of operations or financial position or cash-flows of Marconi, except as discussed in Note 21 to the non-statutory financial statements.

Pension and other Post-retirement Benefits

Pension and other post-retirement benefits costs and obligations are dependent on actuarial assumptions used in calculating such amounts. These assumptions include discount rates, health care cost trend rates, benefits earned, interest cost, expected return on plan assets, mortality rates, and other factors. While the Group believes that the assumptions used are appropriate, the assumptions used may differ materially from actual results due to changing market and economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. These differences may result in a significant impact on the amount of future pension or post retirement benefits expense and the resulting liability. Holding all other assumptions constant, a one-half percent increase or decrease in the discount rate would have increased or decreased the net loss for the three months ended 31 December 2002 by approximately GBP1 million. Likewise, a one-half percent increase or decrease in the expected return on plan assets would have increased or decreased pre-tax loss for the three months ended 31 December 2002 by GBP3 million.

In the three months ended 31 December 2002, the Group charged the profit and loss account with GBP6 million of service cost and GBP2 million of notional interest in respect of defined benefit schemes on the basis of the 30 September 2002 actuarial assessment. This will be updated during the final quarter of the year ending 31 March 2003, and any actuarial gains and losses arising on pension assets and liabilities in the balance sheet will be shown in the statement of total recognised gains and losses for the year ending 31 March 2003. The comparative period for the three months 31 December 2001 was based on actuarial and investment reviews carried out between 1 January 2002 and 31 March 2002.

Product Warranties

Provisions for estimated expenses related to product warranties are made at the time products are sold. These estimates are established using historical information on the nature, frequency, and average cost of warranty claims. The Group actively studies trends of warranty claims and takes action to improve equipment quality and minimise warranty claims. The Group believes that the warranty reserve is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the reserve. If the Group were to experience an increase in warranty claims compared with its historical experience, or if costs of servicing warranty claims were greater than the expectations on which the accrual had been based, the Group's gross margins could be adversely affected.

REPORTING STRUCTURE

For financial reporting purposes, the Group divides its continuing operations into two segments: Core and Capital.

Core is further analysed by business-type: Network Equipment, comprising Optical Networks, Broadband Routing and Switching (BBRS), European Access, North American Access, Outside Plant & Power (OPP) and Other Network Equipment; and Network Services comprising Installation, Commissioning & Maintenance (IC&M) and Value-Added Services (VAS).

Capital comprises businesses which Marconi manages to create value and ultimately for disposal. During the third quarter ended 31 December 2002, Capital included the Group's Tetra and UMTS mobile activities, Marconi Online and other smaller joint ventures and investments. In the comparative period of the previous financial year, Capital also included Marconi Applied Technologies.

In addition, the Group has an economic interest of 71.6 per cent, but voting rights of only 49.6 per cent, in Easynet Group Plc (Easynet). This investment is managed through the Group's Capital division, but is accounted for as an associate in the Group's consolidated accounts.

None of the Group's businesses were reported as discontinued operations during the third quarter. Discontinued operations in the previous financial year included Strategic Communications as well as Medical, Commerce and Data Systems until the date of their respective disposals.

As part of the proposed Restructuring, it is intended that the Group will segment its business along geographic lines and report the equipment and services activities of BBRS, OPP and North American Access (US businesses) separately from the Group's businesses based in Europe and the Rest of the World, which comprise Optical Networks, European Access, Other Network Equipment and the rest of Network Services. As previously disclosed in Marconi's announcement of 29 August 2002, OPP and North American Access are being managed for value and with a view to disposal, the proceeds of which would be used to redeem in part the Junior Notes proposed as part of the Restructuring (or in the event of disposal prior to 1 May 2003, to reduce the amount of Junior Notes issued).

RESULTS OF OPERATIONS

GROUP REVIEW

Group Key Figures (including joint ventures)

in GBP million	3 months ended 31 December 2002	3 months ended 31 December 2001
Sales	466	1,041
Adjusted Gross Profit	102	241
Adjusted Operating Loss	(51)	(109)
Goodwill Amortisation	(28)	(46)
Operating Exceptionals	(54)	(94)
Operating Loss	(133)	(249)
Non-Operating Exceptionals	(10)	341
Associates	(11)	(11)
Loss before interest, finance income and tax	(154)	81

Group Sales

in GBP million	3 months ended 31 December 2002	3 months ended 31 December 2001
Core	456	632
Capital	12	116
Other	(2)	0
Continuing operations	466	748
Discontinued operations	0	293
Group	466	1,041

Group sales for the three months ended 31 December 2002 amounted to GBP466 million, representing a decrease of GBP575 million or 55 per cent to the corresponding three months of the previous year (Q3 2002: GBP1,041 million).

Sales from continuing operations amounted to GBP466 million, a decrease of GBP282 million or 38 per cent compared to the third quarter of the previous year. This decrease was mainly the result of continued reductions in capital expenditure in the global market for telecommunications equipment and services resulting in lower sales in the Group's Core business (see Core Business Review below). Sales in the Group's Capital business have been substantially reduced since the third quarter of the previous year as a result of business disposals, the major component of which was the disposal of the Group's 50 per cent stake in General Domestic Appliances. The GBP12 million sales in Capital during the period related to the Group's Mobile Tetra business and represented a GBP4 million increase compared to the third quarter of the previous year as a result of an increase in sales of Tetra products outside the domestic Italian market, particularly in APAC and CALA.

There were no sales from discontinued operations during the period. The GBP293 million of sales from discontinued operations for the three months ended 31 December 2001 related to disposed businesses, Strategic Communications, Data, Commerce and Medical Systems.

Group Adjusted Gross Profit (including joint ventures)

in GBP million	3 months ended 31 December 2002	3 months ended 31 December 2001
Core	101	122
Capital	1	21
Continuing operations	102	143
Discontinued operations	-	98
Group	102	241

Adjusted gross profit at Group level amounted to GBP102 million, representing an adjusted gross margin of 21.9 per cent and was almost entirely attributable to the Group's Core business. The GBP139 million decrease compared to the third quarter of the previous year reflected mainly the loss of gross profit attributed to business disposals from discontinued operations (GBP98 million) and from Capital (GBP20 million). The GBP21 million reduction in the Core business related mainly to the lower sales volumes in Network Equipment described in the Core Business Review below.

Group Adjusted Operating Profit/(Loss) by Segment

in GBP million	3 months ended 31 December 2002	3 months ended 31 December 2001
Core	(41)	(128)
Capital	(10)	(7)
Continuing operations	(51)	(135)
Discontinued operations	-	26
Group	(51)	(109)

Group adjusted operating loss was reduced by GBP58 million from a loss of GBP109 million in the third quarter of the previous year to a loss of GBP51 million in the reporting period. Operating cost savings achieved in the Core business described in the Core Business Review below were the main driver of the Group's improved operating performance and more than offset the absence of GBP26 million of adjusted operating profit recorded in the previous year relating to discontinued operations.

Core Business Review

Core Key Figures

in GBP million		FY03		FY0
	Q1	Q2	Q3	Q
Sales	510	482	456	63
Adjusted Gross Profit	89	79	101	12
Adjusted Operating Loss	(115)	(90)	(41)	(128
Adjusted Operating Cash Flow after capital expenditure	(81)	(42)	66	(26

Core Sales by Geography

in GBP million		FY03		FY02
	Q1	Q2	Q3	Q3
EMEA	285	285	287	363
US	153	142	127	167
APAC	47	45	29	61
CALA	25	10	13	41
Core	510	482	456	632

Core sales in the third quarter amounted to GBP456 million, a decline of GBP176 million or 28 per cent compared to the corresponding quarter of the previous year. Sales fell across all major geographic regions as a result of the significant reductions in capital expenditure by the majority of telecom operators world-wide. On a sequential basis, the quarter-on-quarter decline in sales was limited to GBP26 million or 5 per cent (Q2 2003: GBP482 million).

Core sales in EMEA fell by GBP76 million or 21 per cent to GBP287 million (Q3 2002: GBP363 million. GBP56 million representing almost three-quarters of this decline occurred in Optical Networks as telecom operators have concentrated their reduced capital expenditure on maximising utilisation in their existing networks to the detriment of new network build. A further GBP10 million of this decline occurred in BBRS mainly as a result of the expiry of a third party distributorship agreement in the United Kingdom during the current financial year. Sales of Network Services in EMEA increased as a result of the phasing of long-term service contracts particularly in the Middle East, UK and Germany.

Core sales in the US fell by GBP40 million or 24 per cent to GBP127 million (Q3 2002: GBP167 million). This was mainly a result of reduced sales of OPP equipment and services following substantial reductions in capital expenditure by US telecom operators. US sales of Optical Networks amounted to less then GBP1 million during the period (Q3 2002: GBP7 million) following the Group's decision to cease the development and manufacture of its SONET product range in April 2002.

In APAC, Core sales declined by GBP32 million or 52 per cent to GBP29 million (Q3 2002: GBP61 million). The main area of decline was Optical Networks and this was mainly a result of the lower level of sales recorded in China following the completion of large network build projects in the region in the previous financial year and delays to certain network build projects by a number of the Group's Chinese customers in the current financial year. Sales of Network Services were also down in the region mainly as a result of business disposals.

Core sales in CALA were down GBP28 million or 68 per cent to GBP13 million (Q3

2002: GBP41 million). Sales were down across all product and service activities as a result of the deterioration in economic conditions compared to the prior year period and the consequent reductions in capital expenditure by most of the major telecom operators in the region.

Core Sales by Product Area

in GBP million	FY03			FY02
	Q1	Q2	Q3	Q3
Optical Networks	134	108	96	189
Broadband Routing and Switching	38	35	32	40
European Access	59	69	69	85
North American Access	25	23	23	24
Outside Plant & Power	46	34	30	48
Other Network Equipment	14	15	11	21
Network Equipment	316	284	261	407
IC&M	97	89	93	122
VAS	97	109	102	103
Network Services	194	198	195	225
Core	510	482	456	632

Sales of the group of activities defined as "US businesses" had sales of GBP125 million during the third quarter and are included in the Core sales reported above (Q3 2002: GBP171 million).

Network Equipment

Sales of Network Equipment amounted to GBP261 million, a decline of GBP146 million or 36 per cent compared to the previous year (Q3 2002: GBP407 million). Significant reductions in capital spending by the majority of telecommunications operators world-wide was the primary reason behind the lower level of sales across all major product areas. This trend was particularly marked in Optical Networks and Outside Plant and Power equipment. In some product areas, particularly European Access, the trend was further exacerbated by the impact of product line rationalisations undertaken in April 2002 as part of the Group's operational restructuring.

Optical Networks

Optical Networks sales declined by GBP93 million, or 49 per cent to GBP96 million (Q3 2002: GBP189 million). Sales were down in all major geographic regions.

Over half of the decline in sales arose in EMEA. In the United Kingdom, the drop in sales was caused by the substantial decline in demand from second tier operators, partially offset by slightly higher sales to BT. During the third quarter, Marconi has begun discussions with a number of second tier operators, who are now beginning to emerge from their own restructuring initiatives, with regard to their future network plans but this has not yet translated to firm sales. Sales to major German customers were lower than in the third quarter of the previous year as a result of lower capital spending amongst operators. Sales were also lower in Italy due to the phasing of the roll-out of Telecom Italia's DWDM network, where the third quarter of the previous year was a peak stage in the deployment of Marconi's PLT products.

In APAC, whilst sales into the Australian market increased as a result of SDH

Series 3 sales to Telstra, sales in China were down partly due to the completion of DWDM sales to China Railcom for the North-West Ring project during the last financial year but also as a result of the difficult conditions in the Chinese market.

In CALA, third quarter capital spending by telecom operators remained at a very low level and this led to reduced Optical Networks sales volumes compared to the previous year.

Third quarter Optical Networks sales in the US were not material, following the Group's decision during the first quarter of the financial year to cease the development of its SONET products for the US market and the subsequent closure of its North American manufacturing plant.

During the third quarter, SDH accounted for 89 per cent of Optical Networks sales (Q3 2002: 91 per cent) and DWDM for 7 per cent (Q3 2002: 9 per cent). The balance related mainly to network management systems.

Broadband Routing and Switching (BBRS)

Sales of BBRS equipment decreased by GBP8 million or 20 per cent to GBP32 million (Q3 2002: GBP40 million). The expiry of a distributorship agreement in EMEA earlier in the current financial year, through which Marconi sold a third party's equipment into the UK market, was the main cause of this decline. Sales in the US remained stable compared to the third quarter of the previous year mainly as a result of the consistent seasonal pattern of spending by the US Federal Government, the largest single customer of Marconi's BBRS business.

European Access

European Access sales fell by GBP16 million or 19 per cent to GBP69 million (Q3 2002: GBP85 million). Reductions in capital spending by a number of European Access customers, particularly second-tier operators in the United Kingdom and Germany, as well as rationalisation of the Group's legacy product lines following a strategic review of the Access portfolio in April 2002 were the primary reasons behind this decline.

Sales of voice systems increased largely due to a software upgrade and the Group recorded higher sales of its Access Hub compared to the modest initial sales of this newly launched product platform in the third quarter of the previous year. These increases were more than offset by lower sales of fixed wireless access products mainly as a result of significant reductions in capital spending by a number of German mobile operators and lower sales of other legacy and discontinued products.

