BT'S SECOND QUARTER AND HALF YEAR FINANCIAL RESULTS: NOVEMBER 2006

Chairman – Sir Christopher Bland

Good morning and welcome to BT's results presentation for our second quarter and half year.

This morning, I will focus on the half-year results, Ben and Hanif will take you through the second quarter in more detail.

First I must draw your attention to the cautionary statement which is also included in your pack.

I must remind you that during this presentation we will make various forward looking statements. Factors which could cause our actual results to differ materially from the results we currently expect are identified in detail on the screen and in your presentation pack.

In the first six months of this financial year the business delivered another set of strong financial results. We've continued to make transformational changes whilst at the same time delivering for customers and for shareholders.

Group turnover increased by 3% to £9.8 billion. New wave now accounts for over a third of group revenue and will continue to become an increasing proportion of the total.

EBITDA before specific items grew 2% year on year to £2.7 billion.

Earnings per share, before specific items, rose 19% to 11.3p. This was driven by revenue growth, cost efficiencies in traditional areas, lower interest and tax; and our ongoing share buyback programme.

As a result, we will pay an interim dividend of 5.1 pence per share, which is 19% higher than last year.

At £321 million free cash flow was 15% lower than last year. This was driven primarily by increased capital expenditure as 21CN deployment gathers pace. In addition the net outflow of working capital in the first half was slightly higher than last year. This is expected to reverse in the second half of the year.

The 3% rise in Group turnover is bolstered by a near 20% increase in new wave revenues in tandem with a traditional revenue decline of less than 4%.

New wave revenue has grown twice as much as the fall in our traditional revenue.

One of the most striking elements of BT's transformation is our changing revenue mix. Back in September 2002 new wave only accounted for 13% of total group revenue, while calls and lines represented 46%.

This half year new wave is 34% of the total, with calls and lines less than a third.

This transformation is now recognised by peers and industry commentators. This chart from a recent edition of the Economist clearly demonstrates how BT has become far less reliant on voice than other telco's.

BT is well positioned to take full advantage of the evolving opportunities which arise in an IP world.

In the past 5 years, despite our voice revenues declining, we have continued to grow earnings and delivered increased shareholder returns.

We have also transformed our balance sheet; our net debt has reduced by £1.5 billion over the last three and a half years. During that time we have also paid out almost £3 billion in dividends and bought nearly £1 billion worth of shares.

Over the same period the pension deficit has fallen from £6.3 billion to £2 billion net of tax on an accounting basis. By the end of December we expect a final decision on the pension funding requirements for the next three years.

Earnings per share, before specific items, rose 19% to 11.3 pence. We have now delivered 18 consecutive quarters of EPS growth - another endorsement of our strategy, it's execution, management's strong financial discipline, and BT's focus on returns.

Finally, the interim dividend we are paying is 5.1 pence, a year on year increase of 19%. This payment is in line with our progressive dividend policy; we continue to target a payout ratio of at least two thirds of earnings next financial year.

Now, I will hand you over to Hanif to take you through the details of the quarterly numbers.

Hanif

Hanif Lalani

Thank you Christopher, good morning. Our second quarter results build on the momentum we have established in recent years and underpins the confidence that we have in the outlook statement that we have provided.

Group revenue at £4.9 billion in the second quarter rose 4%, with double digit growth in new wave revenue more than offsetting the stable rate of decline in traditional revenue.

EBITDA grew 2.4%, a third quarter of positive growth. The EBITDA performance in each Line of Business is in-line with the outlook statement we provided at the start of the year.

Earnings per share before leaver costs, increased by 13% to six pence, the 18th consecutive quarter of year on year growth.

Group revenue – Group revenue grew for the 11th quarter primarily driven by strong growth in new wave revenues, at £1.7 billion, 21% up year on year. The main drivers of growth in new wave revenues are networked IT services which grew by 10% to £1 billion and Broadband revenue which increased by 39% to almost £0.5 billion.

As a group we serve a diverse range of customers from single households to multi-national corporations. You can see that 75% of our revenue is achieved in a business-to-business environment up from 69% a year ago, with all three segments growing year on year. Across all customer segments new wave as a proportion of talking revenue continues to grow, particularly in consumer this quarter.

Revenue growth combined with a focus on cost reduction has once again resulted in EBITDA growing positively in the quarter, extending our improving trend to 7 quarters with the last 3 quarters returning positive growth.

