

# Cash Long Term Incentive Plan (LTIP)

## Index

|   |   |
|---|---|
| Index .....   | 1 |
| 1. Executive summary .....                                    | 2 |
| 2. Background to the Cash LTIP plan .....                     | 3 |
| 3. How is value creation measured? .....                      | 3 |
| 4. How is the value of each Business calculated? .....        | 3 |
| 5. How is the adjusted base value calculated? .....           | 4 |
| 6. What happens if there is an earlier vesting 'event'? ..... | 7 |
| 7. How is the incentive pool shared out?.....                 | 7 |
| 8. The Accounting Treatment .....                             | 8 |
| 9. Illustration of potential incentive pool .....             | 9 |

## 1. Executive summary

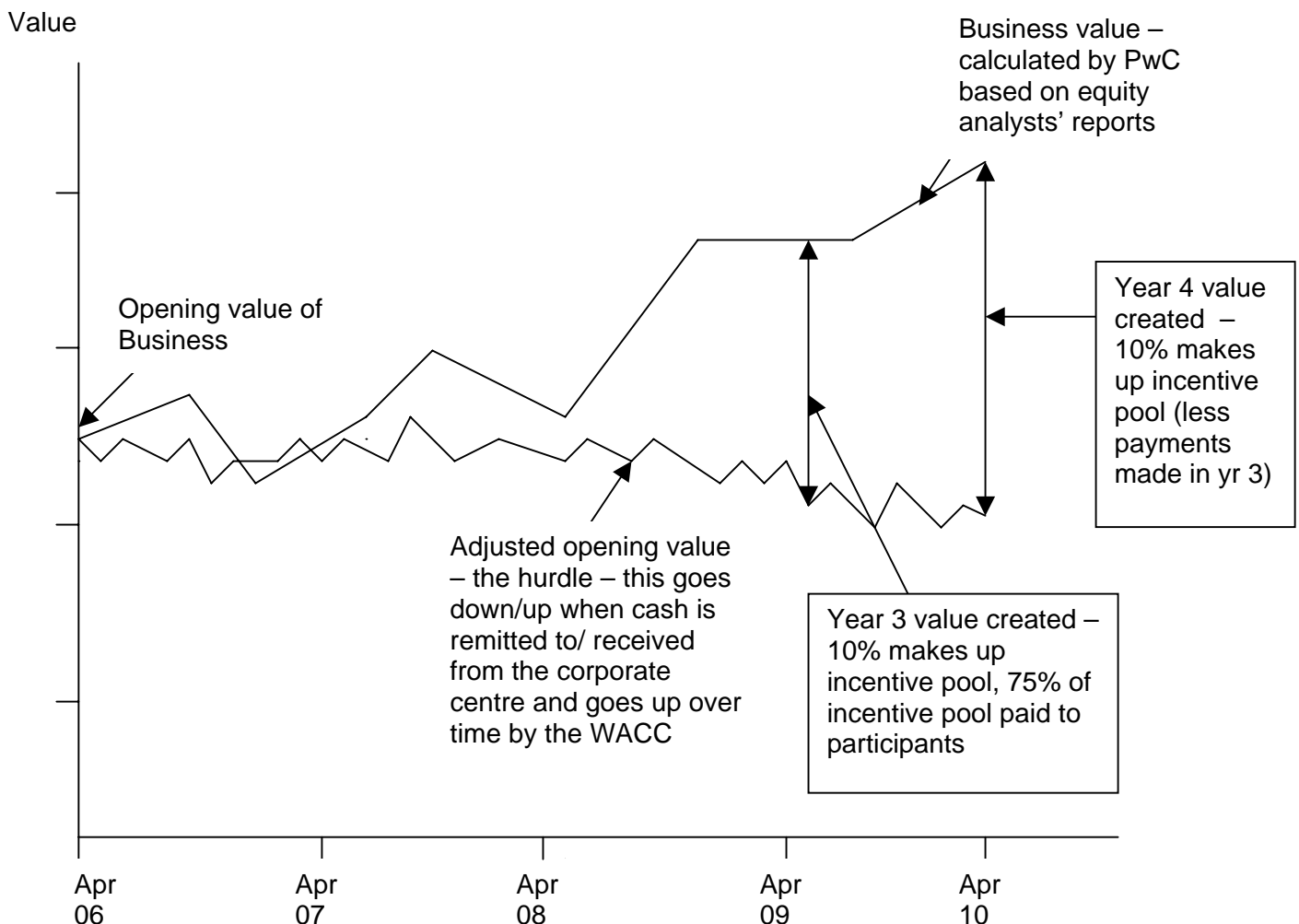
The cash long-term incentive plan (LTIP) rewards the most senior managers for creating shareholder value within their own Business (International or UK). Managers will share in 10% of the value, in excess of a hurdle, created over a 4-year period, or until an earlier vesting event.