North American Access

At GBP23 million, North American Access sales remained relatively stable compared to the third quarter of the previous year fell (Q3 2002: GBP24 million). This was mainly the result of the continued deployment of equipment into BellSouth's access network.

Outside Plant & Power (OPP)

OPP equipment sales fell by GBP18 million or 38 per cent to GBP30 million (Q3 2002: GBP48 million. This was a result of the significant reductions in capital spending in the United States and CALA.

Other Network Equipment

Other Network Equipment declined by GBP10 million or 48 per cent to GBP11 million. While Interactive Systems recorded a modest increase in sales, this was more than offset by declining revenues from legacy businesses, particularly in

EMEA.

Network Services

Sales of Network Services decreased by GBP30 million or 13 per cent to GBP195 million (Q3 2002: GBP225 million). This was driven by decline in sales of Installation, Commissioning and Maintenance activities, particularly in the US, while sales of Value Added Services remained stable.

Installation, Commissioning and Maintenance (IC&M)

IC&M sales fell by GBP29 million or 24 per cent to GBP93 million. Some 65 per cent of the decline arose in the US market and related to both OPP where sales of services fell in line with declines in equipment sales and to enterprise-specific service projects in the region as the Group continues to refocus activities on the service-provider market. IC&M sales in EMEA remained stable compared to the third quarter of the previous year mainly as a result of ongoing long-term support contracts which typically account for approximately 40 per cent of IC&M sales in the region and which provide a more constant revenue stream. In addition, the Group continues to benefit from new business opportunities such as long-term support, repair and maintenance contracts as a result of increased outsourcing of services by major European telecom operators. Major service contracts were won or renewed with BT, Ericsson, Netcologne and Belgacom during the quarter and these revenue streams were sufficient to offset lower levels of installation and commissioning activities associated with sales of Network Equipment.

Value-Added Services (VAS)

At GBP102 million, the Group recorded stable sales of Value-Added Services compared to the third quarter of the previous year (Q3 2002: GBP103 million).

Sales were down in Managed Services as a result of the Group's exit from its IT outsourcing activities completed during December 2002 and in the APAC region as a result of the sale of part of the Group's Hong Kong based legacy operations in October 2002. Sales of Wireless Services and BBRS-related services remained stable while sales of Integrated Systems increased compared to the third quarter of the previous year mainly as a result of the phasing of long-term service contracts in the UK, the Middle East and in Germany.

Core Sales Channels

Marconi sells its products and services through its direct sales force and also through indirect channels such as local partners or distribution partners such as Ericsson, Italtel, Nokia and Siemens. Sales through channel partners were significantly lower than the third quarter of the previous year as a result of the overall reduction in market volumes and particularly, in the case of sales through Ericsson and Nokia, as a result of the completion of 2G and 2.5G wireless network rollouts in the previous year and the ongoing delays to the deployment of 3G network rollouts.

Core Pricing

A high proportion of Core sales, particularly in Europe, are derived from existing frame contracts, which typically contain annual price reductions. The Group estimates that price erosion in Network Equipment under such contracts ranges up to 8 per cent on an annual basis. The Group aims to continue to match this price erosion with planned product cost savings to avoid erosion of gross margins. Network Services tends to be more resilient to price erosion. During the period, the Group has observed increased pricing pressure when competing for new business in certain territories (particularly in China) and in certain product areas (particularly Access and DWDM).

Key Core Customers

The Core business serves a strong customer base of predominantly incumbent operators and government agencies. The ten largest customers during the third quarter were BellSouth, BT, Ericsson, Metro City Carriers, Telecom Italia, Telkom South Africa, UK Government, US Federal Government, Verizon and Vodafone Group. In aggregate, these customers accounted for 46 per cent of third quarter Core sales (Q3 2002: ten largest customers 36 per cent). BT remains the Group's largest customer and accounted for 19 per cent of Core sales in the third quarter (Q3 2002: 13 per cent).

In EMEA, the five largest customers during the third quarter were BT, Telecom Italia, Telkom South Africa, the UK Government and Vodafone Group and in aggregate accounted for 49 per cent of Core sales in the region during the period (Q3 2002: top 5 EMEA customers accounted for 41 per cent).

In the US, the five largest customers during the third quarter were BellSouth, Qwest, SBC, the US Federal Government and Verizon and in aggregate accounted for 52 per cent of Core sales in the region during the period (Q3 2002: top 5 US customers accounted for 35 per cent). The increased concentration of sales resulted from the decline in the number of second tier operator and enterprise customers compared to the third quarter of the previous year.

Core Cost of Sales

Core cost of sales in the third quarter amounted to GBP355 million (Q3 2002: GBP510 million). Of this, approximately 57 per cent related to Network Equipment (Q3 2002: 64 per cent) and 43 per cent to Network Services (Q3 2002: 36 per cent).

In Network Equipment, approximately 75 per cent are material costs, around one-third of which relates to outsourced printed circuit board (PCB) assemblies. The remaining 25 per cent relates to in-house labour and overhead and includes functions and costs such as planning, supplier management, supply chain management, logistics, engineering, quality control, final assembly and test, property costs, asset depreciation, system maintenance and warranty costs.

The decrease in cost of sales in Network Equipment is due to substantial cost savings achieved in both the European supply chain and in the Group's US manufacturing operations. In Europe, material, labour and overhead costs have been significantly reduced year on year and additional savings achieved through asset disposal, site rationalisation and warehouse closures. In the US, three factories have been closed during the current financial year and other plants rationalised in line with the reduced level of sales volumes.

In Network Services, over 60 per cent of cost of sales relates to the cost of in-house labour. The balance relates to the cost of sub-contract labour, materials and other overheads. The reduced costs compared to the previous year relate mainly to headcount reductions.

Core Gross Profit / Margin

The Group continued to make good progress in its initiatives to improve gross margins during the period. Third quarter Core adjusted gross profit before exceptional items amounted to GBP101 million, or 22.1 per cent of sales.

The decrease in adjusted gross profit compared to the previous year (Q3 2002: GBP122 million) related mainly to the reduced volume of Network Equipment sales, and particularly the lower level of sales in Optical Networks. This was partially offset by cost savings achieved in the Group's European supply chain during the period as a result of further rationalisation and benefits of improved procurement. These savings were the main contributing factor to the increase in adjusted gross margin as a percentage of sales compared to the previous year (Q3 2002: 19.3 per cent of sales).

On a sequential basis, excluding the impact of GBP25 million of additional stock provisions charged to cost of sales in the second quarter, adjusted gross profit in the Core remained relatively stable despite the 5 per cent sequential sales decline (Q2 2003: adjusted gross profit GBP104 million reduced to GBP79 million after additional stock provisions). This was achieved through cost savings realised during the period in both Network Equipment and Network Services. These savings were the main drivers of the sequential improvement in adjusted gross margin as a percentage of sales in the quarter (Q2 2003: 21.6 per cent of sales before the impact of additional stock provisions of GBP25 million). They accounted for a 3 percentage point increase in adjusted Core gross margin, which was partially offset by a less favourable business mix (0.5 percentage point decrease) and one-off items relating to contract completions (2 percentage point decrease).

Core Operating Expenses

During the third quarter, operating cost reduction remained a key focus of the Group's strategy.

Core adjusted operating expenses totalled GBP142 million or 31 per cent of Core sales during the period, a reduction of GBP108 million or 43 per cent compared to the third quarter of the previous year (GBP250 million; 40 per cent of Core sales). Significant savings were achieved across all main categories of operating expenditure.

By 31 December 2002, the Group had reached an annualised adjusted operating cost run-rate in the Core business of approximately GBP550 million, reduced from GBP1.1 billion at the end of September 2001 and GBP635 million at the end of September 2002.

Core Operating Expenses - Research & Development (R&D)

Core R&D expenditure (before exceptional items) amounted to approximately GBP64 million, a 12 per cent reduction compared to the previous quarter (Q2 2003: GBP73 million), and a 44 per cent reduction compared to the third quarter of the previous financial year (GBP115 million). Cost savings achieved during the quarter related mainly to headcount reductions and reduced facility costs as well as reduced spend on development materials and a reduced level of depreciation following exceptional asset write-downs relating to development models in prior periods.

Optical Networks accounted for approximately 40 per cent of the total Core R&D spend during the third quarter (Q3 2002: approximately 36 per cent). Around half of this spend was focused on SDH and in particular the release into customer trials of Marconi's new high-capacity SDH platform (MSH2K, MSH64c) and the development of further enhancements to the data-handling capability of the Group's next generation low-capacity SDH platform, the SMA Series 4. Marconi also continued to invest in DWDM, targeting feature enhancements across the Group's existing platforms for Core and Metro applications and further upgrades to the Group's network management software.

R&D spend across the Group's Access portfolio, in Europe and North America combined, accounted for a further 23 per cent of total Core R&D (Q3 2002: approximately 32 per cent). The Group has further cut spend on legacy products in North America and Europe to focus on R&D programmes relating to Fixed Wireless Access products, the Access Hub and the recently launched Softswitch.

BBRS accounted for 21 per cent of Core R&D in the quarter (Q3 2002:

approximately 17 per cent). Over 50 per cent of this spend was focused on the further development of the Group's multi-service core switch-router, the BXR 48000. Other ongoing initiatives include further enhancements to the Group's ASX1000 and ASX4000 product ranges and the Group's ViPr project, a virtual presence desk-top networking terminal which uses Marconi's ATM-based multi-service broadband switch-routing platforms as transport infrastructure.

The remaining 16 per cent of R&D spend in the period related mainly to OPP, wireless software and Other Network Equipment.

Core Operating Expenses - Sales & Marketing

Core Sales & Marketing expenditure (before exceptional items) amounted to GBP59 million, a 2 per cent reduction compared to the previous quarter (Q2 2003: GBP60 million), and a 45 per cent reduction compared to the third quarter of the previous financial year (GBP107 million). Cost savings during the quarter have been achieved mainly through further headcount reductions, a reduced level of discretionary marketing spend and the closure of overseas sales offices.

Core Operating Expenses - General & Administrative (G&A)

G&A expenses (before goodwill amortisation and exceptional items) in the Core amounted to GBP22 million, a 27 per cent reduction compared to the previous quarter (Q2 2003: GBP30 million), and a 45 per cent reduction compared to the third quarter of the previous financial year (GBP40 million). Cost savings during the quarter have been achieved mainly through further headcount reductions, site rationalisation (including the relocation of the Group's UK head office) and reduced spend on professional fees incurred in the normal course of business. Professional fees relating to the Group's financial restructuring are classified as exceptional costs.

Core Operating Expenses - Other

Other Core operating income amounted to approximately GBP3 million and related mainly to income from properties and royalties as well as a net favourable foreign exchange translation gain. (Q2 2003: GBP6 million operating expense; Q3 2002: GBP12 million operating income).

Core Adjusted Operating Loss

in GBP million		FY03		FY02
	Q1	Q2	Q3	Q3
Network Equipment	(96)	(83)	(49)	(80)
Network Services	(2)	7	20	(32)
Other*	(17)	(14)	(12)	(16)
Core	(115)	(90)	(41)	(128)

* Other relates mainly to Head Office and other central costs

The Group significantly reduced the adjusted operating loss in its Core business to GBP41 million during the third quarter, compared to an adjusted operating loss of GBP90 million in the previous quarter and an adjusted operating loss of GBP128 million in the third quarter of the previous year.

This substantial improvement was driven by a combination of increased gross margin and reduced operating expenditure resulting from the Group's ongoing operational cost saving initiatives described above.

Network Equipment

The adjusted operating loss in Network Equipment amounted to GBP49 million, an improvement of GBP34 million or 41 per cent compared to an adjusted operating loss of GBP83 million in the previous quarter and an improvement of GBP31 million or 39 per cent compared to an adjusted operating loss of GBP80 million in the third quarter of the previous year. Substantial cost reductions achieved in the Group's supply chain and manufacturing operations in Europe and the US as well as in all areas of operating expenditure were the main driver of this improvement and more than offset the reductions in sales volumes across Network Equipment.

Network Services

Network Services recorded a marked increase in adjusted operating profit from GBP7 million in the second quarter of the financial year to GBP20 million during the period despite the stable sequential sales profile. This represented a significant increased compared to the third quarter of the previous year when Network Services recorded an adjusted operating loss of GBP32 million. Improved resource utilisation and other ongoing cost reduction initiatives were the main drivers behind this enhanced performance. The most marked progress was recorded in IC&M as a result of increased efficiency and an improved ratio of in-house to sub-contracted labour, giving rise to greater flexibility in the work-force.

OTHER FINANCIAL ITEMS

Exceptional Items

Operating Exceptionals

For the three months to 31 December 2002, exceptional items charged to Group operating loss (including joint ventures) totalled GBP54 million. Of this amount GBP7 million was credited to restructuring costs classified within cost of sales and GBP61 million was charged to administrative expenses.

The GBP7 million exceptional income arose as a consequence of the Group's manufacturing outsourcing arrangements whereby Marconi was able to release stock provisions where the corresponding components, previously provided for by Marconi, had been utilised by the Group's outsourcing partner.

The GBP61 million charge, related mainly to exceptional restructuring and reorganisation costs, comprising costs associated with the Group's operational restructuring including headcount reductions (GBP32 million), site rationalisation (GBP5 million) and fixed asset impairments (GBP11 million) as well as costs associated with the Group's financial restructuring (GBP20 million). These charges were partially offset by a GBP7 million exceptional gain due to lapses of share options granted to vendors of past acquisitions (MSI and Mariposa).

In addition, the Group recorded its share of associates' operating exceptional charges, which amounted to GBP3 million during the quarter.

During the three months to 31 December 2001, exceptional items charged to Group operating loss (including joint ventures) totalled GBP94 million and related wholly to the Group's operational restructuring.

Non-Operating Exceptionals

For the three months to 31 December 2002, non-operating exceptional charges amounted to GBP10 million, which related mainly to the disposals of the Group's legacy operations in South Africa and wireless operations in APAC as well as to the write down of fixed asset investments.

During the three months to 31 December 2001, non-operating exceptional income amounted to GBP341 million and related mainly to gains on disposals of subsidiaries and other fixed assets including Medical Systems, properties and the Group's stakes in Sietel and Lottomattica as well as the mark to market of some of the Group's other investments, namely Lagardere (since disposed) and Easynet.

Interest and Finance Income

In the three months to 31 December 2002, the Group's net interest charge to the Profit and Loss Account was GBP51 million (Q3 2002: GBP66 million).

The charge during the period mainly comprised interest paid and accrued on the Group's bond and bank debt (GBP60 million). These charges were partially offset by interest received on the Group's cash balance and in relation to the tax repayment received during the period (GBP4 million).

Finance income amounted to GBP7 million.

Taxation

The tax charge during the period was GBPnil (Q3 2002: GBPnil).

Goodwill Amortisation

The Group incurred a charge of GBP28 million for goodwill amortisation for the three months to 31 December 2002 compared to a charge of GBP46 million in the corresponding period of the previous year. This significant reduction was a result of the reduced carrying value of goodwill on the Group's balance sheet following the exceptional goodwill impairment charges in the year ended 31 March 2002 and the disposal of businesses and related goodwill.

Associates

The charge of GBP11 million for the three months ended 31 December 2002 represents the Group's share of operating losses and exceptional items of Easynet plc as well as the amortisation of related goodwill. The charge in the three months ended 31 December 2001 was GBP11 million.

Earnings per Share

Basic and diluted loss per share, which reflects goodwill amortisation and exceptional items, was 7.1 pence (Q3 2002: earnings of 2.7 pence).

The loss per share excluding goodwill amortisation and exceptional items was 3.6 pence compared to earnings per share of 4.4 pence in the third quarter of the previous year.

Dividend

In the light of the Group's ongoing financial restructuring, the Board has decided not to propose the payment of a dividend for the year ending 31 March 2003. Furthermore, after the Restructuring, Marconi Corporation will be restricted from paying dividends under the terms of the indentures governing the New Notes. Accordingly Marconi Corporation does not expect to pay a dividend in the foreseeable future.

FINANCIAL CONDITION

Balance Sheet

Net Assets/Liabilities

As at 31 December 2002, net liabilities before net retirement benefit deficits stood at GBP2,285 million compared to GBP2,104 million at 30 September 2002. The GBP181 million increase in net liabilities was due to the loss incurred during the period partially offset by favourable foreign exchange translation movements.

Fixed Assets

The GBP638 million of goodwill on the balance sheet at 31 December 2002 relates mainly to the acquisitions of GPT and Reltec and businesses acquired from Nokia and Bosch. The decrease of GBP34 million from GBP672 million at 30 September 2002 related mainly to the amortisation charge during the period (GBP28 million) and foreign exchange translation movements.

Tangible assets decreased by GBP49 million from GBP329 million at 30 September 2002 to GBP280 million at 31 December 2002. This was mainly due to depreciation (GBP28 million), fixed asset disposals (GBP19 million) and fixed asset impairments as a result of the downsizing and restructuring of the Core business (GBP9 million). The fixed asset disposals related mainly to the disposal of the Group's legacy South African operations and various properties in EMEA and APAC. Capital expenditure during the period was restricted to items essential to support the business.

Investments decreased by GBP15 million from GBP121 million at 30 September 2002 to GBP106 million at 31 December 2002. This was mainly due to the Group's share of the losses of joint ventures and associates and the write down of one of the Group's other investments in Australia, offset by an increase in the value of the Group's investment in Bookham Technology plc which was marked to market at the end of the reporting period.

Working Capital

The Group made particularly strong progress in its initiatives to improve working capital management during the period.

At Group level, net stock and contracts in progress reduced by approximately GBP51 million to GBP305 million. This was driven primarily by reductions in the Core where net stock and contracts in progress fell by GBP47 million. These reductions were achieved mainly through improved control and alignment of inventory in-feed with forecast sales demand, improvements in inventory management practices and the continued rationalisation of stock locations. The increase in Core net stock turns from 5.1 in September 2002 to 6.3 in December 2002 reflected this improved utilisation and management of inventory.

Group net debtors decreased by approximately GBP115 million to GBP747 million. In the Core, net debtors decreased by approximately GBP116 million to GBP726 million. GBP76 million of the decrease in the Core related to net trade debtors partly as a result of the reduced trading volumes during the period and partly as a result of the Group's continued focus on the management of debtor collection and overdue debts. Net Core trade debtor days decreased from 107 in September 2002 to 100 in December 2002, reflecting the Group's continued focus on cash collections, particularly in Northern Europe and Middle East and in businesses in Network Services. Other debtors and prepayments in the Core decreased by GBP39 million to GBP151 million mainly as a result of the release and unwind of advances and prepayments.

Trade, other creditors and accruals fell from GBP1,142 million at 30 September 2002 to GBP1,090 million at 31 December 2002, a reduction of GBP52 million. Trade creditors in the Core were reduced by GBP37 million to GBP225 million. Core trade creditor days remained stable at approximately 54 days. Other Creditors, accruals and prepayments on contracts in the Core reduced by GBP63 million to GBP442 million. This was mainly due to a lower level of contract and payroll-related accruals as a result of the reduced size of the Core business as well as to the settlement of a legal dispute in the field of IT.

Provisions

Provisions for liabilities and charges stood at GBP452 million at 31 December 2002, a net reduction of GBP4 million compared to GBP456 million at 30 September 2002.

Share option provisions amounted to GBP167 million (September 2002: GBP176 million). The net reduction of GBP9 million in share option provisions occurred mainly as a result of the accrued interest on one of the Group's ESOP derivative contracts to new loan agreements and the lapse of options relating to previous acquisitions (namely Mariposa and MSI).

Restructuring provisions amounted to GBP79 million (September 2002: GBP69 million). The Group continues to implement its operational restructuring plans and recorded a total exceptional charge of GBP51 million in the period (including costs arising and settled in the period and a charge to provisions of GBP25 million). Existing restructuring provisions utilised (GBP13 million) and released (GBP3 million) were partially offset by the creation of new provisions, leading to the GBP10 million net increase in restructuring provisions during the quarter.

The balance included provisions for warranty and contract losses, industrial injury claims, supplier obligations, provisions related to previous disposals and deferred tax provisions.

LIQUIDITY AND CAPITAL RESOURCES

Net Debt

Group net debt amounted to GBP2,819 million at 31 December 2002 compared to GBP2,846 million at 30 September 2002.

The decrease of GBP27 million achieved during the third quarter resulted from the Group's total cash inflow before use of liquid resources and financing of GBP29 million. A favourable foreign exchange translation gain of GBP28 million was offset by a GBP30 million non-cash reduction in net debt relating to the termination of interest rate and equity swap arrangements converted to new loan agreements during the period.

The following table sets forth the composition of the Group's net debt at 31 December 2002 and 30 September 2002:

	31.12.02	30.09.02
Euro and US$ Bond Debt	1,699	1,695
Syndicate Bank Debt1	2,114	2,117
Bilateral and Other Bank Debt	91	105
Gross Financial Indebtedness	3,904	3,917
Cash2	1,085	1,071
Net Financial Indebtedness	2,819	2,846

1. including GBP30 million relating to the termination of interest swap and equity derivative arrangements during the quarter and GBP54 million relating to the conversion of interest swap arrangements to new loan agreements during the first half.

   At 31 December 2002, the Group had a total restricted cash balance, defined as cash pledged or advanced as collateral, of GBP868 million. Of this, GBP701 million reflected the cash in the secured accounts described above, GBP107 million reflected cash collateral placed against bonding facilities; GBP17 million reflected cash in the Group's captive insurance company and GBP16 million reflected cash deposited against secured loans in Italy. In addition, GBP27 million has been placed in an escrow account pending determination of certain claims of the Group's ESOP derivative providers in respect of certain previously disposed companies (see "Share Price Risk" for further information).

2. Of the Group's GBP217 million unrestricted cash held outside of the secured accounts as at 31 December 2002, GBP110 million was a combination of cash in transit and global working capital balances held at subsidiary level or within the Group's joint ventures with the remaining GBP107 million held in money market deposits in the Group's Treasury centres.

The Group has not taken into account the impact of its proposed Restructuring when reporting its financial indebtedness position.

Cash Flow for the Three Months Ended 31 December 2002

The Group generated a net cash inflow of GBP29 million before use of liquid resources and financing during the third quarter. This was driven by a net cash inflow from operating activities before capital expenditure and exceptional items of GBP72 million partially offset by net exceptional and non-operating cash outflows of GBP43 million.

During the third quarter, the Group benefited from the receipt of a tax repayment and the lower level of net interest paid in the context of the financial restructuring (see Returns on Investments and Servicing of Finance below), which partially offset the exceptional cash costs relating to the Group's ongoing operating and financial restructuring processes.

Operating Cash Flow

The Group operating loss before exceptional items of GBP77 million offset by depreciation and amortisation of GBP56 million and an GBP93 million reduction in working capital led to the Group's operating cash inflow of GBP72 million during the period. After a GBP3 million inflow from net capital expenditure (including proceeds of fixed asset disposals), the Group adjusted operating cash inflow was GBP75 million.

This was a marked improvement on the adjusted operating cash outflows recorded during the previous quarters of the year (Q1 2003: GBP99 million; Q2 2003: GBP68 million) and was driven mainly by the reduced operating losses and improved working capital contributions, particularly in the Core business where adjusted operating cash flow improved from an outflow of GBP81 million and GBP43 million in the first and second quarters respectively to an inflow of GBP66 million in the third quarter. The overall reduction in working capital during the third quarter was largely driven by cash collections from debtors relating to sales in prior periods when trading volumes were higher than current levels as well as the utilisation of inventory, partially offset by a reduction in creditors.

Capital Expenditure and Financial Investment

Gross capital expenditure amounted to GBP7 million during the period and related primarily to the Core business (GBP6 million). Marconi has maintained capital expenditure well below the level of depreciation, which amounted to GBP28 million, of which GBP26 million related to the Core. Core capital expenditure is generally focused on development models, test equipment, sales demonstration equipment and R&D laboratory equipment. During the third quarter, almost GBP4 million of Core capital expenditure was incurred in Optical Networks and BBRS while a further GBP1 million was spent in North American Access in relation to the purchase of assets from Jabil as part of the transfer of one of the US facilities to a lower cost location.

The disposal of property and other tangible fixed assets contributed a GBP9 million cash inflow during the period.

Returns on Investments and Servicing of Finance

Net interest paid during the period amounted to GBP11 million, comprising interest paid of GBP18 million relating mainly to the payment of interest accrued on the Group's syndicate bank and bond debt, partially offset by interest received on the Group's cash balance and in relation to the receipt of a tax repayment during the quarter (GBP7 million).

As part of the proposed restructuring, GBP435 million is to be distributed to the relevant scheme creditors, of which GBP95 million represents the payment of due and accrued interest already made on Marconi Corporation plc's financial debt. Of this GBP95 million, GBP78 million was paid during the first half of the financial year and GBP17 million was paid during the third quarter. The Group continues to accrue interest on Marconi Corporation plc's financial debt and this is reflected in the Group's Profit and Loss account but no further cash payments have been made in this respect since the payment of interest accrued as at 15 October 2002. As disclosed in the Group's Financial Restructuring announcement dated 18 March 2003, in common with Marconi Corporation's and Marconi plc's approach to other scheme claims, pending the outcome of the schemes of arrangement, neither Marconi Corporation nor Marconi plc intends to make payment in respect of its obligations under its syndicate bank or bond debt due during March 2003, in full or in part. Accrued but unpaid interest of Marconi Corporation and Marconi plc at the record date for the schemes of arrangement will form part of the scheme claims.

Exceptional Cash Flows

The Group incurred operating exceptional cash costs of GBP82 million during the third quarter. Over half of this amount related to the direct cash cost of severance payments and site rationalisation and closures in the context of the Group's operational restructuring and reorganisation. The balance relates mainly to the payment of fees and expenses to advisors in the context of the Group's financial restructuring and to cash costs associated with the Group's manufacturing outsourcing programme.

Cash Flows from Acquisitions and Disposals

Net proceeds from acquisitions and disposals led to a cash inflow of approximately GBP2 million during the third quarter. This related mainly to the disposal of the Group's legacy South African operations.

Tax

The Group received a net tax repayment of approximately GBP45 million during the third quarter relating to the repayment of advanced corporation tax in the United Kingdom on foreign income dividends from previous years.