The incentive pool for each business unit is calculated as follows:

$$\text{Total reward pool} = \left\{ \text{Business value at end of 4 years, or on earlier vesting event} - \text{Adjusted base value of the Business} \right\} \times 10\%$$

The adjusted base value equals the opening value of the Business at 1 April 2006 adjusted over time for the weighted average cost of capital (WACC) and cash remitted by the Business to, or received by the Business from, the corporate centre. This adjustment of the opening value creates the hurdle over and above which the Business must perform before any incentive reward is made.

75% of any incentive pool will be payable at the end of 3 years based on the valuation at 31 March 2009, with 100% payable at the end of 4 years based on the valuation at 31 March 2010, net of any payments already made in respect of the 3 year period. In the case of an earlier vesting event, an earlier award would be made.



## **2. Background to the Cash LTIP plan**

On 31<sup>st</sup> January 2006, Cable & Wireless announced the separation of its business into two discrete and self-contained businesses, UK and International. With dedicated management teams to focus on the differing financial and operational characteristics of the two, each Business is now responsible for its own financial performance and has its own Operating Board with delegated authority from the Cable and Wireless plc Board.

The cash LTIP rewards management for creating value for shareholders within their own business.

## **3. How is value creation measured?**

Within each business, value creation is measured as the increase over time of that business's value, as determined by equity analysts in their sum of the parts (SoTP) valuations of Cable & Wireless

## **4. How is the value of each Business calculated?**

PricewaterhouseCoopers LLP (PwC) has been appointed by Cable & Wireless to conduct the valuation exercise for the two Businesses. Their valuations will be performed on the opening position (at 1 April 2006), at the end of 3 years (31 March 2009), at the end of 4 years (31 March 2010), and every 6 months in the intervening periods to monitor progress. In the case of a vesting event, a special valuation will be undertaken.

The valuation of each Business involves the following six-stage process:

1. The average market capitalisation of Cable & Wireless during the month period preceding the valuation date is determined;
2. A group of independent equity analysts is identified and an analysis undertaken of their SoTP valuations of Cable & Wireless to determine the estimated value of each business. The analysts' valuations will be adjusted, where necessary, to ensure consistency;
3. Group items in the equity analysts' valuations that are not included in the business SoTP but which relate to a specific business are then allocated to that business e.g. pension deficit, minority owned cash;
4. Having allocated appropriate group items to the businesses, the average business valuation is calculated and where appropriate outlying or out of date brokers' reports are excluded from the calculation;
5. Using these average business valuations, the valuation allocation percentage as a percentage of the total group SoTP valuation (excluding analysts' estimated cash) is determined for each business and the corporate centre;
6. These allocation percentages are then applied to the total value of the group to determine the value of each business and the corporate centre. The total value of the Group is the average market capitalisation from stage one less actual net cash/(debt).

The valuation for 1 April 2006 has been completed. Table 1 on the next page, is a summary of the opening valuations for the two businesses.