Syndicate Bank and Bond Debt

At 31 December 2002, drawings under the Group's remaining syndicated facility amounted to an equivalent of GBP2,033 million, comprising of actual drawings of GBP650 million and US$2,226 million.

At 31 December 2002, Marconi had yankee bond debt outstanding with principal US$1,539 million (GBP956 million) and euro bond debt outstanding with principal EUR1,175 million (GBP766 million).

Customer Financing Commitments

Marconi, like its competitors, continues to experience demand for financing from its customers. However, this demand has decreased significantly due to market conditions and the Group's focus on its core base of incumbent carrier customers. When the Group has supported customer financing requests, it has significantly limited its own risk by: i) leveraging funds from third party financiers' having strategic interests aligned with the Group, and ii) developing innovative commercial alternatives that do not involve long-term cash investments from Marconi. Through these actions, the Group has satisfactorily accommodated most customer financing requests and will not require Group cash resources to fund these activities in the foreseeable future.

As at 31 December 2002, the Group had vendor finance commitments of approximately GBP46 million of which GBP39 million had been drawn. The reduction compared to commitments of GBP68 million at 30 September 2002 was primarily due to the resolution of two of the Group's outstanding positions.

In addition, the Group uses export credit agencies to assist in managing political and credit risks on major contracts and makes extensive use of export credit insurance in respect of small to medium-sized contracts.

Some customers in the telecommunications market require that bank bonds or surety bonds (those issued by insurance companies) are provided to guarantee performance of the supplier. Marconi Group companies had GBP213 million of such bonds outstanding as at 31 December 2002 with both banks and insurance companies world-wide (30 September 2002: GBP221 million). Some of these bonds are covered by counter-indemnities from Marconi Corporation plc and others have counter-indemnities from other Group companies. The Group's bonding is normally provided on an uncommitted basis. As a consequence of the Group's ongoing financial restructuring, all new bonds currently have to be fully cash collateralised. Since February 2002, Marconi Bonding Limited (a special purpose vehicle used for this purpose) has procured the issue of approximately GBP107 million of performance bonding (on a fully cash collateralised basis) on behalf of other Group companies.

A maturity profile of all bonds and guarantees outstanding at 31 December 2002 is set out below:

Year ending 31 March,	31.12.02	30.09.02
in GBP million		
2003 or earlier	29	48
2004	37	31
2005	16	13
2006	60	49
2007	35	27
Thereafter	8	6
No expiry date	28	47
Total	213	221

A number of the Group's performance bond arrangements carry rights for the issuer to call for cash collateral, either unconditionally or upon the occurrence of certain events. Marconi estimates that as at 31 December 2002, performance bonds with a face value of approximately GBP70 million have varying conditional or unconditional rights to call for cash collateral.

Bonds will frequently run beyond the contracted maturity dates indicated in the table above. In addition, there are a number of bonds with no expiry date. These may be cancelled by the beneficiaries when the guaranteed works are completed.

RISK MANAGEMENT

The main risks faced by the Group in the financial markets are liquidity risk, interest rate risk, foreign exchange risk and share price risk.

Liquidity Risk

Marconi has funded its liquidity requirements mainly through a combination of internally generated funds, bank borrowings, debt issues in the capital markets and the disposal of non-core businesses. The Group is currently unable to arrange any new lending facility or to raise new funds through the issuance of debt or equity securities. Consequently, Marconi has little or no ability to obtain new external funding and does not expect to have such ability unless and until the proposed Restructuring is complete.

As previously disclosed, the majority of the Group's cash resources are currently held in secured accounts which are subject to interim security arrangements in favour of the Group's Syndicate Banks and bondholders (including the bond trustees) and also to one ESOP derivative provider who has committed to support the proposed Restructuring. The secured accounts were created at the end of April 2002 in accordance with the previously disclosed lock box arrangements entered into in favour of the Group's Syndicate Banks and bondholders. The interim security arrangements contemplated by the Heads of Terms were implemented on 13 September 2002 and were amended on 13 December 2002. As at 13 September 2002, the balance of the secured accounts was approximately GBP866 million. At 31 December 2002, the balance of the secured cash amounted to GBP701 million. The Group is dependent on amounts available to it from the secured amounts in order to meet its short-term liquidity needs. The interim security arrangements described above are not affected by the ESOP settlement referred to below.

Prior to the release of interim security and so long as an enforcement event does not occur, monthly releases from the secured accounts are approved in accordance with an agreed cash flow schedule, subject to specified maximum amounts. This agreed cash flow schedule is consistent with the Group's expectations as to its liquidity needs for the relevant period. The schedule, covering the period to the end of June 2003 is expected to be approved by the Group's Syndicate Banks and the ad hoc committee of bondholders in connection with the request for an extension of the timetable for the Restructuring referred to below.

The interim security is subject to various enforcement events, some of which are tied to the prospectus of successfully completing the Restructuring in accordance with the non-binding indicative heads of terms (and within the agreed timetable, which is currently 15 March 2003). The occurrence of an enforcement event would entitle the requisite majority of creditors to block withdrawals from the secured accounts and/or enforce the interim security. As at the present date a request has been made to the Group's Syndicate Banks and ad hoc committee of bondholders for an extension of the timetable for completion of the Restructuring (to 19 May 2003) and the Marconi plc and Marconi Corporation plc boards are confident that this extension will be granted.

Interest Rate Risk

It has in the past been Group policy to maintain at least 50% of debt at fixed rates of interest. The term structure of interest rates was managed in observance of this policy using derivative financial instruments such as interest rate swaps. However, due to the Restructuring process described above, this has been superceded by the requirement to manage immediate liquidity, which involved the cancellation all outstanding interest-related derivatives positions. Consequently, in the nine months to 31 December 2002, all the Group's out-of-the-money interest rate swap arrangements were converted to new loan agreements. At 31 December 2002, 44 per cent of the Group's interest-bearing borrowings were at fixed rates after taking account of interest rate swaps. Of this total, 24 per cent were at fixed dollar rates of interest and 20 per cent were at fixed euro rates of interest.

In the three months ended 31 December 2002, the average interest rate received on cash and liquid investments was approximately 2.25 per cent per annum, and 100 per cent of deposits were at floating rates. The largest proportion of investments was in US dollar deposits - the Group held an average of approximately $770 million in US dollar deposits, earning an average interest rate of approximately 1.5 per cent per annum. These US dollar deposits match in part the US dollar borrowings referred to under Syndicate Bank and Bond Debt above.

Foreign Exchange risk

The Group conducts a significant portion of its business activities outside the United Kingdom in currencies other than sterling. The Group's principal exchange rate exposures relate to U.S. dollar/pounds sterling and euro/pounds sterling exchange rates for both transactional and translation related exposures. As a matter of general policy, the Group enters into foreign currency forward exchange contracts in the ordinary course of business to protect itself from adverse currency rate fluctuations on firm contracts where cash receipts or payments are in a foreign currency different from that of the Marconi business which is contracting with customers or suppliers. These contracts are executed with creditworthy banks. Marconi has little or no ability to enter into such contracts at present and does not expect to have such ability unless and until the proposed Restructuring is complete.

The Group also has overseas subsidiaries that incur losses / earn profits and whose net liabilities or net assets are denominated in foreign currencies. It is not the Group's policy to use derivatives to hedge exposures arising from the translation of these overseas losses/profits and net liabilities/assets into pounds sterling. However, approximately 82 per cent of gross borrowings were denominated in foreign currencies in order to form a hedge for investments in currencies other than sterling. Of these, 62 per cent, denominated in U.S. dollars, formed a hedge for the Group's investment in the United States, and 20 per cent, denominated in euro, formed a hedge for the Group's investment in the euro zone.

If the pound had strengthened such that the average exchange rates used in the translation of the Group's overseas earnings changed by 10 per cent, our reported loss from continuing operations would have been reduced by 7.1 per cent, in the nine months ended 31 December 2002.

Share price risk

The Group has, in the past, issued share options to its employees under a number of different option plans, collectively known as the Employee Share Option Plans ("ESOP"). Under these plans, options may be satisfied by way of a transfer of existing Marconi ordinary shares acquired in the market by an employee trust or other vehicle, or, under some of the plans only, by an issue of new Marconi shares.

As previously disclosed, during the first half of calendar year 2000, in order to hedge part of the potential cost of the plans estimated at that time, the Marconi Employee Trust entered into contracts with three banks (the "ESOP derivative providers") to purchase a total of 40 million shares in the future at prices which were fixed at the date of contract, of which as at 6 December 2002, 38.5 million remained outstanding. The equity derivative with UBS which related to 10 million shares was consensually closed out on 6 December 2002. The Group's maximum exposure under the equity derivative contracts (including the closed out UBS equity derivative) is GBP337 million, plus accrued finance charges. This level of exposure had accrued as at 31 December 2002. For every 10 per cent movement in the share price, the change in the fair value of the ongoing contracts is immaterial. One of the equity derivative contracts requires (and, before its termination, the UBS equity derivative required) the Marconi Employee Trust to deposit cash collateral with the respective derivative providers if the share price falls to certain levels stipulated in the contracts. Marconi Corporation plc has, in the past, funded the provision of this collateral. Prior to the close out of the UBS equity derivative (and as at 31 December 2002), GBP214 million of collateral, the maximum amount of collateral payable under these contracts, had been paid. No further collateral will become due.

Due to the substantial deterioration in the Group's share price, only limited amounts of options with zero exercise price have been or are likely to be exercised.

The uncollateralised exposure under the ESOP derivative contracts (including the closed out UBS equity derivative) as at 31 December 2002 is comprised of principal of GBP123 million, together with accrued finance charges of GBP46 million.

As previously announced, up to GBP145 million (not including the previously announced GBP25 million Strategic Communications escrow which benefited all of the ESOP derivative providers) was to be set aside into escrow, on the effective date of the Marconi Corporation Scheme, pending determination of potential liabilities of Group companies to participating ESOP derivative providers (those who had undertaken to support the Restructuring) in relation to the ESOP derivative transactions. Only Barclays Bank plc ("Barclays") elected to participate in these arrangements and on 13 September 2002, Barclays, Marconi plc and Marconi Corporation plc entered into a restructuring undertaking agreement under which Barclays undertook, subject to certain termination events, to vote in favour of the Restructuring.

On 13 December 2002, a definitive agreement setting out the terms of that proposed escrow arrangement was entered into between, inter alia, Marconi plc, Marconi Corporation plc and Barclays. The terms of this escrow which would have applied on the effective date of the Restructuring have now been superseded somewhat by the ESOP settlement agreement referred to below.

Marconi plc and Marconi Corporation plc have reached agreement with the Group's ESOP derivative providers for a settlement of their ESOP derivative related claims against the Group (subject to obtaining any requisite creditor consents). Under the terms of the settlement, which is conditional upon the Marconi Corporation scheme of arrangement becoming effective, Marconi Corporation plc will pay a total of GBP35 million (the "Settlement Amount") to the ESOP derivative providers in full and final settlement of their ESOP related claims against the Group.

The Settlement Amount will be paid from the fund of up to GBP170 million (including the Strategic Communications escrow) which was to have been set aside by Marconi Corporation plc, as part of the Restructuring, pending resolution of potential liabilities of Group companies to participating ESOP derivative providers in relation to the ESOP derivative transactions. The settlement has made available approximately GBP135 million in cash which will now form part of the GBP340 million initial cash distribution referred to above (in return for a GBP123 million reduction in the face value of the Junior Notes to be issued as part of the Restructuring i.e. equivalent to redemption at 110 per cent of face value). Without the ESOP settlement, the GBP135 million sum would not have formed part of the initial cash distribution.

Insurance Risk Management

Marconi manages centrally the purchase of global insurance policies in respect of major insurable risks, including property (material damage/business interruption), directors' and officers and public and products liability. The use of global policies and centrally appointed brokers allows the Group to improve internal control and optimise the overall level of retained risk. Risk management and insurance expenditure are concentrated on those insurable risks which are considered potentially catastrophic to the Group as a whole. The Group continues to work with its insurers and advisers to improve its loss prevention and mitigation processes. Insurance market conditions are currently very challenging and premium rates have increased substantially. However, the Group benefits from good relationships with its major insurers.

Marconi plc

Consolidated Profit and Loss Account unaudited

	Note	3 Months to December 20 GBP mil
Turnover		
Continuing operations	4	4
Discontinued operations	4	
Group	4	4
Share of joint ventures		
	3	4
Operating loss		
Group operating loss		
Excluding goodwill amortisation and exceptional items		(4
Goodwill amortisation		(2
Operating exceptional items	5a	(5
	4	(13
Continuing operations		(13
Discontinued operations		
	4	(13
Share of operating (loss)/profit of joint ventures		
Excluding goodwill amortisation and exceptional items		(
Operating exceptional items	5a	(
		(
		(13
Group and joint venture operating loss before goodwill amortisation and exceptional items	3	(5
Share of operating loss of associates		
Excluding goodwill amortisation and exceptional items		(
Goodwill amortisation		(
Goodwill impairment		

Operating exceptional items	5a	(
		(1
Operating loss	3	(14
Non-operating exceptional items		
(Loss)/gain on disposal of discontinued operations	5b	(
(Loss)/gain on disposal of fixed assets and investments in continuing operations	5b	(
		(1
		(15
Net interest payable	6	(5
Net finance income		
(Loss)/profit on ordinary activities before taxation		
Excluding goodwill amortisation and exceptional items		(10
Goodwill amortisation and exceptional items		(9
	3	(19
Tax credit/(charge) on (loss)/profit on ordinary activities		
Excluding tax on goodwill amortisation and exceptional items		
Tax on goodwill amortisation and exceptional items		
(Loss)/profit on ordinary activities after taxation		(19
Equity minority interests		
(Loss)/profit on ordinary activities attributable to the equity shareholders and retained (loss)/profit for the financial year		(19
Basic and diluted (loss)/earnings per share	8	(7.1
Loss per share excluding goodwill amortisation and exceptional items	8	(3.6

		31 Dec
	Note	GBP
Fixed Assets		
Goodwill	9	
Tangible assets	10	
Investments:	11	
Joint ventures		
Share of gross assets		
Share of gross liabilities		
Associates		
Other investments		
Current Assets		
Stocks and contracts in progress	12	
Debtors : amounts falling due within one year	13	

Debtors : amounts falling due after more than one year	13	
Cash at bank and in hand	14	
Creditors: amounts falling due within one year	15	(3
Net current liabilities		(1
Total assets less current liabilities		
Creditors: amounts falling due after more than one year	15	(1
Provisions for liabilities and charges	17	
Net liabilities before retirement benefit surpluses and deficits		(2
Retirement benefit scheme surpluses		
Retirement benefit scheme deficits		
Net liabilities after retirement benefit surpluses and deficits		(2
Capital and reserves		
Called up share capital		
Shares to be issued		
Share premium account		
Capital reserve		
Profit and loss account		(3
Equity shareholders' interests		(2
Equity minority interests		
		(2

Marconi plc

Consolidated Statement of Total Recognised Gains and Losses unaudited

Loss on ordinary activities attributable to the shareholders
    Group
    Share of joint ventures
    Share of associates

Exchange differences on translation

Total recognised gains and losses

Reconciliation of Movements in Equity Shareholders' Interests unaudited

Total recognised gains and losses
Release of reserve in respect of shares to be issued

Total movement in the period

Equity shareholders' interests at 1 October

Equity shareholders' interests at the end of period

Marconi plc

Consolidated Cash Flow Statement unaudited

	Note	3 Months t December GBP
Net cash inflow from operating activities before exceptional items	19a	
Exceptional cash flows from operating activities	5c	
Net cash outflow from operating activities after exceptional items - continuing operations		
Net cash outflow from operating activities after exceptional items - discontinued operations		
Net cash outflow from operating activities after exceptional items		
Dividends from joint ventures and associates		
Returns on investments and servicing of finance	19b	
Tax received/(paid)	19c	
Capital expenditure and financial investment	19d	
Acquisitions and disposals	19e	
Cash inflow before use of liquid resources and financing		
Net cash (outflow)/inflow from management of liquid resources	19f	
Net cash outflow from financing - changes in debt and lease financing	19g	
(Decrease)/increase in cash and net bank balances repayable on demand		

Marconi plc

Reconciliation of Net Cash Flow to Movements in Net Monetary Debt unaudited

3 Months
December

	Note	GBP
(Decrease)/increase in cash and net bank balances repayable on demand		
Net cash outflow/(inflow) from management of liquid resources		
Net cash outflow from decrease in debt and lease financing		
Change in net monetary debt resulting from cash flows		
Net debt disposed with subsidiaries		
Other non-cash changes		
Effect of foreign exchange rate changes		
Movement in net monetary debt in the period		
Net monetary debt at 1 October	20	(2
Net monetary debt at the end of the period	20	(2

Notes

1 Fundamental uncertainty in respect of the application of the going concern basis

Marconi Corporation plc ("Corp") owes approximately GBP2.1 billion under a syndicated credit facility (the "Bank Facility") which is due for repayment on 25 March 2003. Borrowings under the facility are repayable on demand and no further funds may be drawn under its terms. The Group also has in issue Eurobonds and Yankee Bonds (the "Bonds") with a face value of approximately GBP1.7 billion. Marconi plc ("plc") guarantees Corp's debt obligations under the Bonds and the Bank Facility. As at 31 December 2002, net debt of the Group stood at approximately GBP2.8 billion.

On 29 August 2002, plc announced that non-binding indicative Heads of Terms, which set out the principles for the financial restructuring of plc and Corp (the "Restructuring"), had been concluded with the co-ordination committee of syndicate banks and an informal ad hoc committee of Bondholders. On 16 December 2002 plc announced that modifications to the non-binding indicative Heads of Terms had been concluded. The non-binding indicative Heads of Terms envisage that the creditors of plc and Corp, other than certain excluded creditors, will be subject to schemes of arrangement ("Schemes") under which creditor claims will be compromised in consideration for cash, new equity and new debt securities of Corp. As part of the restructuring Corp will become the listed parent for the Group and, following completion of its Scheme, it is currently anticipated that plc will be dissolved. The Restructuring will leave existing plc shareholders with 0.5% of the equity in Corp.

On 17 March 2003, documentation for the proposed Schemes was filed with the High Court of England and Wales, initiating the final steps towards implementation of the Restructuring.

The non-binding indicative Heads of Terms envisage a new capital structure for the Group that is appropriate to the latest business plan developed by the Group. The implementation of this capital structure involves, among other things, the payment of GBP340 million of cash (in addition to GBP95 million accrued interest on Corp's financial debt, paid in September and October 2002), the issue of new equity and the issue of new notes with a face value, using 31 December 2002 exchange rates, of approximately GBP753 million by Corp to Scheme creditors through the operation of the Schemes.

As part of the arrangements to implement the Restructuring, the majority of the Group's cash resources are currently held in secured accounts which are subject to interim security arrangements in favour of the Group's syndicate banks and Bondholders (including the Bond trustees, but excluding Ancrane, a subsidiary of plc which holds Bonds) and also to one of the Group's ESOP derivative providers (who committed to support the proposed Restructuring within the required time period). At 31 December 2002, the balance of this secured cash amounted to GBP701 million. The Group is dependent on amounts available to it from the secured amounts in order to meet its short-term liquidity needs.

Prior to the release of interim security and so long as an enforcement event does not occur, monthly releases from the secured accounts are approved in accordance with an agreed cash flow schedule, subject to specified maximum amounts. This agreed cash flow schedule is consistent with the Group's expectations as to its liquidity needs for the relevant period. The current agreed cash flow schedule covers the period to the end of March 2003. A revised schedule, covering the period to the end of June 2003 is expected to be approved by the Group's syndicate banks and the ad hoc committee of Bondholders in connection with the request for an extension of the timetable for the Restructuring referred to below.

When the Heads of Terms were announced on 29 August 2002, the Group indicated that the Restructuring was scheduled to be completed by 31 January 2003 (the "Effective Date"). This date was extended to 15 March 2003 in December 2002. As a result of the complexity of the Restructuring the Effective Date of the Schemes is now expected to be on or around 19 May 2003. The change to the timing of the Restructuring introduces risks associated with certain financial debt falling due in March 2003. In particular, as noted above, the Bank Facility is due for repayment on 25 March 2003 and interest payments were due on the Yankee Bonds on 17 March 2003 and are due on the Eurobonds on 31 March 2003. Failure to repay the Bank Facility, either on demand or on 25 March 2003, will give rise to direct rights on the part of individual syndicate banks to bring actions for recovery of the debt owing to them and, in addition, after the expiry of a five business day grace period, result in a cross default under the Bonds. In common with the Group's approach to other Scheme claims, pending the outcome of the Schemes, the Group does not intend to make payment in respect of such obligations, in full or in part.

The fact of the aforementihe Compensation Committee Charter provides, among other things, that the Committee is to review and recommend to the Board the Company s senior management compensation and benefits policies generally, evaluate the performance of the Company s executive officers and review and recommend to the Board the compensation of the Company s executive officers. The Compensation Committee also is responsible for the administration of and the granting of stock options and other awards under the Company s 1996 Stock Incentive Plan (no further options or awards may be granted under this Plan), 2001 Stock Incentive Plan and 2005 Stock Incentive Plan. The Compensation Committee Charter is available on the Company s web site under Investor Relations, Corporate Governance, at *http://www.csgsystems.com.* Information on the Company s web site is not incorporated by reference in this Proxy Statement. As required by the Compensation Committee Charter, all of the members of the Committee are independent directors as defined in the applicable NASD rule and also are outside directors for purposes of Section 162(m) of the Internal Revenue Code of 1986. The Compensation Committee held seven meetings during 2005 and on three other occasions acted by unanimous written consent.

Nominating and Corporate Governance Committee

The Board has a standing Nominating and Corporate Governance Committee, presently composed of Ms. Obuchowski (Chair), Mr. Reed and Mr. Smith. The Nominating and Corporate Governance Committee Charter provides, among other things, that the Committee is to identify individuals qualified to become Board members, recommend to the Board nominees for election as directors, recommend directors for appointment to Board committees, evaluate the Board s performance, review and recommend to the Board the compensation of the Company s directors and develop and recommend to the Board the Company s Corporate Governance Guidelines and Code of Business Conduct and Ethics. The Nominating and Corporate Governance Committee Charter is available on the Company s web site under Investor Relations, Corporate Governance, at *http://www.csgsystems.com.* Information on the Company s web site is not incorporated by reference in this Proxy Statement. As required by the Nominating and Corporate Governance Committee Charter, all of the members of the Committee are independent directors as defined in the applicable NASD rule. The Nominating and Corporate Governance Committee held nine meetings during 2005.

In recommending to the Board nominees for election as directors, the Nominating and Corporate Governance Committee reviews the present composition of the Board to determine the qualities, skills and areas of expertise (including but not limited to financial and accounting expertise) needed to enable the Board and its committees to properly discharge their responsibilities. The Committee considers it necessary for the Board to have at least one of its independent members qualify as an audit committee financial expert and takes that requirement into account in making its recommendations to the Board. While the Committee has not established other specific minimum requirements for service on the Board, when assessing and determining a candidate s qualifications, the Committee considers among other things the number and type of other boards on which the candidate serves; other business and professional commitments of the candidate and potential conflicts of interest; the ability and willingness of a candidate to devote the required amount of time to the candidate s responsibilities as a Board member and as a member of one or more committees of the Board; the age, background, reputation, independence, experience, skills and judgment of the candidate; and the diversity of the Board s membership. Directors, while relying on the honesty and integrity of the Company s senior management and its outside advisors and auditors, are expected to exercise their best business judgment when acting on behalf of the Company and its stockholders and to adhere to the applicable provisions of the Company s Code of Business Conduct and Ethics.

The Committee will consider qualified nominees for election as directors recommended by the Company s stockholders. A stockholder who wishes to recommend a nominee for consideration by the Committee should submit the recommendation in writing to the Secretary of the Company at the address shown on the first page of this Proxy Statement, indicating the proposed nominee s qualifications and other relevant biographical information and providing written confirmation of the proposed nominee s consent to serve as a director if nominated and elected. The Secretary of the Company will forward legitimate recommendations from stockholders to the chair of the Committee for further review and consideration. The bylaws of the Company provide that stockholder nominations of persons for election to the Board (as distinguished from recommendations to the Committee) are subject to certain advance notice and informational requirements; stockholders may obtain a copy of the relevant bylaw provisions from the Secretary of the Company at the address shown on the first page of this Proxy Statement.

Upon the recommendation of the Nominating and Corporate Governance Committee, the Board has adopted a Code of Business Conduct and Ethics applicable to all of the directors, officers and employees of the Company and its subsidiaries. The Company s Code of Business Conduct and Ethics and the Company s Corporate Governance Guidelines are available on the Company s web site under Investor Relations, Corporate Governance, at *http://www.csgsystems.com.* Information on the Company s web site is not incorporated by reference in this Proxy Statement.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company s officers (as defined in the applicable regulations) and directors, and persons who beneficially own more than 10% of a class of the Company s equity securities registered under such Act, to file certain reports of ownership and changes of ownership of the Company s equity securities with the SEC. Officers, directors and more than 10% stockholders are required by SEC regulation to furnish to the Company copies of all Section 16(a) forms which they file.

Based solely on its review of the copies of such forms submitted to it, or written representations from certain reporting persons that no Form 5 was required for those persons, the Company believes that all filing requirements applicable to its officers and directors were complied with for the year ended December 31, 2005, except that Form 4 reports for Edward C. Nafus and John H. Bonde were filed one day late with respect to restricted stock awards made to them on June 30, 2005.

Compensation of Directors

Effective January 1, 2005, each non-employee director of the Company is entitled to receive an annual retainer fee of $45,000 payable in quarterly installments, a meeting attendance fee of $2,000 for attendance at a meeting of the Board and a meeting attendance fee of $1,250 for attendance at a meeting of a committee of the Board. The chairperson of the Audit Committee of the Board also is entitled to receive an annual retainer fee of $16,000 payable in quarterly installments, and the chairpersons of the Compensation Committee of the Board and the Nominating and Corporate Governance Committee of the Board also are entitled to receive an annual retainer fee of $8,000 payable in quarterly installments.