Table 1: Summary of the opening value for each Business

|   | UK         | International | Corporate   | Total        |
|---|------------|---------------|-------------|--------------|
| <b>Base opening value at 1 April 2006</b> | <b>536</b> | <b>2,041</b>  | <b>(49)</b> | <b>2,528</b> |

Note: The cash LTIP and all values are determined in sterling. Therefore any currency risks rest with the individual Businesses.

## 5. How is the adjusted base value calculated?

The cash LTIP rewards managers for value creation over and above a given hurdle rate. The hurdle rate is applied by adjusting the opening value of the Businesses at 1 April 2006 for their cost of capital and any cash remitted to or from the corporate centre.

Over time, the opening value of a business increases by the cost of capital, and decreases or increases as cash is remitted to or from the corporate centre.

In order to make these adjustments, notional capital structures have been created for both the UK and International Businesses, reflecting how the businesses might be financed if owned by private equity.

The opening notional capital structure for the International Business is shown in Table 2. The table shows the notional cost of capital applied to the equity and the debt. The opening WACC of the International Business is 8.3% pa. Overtime the WACC will change depending on the development of the capital structure. As a minimum, the WACC will never be less than 8%.

Table 2: International notional capital structure.

|                    | <u>Interest</u><br>pa% | <u>£m</u>    | <u>Interest</u> | <u>WACC %</u>                           |
|--------------------|------------------------|--------------|-----------------|---|
| <b>Equity</b>      | <b>8%</b>              | <b>1,041</b> | <b>83</b>       |   |
| <b>Senior debt</b> | <b>6%</b>              | <b>600</b>   | <b>36</b>       | Debt to be repaid over 10 years         |
| <b>Junior debt</b> | <b>10%</b>             | <b>200</b>   | <b>20</b>       | Debt to be repaid over 10 years         |
| <b>PIK</b>         | <b>15%</b>             | <b>200</b>   | <b>30</b>       |   |
|                    |                        | <b>2,041</b> | <b>169</b>      | 8.3% ie 169 divided by 2041 equals 8.3% |

\*Payment in Kind (PIK) is an accumulating debt with no fixed repayment schedule.

Cash flows to or from the corporate centre decrease or increase the opening base value. The increase or decrease from these cash flows is on a £ for £ basis at the time when cash is remitted to or received from the corporate centre.

Interest on the debt will be calculated on a monthly basis, based on the opening debt position. Cash that is remitted to the corporate centre is applied against the notional balance sheet on the following basis:

1. Total monthly cash repatriation will be applied in the following order:
  - a. Accrued interest on senior and junior debt
  - b. Scheduled senior debt principal repayments until the required level of repayment for the financial year has been met
  - c. Once the required level of senior debt repayment for the financial year has been met, to scheduled junior debt repayments

- d. Once the required level of junior debt repayment for the financial year has been met, any additional excess net cash to PIK repayments
  - e. Disposal proceeds will be applied pro-rata to the principal amount of each tranche of debt outstanding at the beginning of the month of receipt by the corporate centre.
2. Any such pre-payments will not reduce the required level of scheduled repayments in subsequent years.
  3. The proceeds of any borrowings raised by International and returned to the corporate centre by way of special dividend or capital reduction will be credited against the PIK tranche.
  4. Funds simply deposited with the corporate centre will not be counted as cash payments to the corporate centre.

Within the plan there is the facility to create other tranches of debt, subject to agreement between the business and corporate.