Effective July 1, 2005, Mr. Reznicek was elected as Chairman of the Board of the Company. He receives a fee for his non-executive services in such capacity at an annual rate of $50,000, payable in quarterly installments. Such fee is in addition to the fees referred to in the preceding paragraph. Mr. Reznicek is not an employee of the Company and receives no employee benefits from the Company.

A director who is an officer or employee of the Company does not receive additional compensation for serving as a director or committee member. Mr. Nafus, Chief Executive Officer of the Company, is the only officer of the Company who serves as a director of the Company. No officers or employees of the Company currently serve on any committee of the Board.

The Company has a Stock Option Plan for Non-Employee Directors which was approved by the stockholders of the Company in 1997. The Company made no stock option grants to non-employee directors during 2005.

On July 1, 2005, the Company granted 3,000 shares of restricted stock of the Company to each of the Company s six present non-employee directors of the Company. Such shares of restricted stock will vest on the first anniversary of the grant date so long as the grantee has continuously served as a director of the Company from the grant date to such anniversary date. The value of such shares (based upon the $19.95 closing price of the Common Stock on such grant date) was $57,450 for each of such non-employee directors. Although there is no commitment or formal plan to do so, the Company anticipates that similar grants will be made in the future on an annual basis to each of the then non-employee directors of the Company.

EXECUTIVE COMPENSATION

Compensation of Executive Officers

The following table sets forth information with respect to the compensation paid by the Company for services rendered during 2005 to each of the persons who served as chief executive officer of the Company during 2005, to each of the Company s executive officers who were serving at the end of 2005 and to one additional person who served as an executive officer of the Company until December 9, 2005.

9

Summary Compensation Table

Name and Principal Position During 2005	Year	Salary(1) ($)	Bonus(2) ($)	Other Annual Compensation(3) ($)	Restricted Stock(4) ($)	Stock Options (#)	All Other Compensation(5) ($)
	Annual Compensation				**Long-Term Compensation Awards**		
Neal C. Hansen Chairman of the Board and Chief Executive Officer(6)	2005	372,115		7,046			9,648,212
	2004	778,846	750,000	63,019			9,225
	2003	750,000		136,371	6,552,000		6,000
Edward C. Nafus President and Chief Executive Officer(7)	2005	519,231	1,049,000	1,394	2,697,000		15,700
	2004	389,423	243,750	1,394			14,896
	2003	375,000	150,000	3,139		100,000	12,250
Peter E. Kalan Executive Vice President and Chief Financial Officer	2005	400,000	604,000	1,394	1,748,000		14,450
	2004	363,462	227,500	1,394			14,677
	2003	350,000	150,000	5,609		100,000	11,249
Robert Michael Scott Executive Vice President and President of Broadband Services Division(8)	2005	275,000	310,925	973	998,400		15,700
	2004	217,589	95,945	1,023			11,743
John H. Bonde Executive Vice President and President of Global Software Services Division(9)	2005	474,616	337,500		1,785,500		507,116
Alan Michels Executive Vice President and President of Global Software Services Division Worldwide Delivery(10)	2005	276,923	195,000	1,433	998,400		336,300
	2004	280,385	121,500				6,150

(1) The annualized salaries of Messrs. Hansen, Nafus and Kalan did not increase during 2004; however, the Company pays all of its employees salaries in arrears every two weeks (each a pay period). Because of the 2004 salary payment schedule, the Company paid all of its employees who were employed for the full year in 27 pay periods in 2004 instead of the usual 26 pay periods per year.

(2) Bonuses (except for the special bonuses referred to below in this footnote) are annual performance bonuses paid to the executive officers pursuant to the Company s Performance Bonus Plan for a particular year. Such bonuses are based upon the level of achievement of pre-established Company financial objectives and individual performance objectives and are subject to Board approval. The bonus earned for each year generally is paid in the first quarter of the subsequent year. Messrs. Nafus, Kalan and Scott also received special bonuses of $400,000, $250,000, and $50,000, respectively, for 2005 in recognition of their significant contributions to the consummation of the sale of the Company s Global Software Services business.

(3) The amounts shown include (i) for each year, reimbursements to each named executive officer for income taxes on perquisites and other personal benefits and on the tax reimbursement amounts,

(ii) for 2004, perquisites and other personal benefits of $52,152 received by Mr. Hansen, including $34,345 for financial and tax planning and tax preparation services, and (iii) for 2003, perquisite and other personal benefits of $81,616 received by Mr. Hansen, including $62,002 for financial and tax planning and tax preparation services. With respect to Messrs. Nafus, Kalan, Scott, Bonde and Michels for all years and to Mr. Hansen for 2005, the aggregate amount of perquisites and other personal benefits received did not exceed the lesser of $50,000 or 10% of the total amount of annual salary and bonus reported for such individual and has been excluded from this table.

(4) The dollar values of the restricted stock awards shown in this table are based upon the closing market prices of the Common Stock on the dates of the award grants. The number of restricted shares held by the persons named in this Table on December 31, 2005, and the value of such shares (based upon the $22.32 closing price of the Common Stock on December 30, 2005, the last trading day of 2005) are as follows:

Executive Officer	Number of Restricted Shares	Value	
Neal C. Hansen			
Edward C. Nafus	150,000	$	3,348,000
Peter E. Kalan	100,000	$	2,232,000
Robert Michael Scott	60,000	$	1,339,200
John H. Bonde			
Alan Michels			

On January 11, 2005, and June 30, 2005, the Company granted Mr. Nafus restricted stock awards covering, respectively, 100,000 and 50,000 shares of Common Stock. Of the shares awarded to Mr. Nafus on January 11, 2005, 50% vested on January 11, 2006, an additional 25% will vest on July 11, 2006, and the remaining 25% will vest on January 11, 2007, so long as he is continuously employed by the Company until such vesting dates; however, if his employment is terminated by the Company without cause prior to such vesting dates, then all unvested shares will fully vest. Of the shares awarded to Mr. Nafus on June 30, 2005, 25% will vest on each of the first four anniversaries of the award date so long as he is continuously employed by the Company until such vesting dates; however, if Mr. Nafus employment with the Company terminates after March 31, 2008, solely as a result of his voluntary retirement, then all unvested shares will fully vest. The shares awarded to Mr. Nafus on June 30, 2005, also will fully vest, to the extent not previously vested, upon the occurrence of certain change-of-control events specified in the award agreement.

On January 11, 2005, the Company granted Mr. Kalan a restricted stock award covering 100,000 shares of Common Stock. 25% of such shares vested on January 11, 2006, and the remaining 75% of such shares will vest on January 11, 2007, so long as Mr. Kalan is continuously employed by the Company until such vesting date; however, if Mr. Kalan s employment is terminated by the Company without cause prior to such vesting date, then all unvested shares will fully vest.

On January 11, 2005 and March 25, 2005, the Company granted Mr. Scott restricted stock awards covering, respectively, 25,000 and 35,000 shares of Common Stock. 25% of the shares awarded to Mr. Scott on January 11, 2005, vested on January 11, 2006, and an additional 25% of such shares will vest on each of the next three anniversaries of the award date so long as Mr. Scott is continuously employed by the Company until such vesting dates. One-third of the shares awarded to Mr. Scott on March 25, 2005, vested on March 25, 2006, and an additional one-third of such shares will vest on each of the next two anniversaries of the award date so long as Mr. Scott is continuously employed by the Company until such vesting dates. The award agreements also provide for accelerated vesting upon the occurrence of an involuntary termination of Mr. Scott s employment with the Company after the occurrence of certain change-of-control events.

100,000 restricted shares were granted to Mr. Bonde and 60,000 restricted shares were granted to Mr. Michels during 2005; such shares, and 40,972 restricted shares granted to Mr. Michels in prior years, fully vested in connection with the consummation of the sale of the Company s Global Software Services business in December 2005.

The Company has never paid any dividends on its Common Stock and has no present plans to do so.

(5) All other Compensation for 2005 for Mr. Hansen consists of (i) $12,600 of employer contributions to the CSG Incentive Savings Plan (a 401(k) retirement plan), (ii) $9,605,000 of payments to be made to him in 2006 and 2007 in connection with his retirement on June 30, 2005, as discussed in more detail under Employment Agreements below, (iii) $28,875 of accrued vacation pay due in connection with such retirement and (iv) $1,737 of health insurance premiums paid pursuant to his employment agreement in connection with such retirement. All Other Compensation for 2005 for Mr. Bonde consists of (i) $475,962 paid to him pursuant to an employment agreement in connection with the termination of his employment with the Company as of December 31, 2005, and (ii) $31,154 of accrued vacation pay due in connection with such termination of employment. All Other Compensation for 2005 for Mr. Michels consists of (i) $6,300 of employer contributions to the CSG Incentive Savings Plan, (ii) $317,308 paid to him pursuant to an employment agreement in connection with the termination of his employment with the Company on December 9, 2005, and (iii) $12,692 of accrued vacation pay due in connection with such termination of employment. All Other Compensation for 2005 for Messrs. Nafus, Kalan and Scott consists of employer contributions to the CSG Incentive Savings Plan ($9,450 each) and employer credits to the CSG Systems, Inc. Wealth Accumulation Plan (Nafus-$6,250, Kalan-$5,000 and Scott-$6,250). The CSG Systems, Inc. Wealth Accumulation Plan is an unfunded deferred compensation plan which provides for elective salary and incentive compensation deferrals by participants; CSG Systems, Inc., a subsidiary of the Company, matches a participant s deferral up to 25% thereof, with a maximum annual credit of $6,250 per participant.

(6) Mr. Hansen served as Chief Executive Officer through March 31, 2005, and as Chairman of the Board through June 30, 2005.

(7) Mr. Nafus became Chief Executive Officer on April 1, 2005. Previously, he served as Executive Vice President and President of the Company s Broadband Services Division.

(8) Mr. Scott became an executive officer of the Company on December 14, 2004, and this table shows all compensation received by Mr. Scott during 2004.

(9) Mr. Bonde became an executive officer of the Company on January 1, 2005. His employment with the Company terminated on December 31, 2005, following the sale of the Company s Global Software Services business.

(10) Mr. Michels became an executive officer of the Company on November 29, 2004, and this table shows all compensation received by Mr. Michels during 2004. His employment with the Company terminated on December 9, 2005, upon the consummation of the sale of the Company s Global Software Services business.

No Option Grants in 2005

The Company did not grant any stock options to the named executive officers during 2005.

12

Aggregated 2005 Option Exercises and 2005 Year-End Option Values

The following table sets forth certain information regarding the exercise of stock options during 2005 by the named executive officers and the number and value of their unexercised stock options at December 31, 2005.

Name	Shares Acquired On Exercise (#)	Value Realized ($)	Number of Unexercised Options at December 31, 2005 Exercisable (#)	Number of Unexercised Options at December 31, 2005 Unexercisable (#)	Value of Unexercised In-the-Money Options at December 31, 2005(1) Exercisable ($)	Value of Unexercised In-the-Money Options at December 31, 2005(1) Unexercisable ($)
Neal C. Hansen			80,000		95,600	
Edward C Nafus			235,120		1,202,108	
Peter E. Kalan			114,100		1,449,627	
John H. Bonde						
Alan Michels	17,500	175,134				
Robert Michael Scott	3,750	32,266	7,500		99,075	

(1) In-the-Money Options are options outstanding at the end of 2005 for which the fair market value of the Common Stock at the end of 2005 (closing price of $22.32 per share on December 30, 2005, the last trading day of 2005) exceeded the exercise price of the options.

Employment Agreements

Mr. Hansen

Mr. Hansen retired as Chief Executive Officer of the Company on March 31, 2005, and as Chairman of the Board and an employee of the Company on June 30, 2005, having served in those capacities since the Company was formed in 1994. He also resigned from the Board on June 30, 2005. Pursuant to an Employment Agreement between Mr. Hansen and the Company dated November 17, 1998, as amended on December 20, 2004, to provide for such retirement, the Company agreed to pay Mr. Hansen $1,500,000 on January 2, 2006, as a severance payment and in lieu of an annual incentive bonus for 2005 in recognition of his continuous service to and leadership of the Company as Chairman of the Board and Chief Executive Officer since the Company became independently owned in 1994. In such amended Employment Agreement, Mr. Hansen agreed to serve as a consultant to the Board and the Chief Executive Officer of the Company during the period from July 1, 2005, through December 31, 2006, with respect to the strategic planning and business development activities of the Company and to provide up to 20 hours of service per month in such capacity upon the request of the Board or the Chief Executive Officer of the Company. In consideration of such agreement and the provision of such services if requested, the Company agreed to pay Mr. Hansen $4,052,500 on January 2, 2006, $2,026,250 on July 1, 2006, and $2,026,250 on January 2, 2007, without interest. If Mr. Hansen were to die prior to his receipt of such payments, his estate is entitled to receive the unpaid amounts. The Company also agreed to provide Mr. Hansen during his lifetime after June 30, 2005, with a Medicare supplement insurance policy having a monthly cost not to exceed $300, adjusted annually for cost-of-living increases. Mr. Hansen is precluded from competing with the Company and from soliciting Company employees for other employment prior to June 30, 2007. The payment and consulting arrangements described in this paragraph replaced certain long-term consulting obligations on the part of Mr. Hansen and related long-term obligations of the Company to Mr. Hansen involving the use of an aircraft, the provision of office space and related services, and tax payments that were contained in Mr. Hansen s Employment Agreement prior to its amendment in December 2004.

Messrs. Nafus and Kalan

In November 1998 and January 2001, the Company entered into employment agreements with Messrs. Nafus and Kalan, respectively. The agreements currently cover the period from January 1, 2006,

13

through December 31, 2007, and provide for automatic one-year extensions unless, not later than one year prior to a particular December 31, either the Company or the executive notifies the other that such extension shall not occur, in which case the agreement will terminate at the end of its then remaining term. Mr. Nafus agreement, as amended in March 2005, provides for an annual base salary of not less than $550,000, an annual incentive bonus target of not less than 100% (his current target) of his base salary, various group insurance coverages, paid vacations and holidays, an automobile allowance and certain financial and tax planning services. Mr. Nafus current annual base salary is $600,000. Mr. Kalan s agreement provides for a minimum annual base salary of not less than $225,000 (with CPI adjustments), an annual incentive bonus target of not less than 50% of his base salary, paid vacations and holidays and various group insurance coverages; Mr. Kalan s current annual base salary is $425,000, and his current incentive bonus target is 75% of his base salary. The employment of Mr. Nafus or Mr. Kalan will terminate upon such person s death, and the Company may terminate the employment of Mr. Nafus or Mr. Kalan in the event of such person s disability for a continuous period of more than six months or for more than 180 days in the aggregate during any 12-month period. The Company also may terminate the employment of Mr. Nafus or Mr. Kalan for cause , as defined in their employment agreements. In the cases of death or disability, Mr. Nafus or Mr. Kalan (or his estate) would be entitled to receive his base salary through the employment termination date and a pro rata portion of his annual incentive bonus for the year in which his employment terminates. In the case of termination for cause, Mr. Nafus or Mr. Kalan is not entitled to receive any salary after the employment termination date or any portion of his incentive bonus for the year in which his employment terminates.

If the Company terminates the employment of Mr. Nafus or Mr. Kalan without cause prior to a change of control of the Company, then the Company must continue to pay such person s base salary for one year after the termination (less compensation received from another employer) and also must pay such person s annual incentive bonus for the year of termination (payable at the regularly scheduled time and to be not less than such person s incentive bonus for the preceding calendar year) and an additional amount equal to 55% (in the case of Mr. Nafus) or 50% (in the case of Mr. Kalan) of such person s base salary (payable one year after the termination). If the termination without cause occurs after a change of control of the Company, then the Company must pay the person s base salary for two years after the termination (within 30 days after the termination and without regard to other employment), the annual incentive bonus for the year of termination (not less than such person s incentive bonus for the preceding calendar year, with such minimum amount being paid within such 30-day period and the balance being paid at the regularly scheduled time) and an additional amount equal to 110% (in the case of Mr. Nafus) or 100% (in the case of Mr. Kalan) of such person s base salary (within 30 days after the termination). The agreements contain provisions relating to a constructive termination but require that the employee give notice to the Company of a claimed constructive termination, and the Company then has an opportunity to take appropriate actions to remove the basis for such claim. If Mr. Nafus or Mr. Kalan voluntarily resigns prior to the expiration of his agreement, then he is entitled to receive only his base salary through the employment termination date (unless such date is December 31, in which case he also is entitled to receive his incentive bonus for the year of termination).

Mr. Nafus agreement, as amended, also provides that he was entitled to receive a restricted stock award of 50,000 shares of Common Stock if he was employed by the Company on January 1, 2006, and such shares have been awarded to him. Such shares will vest at the rate of 25% on each of the first four anniversaries of the award date if Mr. Nafus is then employed by the Company. Any unvested shares covered by such award will fully vest upon a change of control of the Company or upon the termination of Mr. Nafus employment with the Company after March 31, 2008, solely as a result of his voluntary retirement.

Mr. Scott

On June 6, 2005, the Company entered into an employment agreement with Mr. Scott which currently extends through December 31, 2006. After December 31, 2006, the agreement automatically continues on a month-to-month basis for successive periods of one calendar month each unless, not later than 30 days prior to the last day of any calendar month, either the Company or Mr. Scott notifies the other that such extension shall not occur, in which case the agreement will terminate at the end of its then current term. The agreement provides for an annual base salary for Mr. Scott of not less than $275,000, an annual incentive bonus target of not less than 65% of his base salary, paid vacations and holidays and various group insurance coverages; Mr. Scott s current annual base salary is $325,000, and his current incentive bonus target is 75% of his base salary.

If the Company terminates the employment of Mr. Scott without cause prior to a change of control of the Company, then the Company must continue to pay his base salary for one year after the termination (less compensation received from another employer) and also must pay a pro rata portion of his incentive bonus for the year of termination (payable at the regularly scheduled time). If the termination without cause occurs after a change of control of the Company, then the Company must pay Mr. Scott one year s base salary (within 30 days after the termination and without regard to other employment) and 100% of his incentive bonus for the year of termination (payable at the regularly scheduled time). The agreement contains provisions relating to a constructive termination, a voluntary termination and a termination for death, disability or cause which are similar to those contained in the employment agreements of Messrs. Nafus and Kalan described above.

Messrs. Bonde and Michels

Messrs. Bonde and Michels each had employment agreements with the Company. Such employment agreements terminated on December 31, 2005, and December 9, 2005, respectively, upon the termination of the employment of Messrs. Bonde and Michels with the Company. Pursuant to such employment agreements, in connection with such terminations of employment, Messrs. Bonde and Michels received the payments described in footnote (5) to the Summary Compensation Table appearing earlier in this Proxy Statement.

**REPORT OF THE COMPENSATION COMMITTEE
ON EXECUTIVE COMPENSATION**

The Compensation Committee of the Board of Directors (the Committee), consisting entirely of independent non-employee directors, reviews and recommends to the Board senior management compensation and benefits policies generally, evaluates the performance of the Company s executive officers and reviews and recommends to the Board the compensation of the Company s executive officers. The Committee currently is composed of Messrs. Sica (Chairman), Smith and Unruh. Mr. Unruh became a member of the Committee on July 1, 2005, replacing Mr. Reznicek in such position.

Compensation Philosophy

The Company s senior management compensation program is premised on the belief that the interests of the Company s executives should be closely aligned with those of the Company s stockholders and is designed to attract, retain, motivate and appropriately reward individuals who are responsible for both short-term and long-term profitability and growth of the Company. Based on this philosophy, a significant portion of each executive s total compensation is placed at-risk and linked to the accomplishment of specific Company and individual financial, strategic and other performance objectives, as well as to potential appreciation in the value of the Common Stock.

Compensation Program

Periodically, we review the Company s overall senior management compensation and benefits policies. Such reviews include consideration of compensation programs adopted by competing companies and by other employers likely to recruit executives with skill sets similar to those which the Company regularly seeks. In connection with such reviews, we have utilized an independent compensation consulting firm to prepare a comprehensive formal assessment of the competitiveness of the Company s senior management compensation program and to compare the several components of the Company s senior management compensation program with those of other publicly owned technology companies. We also have utilized an independent compensation consulting firm in connection with particular compensation programs that were implemented for the Company s senior management, including executive officers, in recent years.

We annually review and recommend to the Board the compensation of the executive officers of the Company, including the Chief Executive Officer, each of whose compensation is presented in detail earlier in this Proxy Statement.

The key elements of the Company s current compensation program for its executive officers consist of annual base salaries, performance bonuses and restricted stock awards. Our approach to each of these elements, including the basis for the compensation paid to Messrs. Hansen and Nafus, who served as Chief Executive Officer during 2005, is discussed below.

Annual Base Salaries

We initially have determined annual base salaries for executive officers by evaluating the responsibilities of the position, the experience and knowledge of the individual and the scope and complexity of the executive s position relative to other senior management positions both internally and at a select group of other companies. We have based our external comparison on the results of reports prepared by the Committee s independent compensation consulting firm, and we take into consideration the compensation practices and programs of other companies which are likely to compete with the Company for the services of senior executive management personnel.

We determine annual base salary adjustments by evaluating both the position and the performance of each executive officer, taking into account any year-to-year changes in responsibilities and other relevant factors. Individual performance evaluations are based in part upon the executive s achievement of specific individual objectives as well as upon the executive s performance of his overall responsibilities. 2005 was a transition year for the Company in terms of its executive leadership, and the increased responsibilities of the Company s current executive officers during 2005 were of particular importance as we considered their base salaries.

Mr. Hansen s retirement at the end of June 2005 was agreed upon in December 2004 (as discussed above under Employment Agreements), and his annual base salary rate of $750,000 for the period from January 1, 2005, through June 30, 2005, did not change from his annual base salary rate for 2004.

Mr. Nafus became the Chief Executive Officer of the Company on April 1, 2005. In recognition of his performance as Executive Vice President of the Company and President of the Company s Broadband Services Division prior to that date and the increased responsibilities that he was assuming as Chief Executive Officer, we recommended and the Board approved an increase in Mr. Nafus annual base salary rate from $375,000 to $550,000 for the period from April 1, 2005, through December 31, 2005.

Information concerning the current annual base salaries of the Company s executive officers appears above under Employment Agreements .

16

Performance Bonuses

The Company maintains an annual Performance Bonus Plan (the Bonus Plan), which provides for the potential payment of performance bonuses to most of the management employees of the Company who do not receive sales commissions. Executive officers of the Company participate in the Bonus Plan, which is a pay-for-performance plan designed to compensate participants for achieving certain objectives established in the context of the Company s annual financial plan.

Annually, at the beginning of each year, we review and recommend to the Board targeted levels and minimum threshold levels of Company performance with respect to key financial objectives affecting the executive officers performance bonuses. For executive officers of the Company, the performance bonus objectives are based primarily upon Company revenue and earnings targets determined at the beginning of the year but also take into account the executives respective areas of responsibility and individual performances. Each executive officer of the Company has as his performance bonus target a specified percentage of his year-end base salary (for 2005, Mr. Nafus target percentage was 100%, Mr. Kalan s target percentage was 75% and Mr. Scott s target percentage was 65%). The Company s 2005 revenue and earnings on a combined basis exceeded the Company s Bonus Plan goal and resulted in performance bonus payments to the Company s executive officers of 118% of their respective targets. The 2005 performance bonus target payments to the Company s executive officers therefore ranged from 76.7% of year-end base salary for Mr. Scott, 88.5% of year-end base salary for Mr. Kalan and 118% of year-end base salary for Mr. Nafus; however, Mr. Scott received an additional bonus of $50,000 under the Company s 2005 Bonus Plan in recognition of his extraordinary performance during 2005, including but not limited to his assumption of the presidency of the Company s Broadband Services Division. The Company generally pays performance bonuses during the first calendar quarter after the year in which they are earned.

As discussed above under Employment Agreements , Mr. Hansen did not receive a performance bonus payment for 2005. Mr. Nafus performance bonus for 2005 was based on the Company s overall revenue and earnings. Mr. Nafus earned a performance bonus of $649,000, representing 118% of his year-end annual base salary, based upon the levels of achievement of the applicable Company targets. In 2004 Mr. Nafus received a performance bonus equal to 65% of his 2004 annual base salary.

Information concerning the current incentive bonus targets of the Company s executive officers appears above under Employment Agreements .

During 2005, the Company completed the sale of its Global Software Services business in a transaction that generated approximately $240 million in cash for the Company. In recognition of the significant contributions of Mr. Nafus to the successful consummation of such transaction, we recommended and the Board approved the payment of a special bonus of $400,000 to Mr. Nafus. The Board also authorized Mr. Nafus to pay special bonuses, in an aggregate amount not to exceed $500,000, to such other executives of the Company designated by Mr. Nafus who also made significant contributions to the successful consummation of such transaction; from such authorized amount, Messrs. Kalan and Scott received $250,000 and $50,000, respectively.

Restricted Stock Awards

A further component of executive officer compensation is the Company s 2005 Stock Incentive Plan. We are responsible for the administration of such plan and the granting of stock options and other awards under such plan to executive officers and other employees of the Company.

We have determined, after consideration of a report of our independent compensation consultant, that restricted stock awards are an effective means of providing the long-term incentive component of executive officer compensation. Based upon recommendations of our independent compensation consultant, in 2005 we granted the restricted stock awards shown in the Summary Compensation Table appearing earlier in this Proxy Statement to the executive officers of the Company other than Mr. Hansen. Footnote (4) to the Summary Compensation Table contains additional information concerning such restricted stock awards. The basic awards were made in January 2005, including an award of 100,000 shares to Mr. Nafus, with supplemental awards to Messrs. Michels and Scott in March 2005 in recognition of their assumption of significant additional management responsibilities, an additional award to Mr. Bonde in June 2005 pursuant to his employment agreement and an additional award of 50,000 shares to Mr. Nafus pursuant to the March 2005 amendment of his employment agreement in connection with his becoming Chief Executive Officer of the Company. Because the vesting of such restricted shares generally is structured to occur in installments over a period of up to four years and the ultimate value of the restricted shares is entirely dependent upon the market price of the Common Stock, we believe that such awards provide a meaningful incentive to the recipients both to remain in the employ of the Company and to use their best efforts to assure that the Company achieves financial results that will favorably impact the value of the Common Stock, thereby closely aligning the interests of the Company s executive officers with the interests of the Company s stockholders generally.