Table 3 Illustrative calculation of the adjusted opening International capital structure at the end of year 1

| <b><u>Assuming a gross flow from International of £156m in Year 1</u></b> |            |                   |                 |                |                  |
|---|------------|-------------------|-----------------|----------------|------------------|
|   |            |                   |                 |                | <b><u>£m</u></b> |
| <b>Opening value of International business unit</b>                       |            |                   |                 |                | 2,041            |
| <b>ADD: Cost of Capital</b>   |            |                   |                 |                |                  |
| Equity at 8%  |            | 1,041 x 8%        |                 |                | 83               |
| Senior debt at 6%   |            | 600 x 6%          |                 |                | 36               |
| Junior debt at 8%   |            | 200 x 10%         |                 |                | 20               |
| Payment in Kind at 15%  |            | 200 x 15%         |                 |                | 30               |
|   |            |                   |                 |                | 169              |
| <b>LESS: Cash remittances to the corporate centre</b>                     |            |                   |                 |                |                  |
| Senior debt interest repaid   |            |                   |                 |                | -36              |
| Junior debt interest repaid   |            |                   |                 |                | -20              |
| Senior debt repaid  |            | 600 over 10 years |                 |                | -60              |
| Junior debt repaid  |            | 200 over 10 years |                 |                | -20              |
| Additional cash repaid - pays down interest on the PIK                    |            |                   |                 |                | -20              |
|   |            |                   |                 |                | -156             |
| <b>Adjusted opening value at the end of year 1</b>                        |            |                   |                 |                | 2,054            |
| <b>Notional capital structure at the end of year 1</b>                    |            |                   |                 |                |                  |
| Equity  | 1,041 + 8% |                   |                 |                | <u>1,124</u>     |
|   |            | <u>Interest</u>   | <u>Interest</u> | <u>Capital</u> |                  |
|   |            | <u>Accrued</u>    | <u>Paid</u>     | <u>Repaid</u>  |                  |
| Senior debt   | 600        | 36                | -36             | -60            | 540              |
| Junior debt   | 200        | 20                | -20             | -20            | 180              |
| PIK   | 200        | 30                | -20             | 0              | 210              |
|   |            |                   |                 |                | 930              |
|   |            |                   |                 |                | 2,054            |

The opening notional capital structure of the UK business is shown in Table 4 below. The table shows the notional cost of capital applied to the equity and the interest rate at which future debt may be charged. The opening WACC of the UK is 8% pa. Overtime the WACC will change depending on the development of the balance sheet. As a minimum the WACC will never be less than 8%.

Any cash required by the UK business will be supplied through a PIK with interest charged on any cash received from the corporate centre at 15% per annum. The structure of the UK capital structure is designed to encourage the minimum use of cash and the fastest pace to achieve self-sufficiency.

Table 4: UK notional capital structure

|               |   |                         |                              |
|---------------|---|-------------------------|------------------------------|
| <b>Equity</b> | <b><u>Interest pa%</u></b><br>8%                        | <b><u>£m</u></b><br>536 | <b><u>Interest</u></b><br>43 |
| <b>PIK</b>    | <b>15% as and when cash is requested from corporate</b> |                         |                              |

Cash flows to or from the corporate centre decrease or increase the opening base value. The increase or decrease for these cash flows is on a £ for £ basis at the time when cash is remitted to or received from the corporate centre.

Interest on the debt will be calculated on a monthly basis, based on the opening debt position. Any cash that is remitted to the corporate centre will be applied against the PIK in the notional balance sheet.

Table 5 Illustrative calculation of the adjusted opening UK balance sheet at the end of year 1.

| <i>Assuming the UK receive £200m from the corporate centre half way through Year 1.</i> |  |            |                          | <u>£m</u>  |
|---|--|------------|--------------------------|------------|
| <b>Opening value of the UK business</b>   |  |            |                          | 536        |
| <b>ADD: Cost of Capital</b>   |  |            |                          |            |
| Equity at 8%  |  | 536 x 8%   |                          | 42         |
| PIK   |  | 200 x 7.5% | (half a year's interest) | <u>15</u>  |
|   |  |            |                          | 57         |
| <b>ADD: Cash received from the corporate centre</b>                                     |  |            |                          | 200        |
| <b>Adjusted opening value at the end of year 1</b>                                      |  |            |                          | <u>793</u> |
| <b>Notional capital structure at the end of year 1</b>                                  |  |            |                          |            |
| Equity  |  | 536 + 8%   |                          | 578        |
| PIK after interest added  |  | 200 + 15   |                          | <u>215</u> |
|   |  |            |                          | <u>793</u> |

## **6. What happens if there is an earlier vesting 'event'?**

A 'vesting event' for the purposes of the cash LTIP is defined as a take-over of Cable & Wireless (other than as part of a reorganisation), a sale of one or both Business or a de-merger of one or both Businesses.