Conclusion

Through the programs described above, we have based significant portions of the Company s executive compensation directly upon individual and Company performance and upon the future value and potential price appreciation of the Company s stock. We presently intend to continue compensation policies which link executive compensation to Company performance and stockholder return.

Frank V. Sica, Chairman
Donald V. Smith
James A. Unruh
Compensation Committee of the Board of Directors

STOCK PRICE PERFORMANCE

The following graph compares the cumulative total stockholder return on the Common Stock, the S&P 500 Index and the Company s Standard Industrial Classification (SIC) Code Index: Computer Processing and Data Preparation and Processing Services during the indicated five-year period. The graph assumes that $100 was invested on December 31, 2000, in the Common Stock and in each of the two indexes and that all dividends, if any, were reinvested.

	12/31/2000	**12/31/2001**	**12/31/2002**	**12/31/2003**	**12/31/2004**	**12/31/2005**
CSG Systems International, Inc.	100.00	86.18	29.08	26.61	39.84	47.55
Data Preparation & Processing Services	100.00	102.741	78.72	93.71	102.93	103.43
S&P 500 Index	100.00	88.12	68.64	88.33	97.94	102.75

RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITOR

The firm of KPMG LLP served as the Company s independent auditor for 2005 and has been appointed by the Company s Audit Committee to serve in such capacity for 2006. The Company expects that a representative of KPMG LLP will be present at the Annual Meeting, with the opportunity to make a statement if he or she desires to do so, and that such representative will be available to respond to appropriate questions.

The following table sets forth (i) as Audit Fees the aggregate fees billed by KPMG LLP for 2005 and 2004 for professional services rendered for audits of the Company s financial statements (including work related to the issuance of an attestation report on management s assessment of, and the effectiveness of, the Company s internal controls over financial reporting as of December 31, 2005, as required by Section 404 of the Sarbanes-Oxley Act), reviews of financial statements included in the Company s quarterly reports to the SEC on Form 10-Q, and other statutory and regulatory filings, (ii) as Audit-Related Fees the aggregate fees billed by KPMG LLP in 2005 and 2004 for audits of an employee benefit plan and other miscellaneous audit-related projects, (iii) as Tax Fees the aggregate fees billed by KPMG LLP in 2005 and 2004 for federal, state and foreign tax compliance services and various other tax services and analyses, including transfer pricing and international tax structuring and (iv) as All Other

Fees the aggregate fees billed by KPMG LLP in 2004 for executive tax services (no such fees having been billed in 2005):

	2005	2004
Audit Fees	$ 1,044,900	$ 1,429,000
Audit-Related Fees	41,400	32,200
Tax Fees	106,157	320,019
All Other Fees		2,500

The substantial decrease in the Audit Fees paid to KPMG LLP for 2005, as compared with 2004, resulted primarily from the sale in 2005 of the Company s Global Software Services business, which eliminated the need for various foreign statutory audits, and the non-recurrence in 2005 of audit fees incurred in 2004 in connection with the SEC registration of certain Company securities. The substantial decrease in Tax Fees paid to KPMG LLP for 2005, as compared with 2004, resulted primarily from reduced tax services required by the Company in 2005 for its Global Software Services business.

The Charter of the Company s Audit Committee requires the Committee to approve, in advance of the performance of the services, all audit and permissible non-audit services to be provided to the Company by the Company s independent auditor. The Audit Committee has delegated to the chairman of the Committee the authority to perform the Committee s responsibilities with respect to such approvals. The Committee chairman is required to report to the Committee at its next meeting on the manner in which such delegated performance was carried out by him. Since the May 2003 effective date of the SEC rule stating that an accountant is not independent of an audit client if the services it provides to the client are not appropriately approved in accordance with such rule, each new engagement of KPMG LLP to provide services to the Company has been approved in advance either by the Audit Committee or by the chairman of the Committee pursuant to the delegated authority referred to above.

Although the Company s Audit Committee by law and the Committee s Charter is directly responsible for the appointment of the Company s independent auditor, the Board is requesting the Company s stockholders to ratify the Audit Committee s appointment of KPMG LLP to serve in such capacity for 2006 so that the Company will have the benefit of its stockholders views on such appointment. If the stockholders do not ratify such appointment, the Audit Committee nevertheless may determine that it is in the best interests of the Company and its stockholders to keep such appointment in effect for 2006. Whether or not the appointment of KPMG LLP is ratified by the stockholders, the Audit Committee at any time during the year may appoint a different independent auditor for 2006 if the Audit Committee determines that such a change would be in the best interests of the Company and its stockholders.

Ratification of the appointment of KPMG LLP as the Company s independent auditor for 2006 requires the affirmative vote of the holders of a majority of the shares of Common Stock present or represented by proxy at the Annual Meeting and entitled to vote on such matter. Abstentions will have the effect of a no vote with respect to such matter.

The Board Recommends that Stockholders
Vote FOR Ratification of the Appointment of
KPMG LLP as the Company s Independent Auditor for 2006.

20

REPORT OF THE AUDIT COMMITTEE

The purpose of the Audit Committee, as set forth in its Charter, is to oversee the accounting and financial reporting processes of the Company and the audits of the financial statements of the Company.

We have implemented procedures to assure that the Audit Committee performs each of its responsibilities under its Charter. During 2005, and thereafter through the completion of the audit of the Company s financial statements for such year, those procedures included regular meetings with management of the Company and with appropriate representatives of the Company s independent auditor.

We reviewed and discussed both with management of the Company and with the Company s independent auditor, KPMG LLP, the Company s audited financial statements for 2005.

We also discussed with KPMG LLP the matters required to be discussed by Statement on Auditing Standards No. 61, *Communication with Audit Committees*, as amended.

We received the written disclosures and the letter from KPMG LLP required by Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, and discussed with KPMG LLP its independence.

Based upon the reviews and discussions referred to in the immediately preceding three paragraphs of this report, we recommended to the Board that the audited financial statements of the Company for 2005 be included in the Company s Annual Report on Form 10-K for such year for filing with the Securities and Exchange Commission.

Bernard W. Reznicek, Chairman
Donald B. Reed
Janice I. Obuchowski
Audit Committee of the Board of Directors

OTHER MATTERS

Because no stockholder has given the Company timely written notice of business not discussed in this Proxy Statement which such stockholder intends to bring before the Annual Meeting, under the bylaws of the Company no stockholder may properly bring any other business before the Annual Meeting. As of the date of this Proxy Statement, the Company does not know of any matter that may come before the Annual Meeting other than the matters discussed in this Proxy Statement; however, if any other matter is properly presented at the Annual Meeting, the persons named in the accompanying proxy or their substitutes will have discretionary authority to vote on such matter in accordance with their judgment.

DEADLINE FOR SUBMISSION OF STOCKHOLDER PROPOSALS

Under the bylaws of the Company, a stockholder who wishes to bring any business before the 2007 annual meeting of stockholders of the Company must give advance written notice to the Company of such business and of any proposal which such stockholder wishes to have included in the Company s proxy statement and on the Company s proxy card for such annual meeting. The notice must be sent to the Secretary of the Company at the principal executive office of the Company, must be received by the Secretary of the Company not later than December 4, 2006, and must contain certain information required by the bylaws of the Company. Such advance notice requirement applies to all matters even if a stockholder does not seek to include in the Company s proxy statement a proposal with respect to a particular matter.

The bylaws of the Company also provide that stockholder nominations of persons for election to the Board are subject to certain advance notice and informational requirements.

Copies of the Company s bylaws are available to stockholders upon request made to the Secretary of the Company at the address set forth on the first page of this Proxy Statement.

The bylaw requirements referred to above do not supersede the conditions and requirements established by the SEC for stockholder proposals to be included in the Company s proxy materials for a meeting of stockholders, and in that regard stockholders also must comply with the applicable requirements of Rule 14a-8 under the Securities Exchange Act of 1934.

DELIVERY OF DOCUMENTS TO STOCKHOLDERS SHARING AN ADDRESS

In some cases, only one copy of this Proxy Statement and the Company s Annual Report on SEC Form 10-K is being delivered to multiple stockholders who share an address, unless the Company has received contrary instructions from one or more of such stockholders. Upon written or oral request, the Company promptly will deliver a separate copy of this Proxy Statement and such Annual Report to a stockholder at a shared address to which only a single copy of such documents was delivered. To request a separate delivery of such documents now or in the future, a stockholder may submit a written request to the Investor Relations Department of the Company at the address appearing on the first page of this Proxy Statement or may submit an oral request to such department at (303) 796-2850. Stockholders sharing an address who currently receive multiple copies of the Company s proxy statements or annual reports and who would rather receive only a single copy of either or both of such documents may request such delivery by writing or calling the Investor Relations Department of the Company in the manner described above.

By Order of the Board of Directors,

Joseph T. Ruble
Secretary

April 3, 2006

ALL STOCKHOLDERS ARE WELCOME TO ATTEND THE ANNUAL MEETING. REGARDLESS OF WHETHER YOU PLAN TO ATTEND, YOU ARE URGED TO COMPLETE, DATE AND SIGN THE ENCLOSED PROXY AND RETURN IT IN THE ACCOMPANYING ENVELOPE. YOU ALSO MAY FILE YOUR PROXY BY TELEPHONE OR THE INTERNET IN ACCORDANCE WITH THE INSTRUCTIONS ACCOMPANYING THE PROXY. A PROMPT RESPONSE WILL FACILITATE ARRANGEMENTS FOR THE ANNUAL MEETING, AND THE COMPANY WILL APPRECIATE YOUR COOPERATION. STOCKHOLDERS OF RECORD WHO ATTEND THE ANNUAL MEETING MAY VOTE THEIR STOCK PERSONALLY EVEN THOUGH THEY HAVE SENT IN THEIR PROXIES.

CSG Systems International, Inc.

o Mark this box with an X if you have made changes to your name or address details above.

Annual Meeting Proxy Card

A Election of Directors

PLEASE REFER TO THE REVERSE SIDE FOR INTERNET AND TELEPHONE VOTING INSTRUCTIONS.

1. The Board of Directors recommends a vote FOR the listed nominees.

	For	Withhold
01 - Frank V. Sica	o	o
02 - James A. Unruh	o	o

B Issues

The Board of Directors recommends a vote FOR the following proposal.

	For	Against	Abstain
2. Ratification of appointment of KPMG LLP as the Corporation s independent auditor for 2006.	o	o	o

C Authorized Signatures - Sign Here - This section must be completed for your instructions to be executed.

NOTE: Please sign exactly as name appears hereon. When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. Corporations, partnerships and limited liability companies should sign in their names by an authorized officer, partner, member or manager.

Signature 1 - Please keep signature within the box	Signature 2 - Please keep signature within the box	Date (mm/dd/yyyy)

Proxy CSG Systems International, Inc.

PROXY FOR ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD ON MAY 26, 2006
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby constitutes and appoints Edward C. Nafus and Peter E. Kalan, and each or either of them, as attorneys and proxies of the undersigned, with full power of substitution to each of them, to vote all shares of stock of CSG Systems International, Inc. (the Corporation) standing in the name of the undersigned at the annual meeting of stockholders of the Corporation to be held at the office of the Corporation, 9555 Maroon Circle, Englewood, Colorado, at 8:00 a.m. (Mountain Time) on May 26, 2006, and at any adjournments thereof, on the matters set forth on the reverse side hereof and in their discretion on any other matters that properly may come before such meeting or any adjournments thereof.

THIS PROXY, WHEN PROPERLY SIGNED, WILL BE VOTED AS SPECIFIED. IF NO SPECIFICATION IS GIVEN, THIS PROXY WILL BE VOTED FOR THE NOMINEES FOR ELECTION AS DIRECTORS AND FOR THE OTHER MATTER SET FORTH ON THE REVERSE SIDE HEREOF.

The undersigned hereby ratifies and confirms all that either of such attorneys and proxies, or their substitutes, may do or cause to be done by virtue hereof and acknowledges receipt of the Notice of Annual Meeting of Stockholders of the Corporation to be held on May 26, 2006, the Proxy Statement of the Corporation for such Annual Meeting, and the 2005 Annual Report of the Corporation on SEC Form 10-K.

PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY PROMPTLY USING THE ENCLOSED ENVELOPE.

Internet and Telephone Voting Instructions
You can vote by telephone OR Internet! Available 24 hours a day 7 days a week!
Instead of mailing your proxy, you may choose one of the two voting methods outlined below to vote your proxy.

To vote using the Telephone (within U.S. and Canada)

Call toll free 1-800-652-VOTE (8683) in the United States or Canada any time on a touch tone telephone. There is **NO CHARGE** to you for the call.

Follow the simple instructions provided by the recorded message.

To vote using the Internet

Go to the following web site:
WWW.COMPUTERSHARE.COM/EXPRESSVOTE

Enter the information requested on your computer screen and follow the simple instructions.

VALIDATION DETAILS ARE LOCATED ON THE FRONT OF THIS FORM IN THE COLORED BAR.

If you vote by telephone or the Internet, please DO NOT mail back this proxy card.
Proxies submitted by telephone or the Internet must be received by 1:00 a.m., Central Time, on May 26, 2006.
THANK YOU FOR VOTING