At the point of a 'vesting event', the performance period will end and all outstanding awards will vest in full immediately.

In these circumstances, final valuations by reference to the vesting event will be carried out broadly on the same basis as outlined in 4 above, but where necessary, adjusted by the Remuneration Committee to reflect the terms of the vesting event.

For example, following a take-over, the market capitalisation of C&W for the purposes of the take-over will be used to determine the business valuations (rather than a 30 day average). If a vesting event involves consideration other than cash then the remuneration committee will estimate fair value and determine payments based on that amount.

Participants will receive the full value of their awards following the vesting event (net of any payments made in respect of earlier periods) unless the Remuneration Committee exercises its discretion to defer. The Remuneration Committee may defer payment of up to 50% of the award for up to 6 months in the event of a sale of a business and up to 12 months in the case of a de-merger. The Remuneration Committee may exercise the right to defer payment generally or for specified participants only. These payments would be forfeited if an individual resigns and leaves or is dismissed for cause within the deferment period, but would be payable in all other circumstances.

## **7. How is the incentive pool shared out?**

Members are allocated a number of units within the cash LTIP. The total number of units available within International is 10,000.

The value of each unit at any point is calculated as the value of the incentive pool divided by 10,000 units. In order to obtain this the following calculation will be carried out:

$$\text{(Business value – adjusted base value) x 10\% / 10,000 units = value of each unit}$$

Payments may be scaled back by the remuneration committee if, having taken advice, the committee considers that the price of Cable & Wireless's shares in the relevant valuation period has been materially affected by non-disclosable inside information.

In addition, there is a cap on the amount that any one individual will be entitled to receive. The cap is £10 million if there is a vesting event before 1 April 2007, and £20 million thereafter.

## **8. The Accounting Treatment**

The accounting for the LTIP will be under IAS 19 - Employee benefits. This results in the following key points:

- All cash payments under the award will be charged in full to the income statement through staff costs;
- As the award is earned through the relevant employees' service with the company, the charge will be spread over the life of the scheme.

IAS 19 requires the use of the Projected Unit Credit method for valuing 'other long term employee benefits'. In short the expected payout needs to be estimated at each reporting period and the amount earned to that date accrued in the balance sheet. The P&L charge for each period will be the movement in the balance sheet accrual.

The scheme rules allow for a valuation to be carried out every 6 months. Each valuation will be used to calculate how much value has been created by the International and UK businesses and therefore the size of the payout under the scheme. This valuation will be used as the basis for the accounting charge.

In addition to the underlying accounting charge, an accrual will also need to be made to cover national insurance and other related employee taxes. It has been agreed with Group Tax that a rate of 12.8% will be applied to the UK part of the scheme and 15% to the IB part of the scheme.

By way of illustration:

If the value created at 30 September 2006 were calculated to be £40m for each of the two businesses an accrual of £5m (£40m divided by 8, the number of half year periods in the 4 year scheme) would be made in the books of International and the UK. In addition accruals for national insurance and related taxes of £0.75m (15%) and £0.64m (12.8%) would be made in the books of International and the UK respectively. Consequently a total charge of £11.39m would be included in the consolidated accounts of Cable & Wireless.

(The actual amounts booked in the accounts would differ marginally from this due to additional requirements under IAS19).

## 9. Illustration of potential incentive pool

This scenario has used an assumption on EBITDA multiples to determine business value in successive years. This approach is purely for illustrative purposes and the actual business value will be determined as a portion of the market capitalisation of Cable and Wireless plc at the time, not a multiple of EBITDA. This scenario is not intended to be anything other than illustrative.

| International Cash LTIP (all figures in £ million) |                         |       |             |       |       |       |             |
|--|-------------------------|-------|-------------|-------|-------|-------|-------------|
| Notes  |                         |       |             |       |       |       |             |
| 1  | Starting Valuation      | 2,041 |             |       |       |       |             |
| 2  | Hurdle rate             | 8%    | (On equity) |       |       |       |             |
|  | Bonus pot               | 10%   |             |       |       |       |             |
|  | Debt                    |       |             |       |       |       |             |
| 3  | Senior                  | 600   | 6%          |       |       |       |             |
| 4  | Junior                  | 200   | 10%         |       |       |       |             |
| 5  | PIK                     | 200   | 15%         |       |       |       |             |
|  | Year to April           | 2006  | 2007        | 2008  | 2009  | 2010  |             |
|  | EBITDA                  | 391   | 386         | 414   | 438   | 450   |             |
| 6  | Gross cash-flow         | 146.4 | 155.7       | 131.5 | 145.1 | 144.7 |             |
| 7  | Debt interest paid      |       | 56          | 50    | 45    | 39    |             |
| 8  | Debt repayment          |       | 80          | 80    | 80    | 80    |             |
| 9  | Net cash-flow           |       | 20          | 1     | 20    | 26    |             |
| 10   | Senior debt outstanding | 600   | 540         | 480   | 420   | 360   |             |
| 11   | Junior debt outstanding | 200   | 180         | 160   | 140   | 120   |             |
| 12   | PIK                     | 200   | 210         | 239   | 253   | 264   |             |
| 13   | Business Value          | 2,041 | 2,020       | 2,138 | 2,238 | 2,289 |             |
| 14   | Adjusted Base Value     | 2,041 | 2,054       | 2,093 | 2,124 | 2,160 |             |
| 15   | Payout                  |       |             |       | 8.5   | 4.3   | <b>12.9</b> |
|  |                         |       | Parameters  |       |       |       |             |
|  |                         |       | Projections |       |       |       |             |
|  |                         |       | Baseline    |       |       |       |             |

### Notes:

1. Base value of International Business as at 1<sup>st</sup> April 2006
2. 8% annual rate hurdle rate applied to equity
3. £600m Senior debt, amortised over 10 years with a 6% interest rate
4. £200m Junior debt, amortised over 10 years with a 10% interest rate
5. £200m Payment in Kind (PIK), accumulating debt with no fixed repayment schedule
6. Potential projections of gross cash flow to the Corporate Centre for the next 4 years
7. Total of 6% interest on senior debt and 10% interest on junior debt e.g. in 2007 £36m senior interest and £20m junior interest
8. Annual debt repayment which is fixed at a constant of £80 per annum, £60m for senior debt and £20m for junior debt
9. Net cash flow is the balance of the gross cash remitted to the Corporate Centre once the interest and debt have been deducted.
10. Senior debt outstanding is the total debt minus the annual repayment i.e. £60m
11. Junior debt outstanding is the total debt minus the annual repayment i.e. £20m
12. The PIK, increases by a rate of 15% per annum. Any additional excess net cash once the annual interest and debt repayment can be credited to the PIK. The model assumes that the net cash is attributed to the PIK half way through the financial year.
13. Business value is the value of the International business (based on analysts' SoTP valuations applied to the market capitalisation of C&W adjusted for actual net cash/ debt) at the relevant valuation date.
14. Adjusted base value is the value of the equity (£1,041m) increased by its hurdle rate of 8% per annum, plus the outstanding senior, junior debt and the PIK.
15. The incentive pool to distribute is calculated for the year to April 2009, as the difference between the business value and the adjusted base value (value created), multiplied by 10% to obtain the incentive pool of which 75% is then payable. For the year to April 2010 the same process is followed, but any incentive pool is reduced by the payments made in 2009.