Let's review, the Group P&L.

Operating profit rose £22 million, whilst margin remained unchanged at 14.5%. Lower finance cost, due to refinancing of higher coupon debt resulted in a reducing average interest rate. This combined with an increase in Pension credit when profit before tax was £632 million - £73 million higher than last year.

The effective tax rate reduced by 0.4 percentage points to 24.5%, taking profit after tax to £477 million, 13.6% or £57 million higher year on year. All of these numbers excluded specific items.

Specific items this quarter were a £23 million charge relating to our property rationalisation programme and a £20 million profit on the part disposal of our stake at the IPO of Tech Mahindra in India during August. Our remaining equity in Tec Mahindra is currently worth around $1 billion.

Capital expenditure in the quarter amounted to £812 million, an increase of 17% on last year.

We continue to reduce expenditure on legacy and transmission equipment as 21CN preparation activity and deployment gathers pace. At the same time we are investing heavily in systems and network software to deliver 21CN expenditure and LLU capabilities for other service providers.

Our annual expenditure on capex will remain at around £3.1 billion for the next 2 years.

Let us look at free cash flow. EBITDA post leavers rose £37 million. During the quarter we benefited by £48 million from lower interest and tax payments. However, increased investment in 21CN as well as systems to support and deliver our commitments under the Telecoms Strategic Review resulted in capex rising £123 million this quarter.

Other inflows were offset by a higher working capital outflow, giving the impact of timing differences. These timing differences will reverse out during the second half of the year.

Free cash flow in the quarter was a net inflow of £338 million and year on year net debit was reduced by £54 million to just under £8.1 billion.

Let us review the Line of Business performance.

Global Services. Revenue rose in the second quarter by 3% to £2.2 billion. UK traditional revenue decreased by 8% with reductions in Dial IP volumes. New wave grew by 6% despite an adverse foreign exchange movement of £12 million.

A combination of increased revenue and a proactive focus on supplier management resulted in gross profit improvement of £26 million at £638 million. EBITDA increased 4% year on year to £229 million, while the gross profit improvement was partially offset by higher SG&A costs.

Lower depreciation contributed to a 16% increase in operating profit of £72 million before leaver costs.

Moving onto BT Retail. Traditional revenue declined by 9% whilst new wave revenue grew by 34%, driven primarily by Broadband. Although revenue fell by 3%, gross profit increased by 7%, reflecting successful margin and supplier management both in the consumer and SME market. This resulted in gross profit margins improving by 2.5 percentage points.

With SG&A costs falling 2% driven by continued focus on delivering cost efficiencies, EBITDA rose 23% to £235 million. So operating profit before leaver costs improved 29% to £196 million.

BT Wholesale. Revenue at £1.9 billion increased by 4%, driven by external revenue growth of 7%. External revenue in the second quarter of over a billion pounds was boosted by strong growth in new wave services. Internal revenue increased marginally to £855 million due to growth in internal Broadband revenue partly offsetting the impact of lower call volumes and lower regulatory prices.

Gross variable profit improved by 1%, although margins decreased to 49% due to the changing sales mix. In spite of greater 21CN opex expenditure, network and SG&A costs decreased by 1% as a result of efficiency savings.

Overall, EBITDA before leaver costs has increased by £14 million to £484 million. High depreciation due to the shortening of useful economic lives of legacy transmission assets, to be replaced by 21CN equipment, resulted in a 2% decline in operating profit at £193 million.

And finally, Openreach. Revenue in the second quarter was 1% higher at £1.3 billion, despite price reductions in WLR amounting to £45 million year on year. External revenue increased by £102 million predominately due to the growth of WLR and LLU volumes. Internal revenues declined by 8% to just over £1.1 billion, reflecting the volume shift from internal to external channels and reductions in price in the prior periods.

Operating costs increased 4% as staffing levels and overtime was increased to help improve service levels and handle the significant increase in activity volumes.

Consequently, EBITDA fell 5% to £460 million.

As you can see each line of business has specific strengths and unique capabilities, which together have contributed to the positive momentum the group has established.

Once again we have demonstrated that we have the right strategy to continue to drive improving financial results across the group and have delivered our 18th consecutive quarter of EPS growth. This supports our positive outlook for growth in revenues, EBITDA, EPS and dividends.

Over to you Ben.

Ben Verwaayen

Hanif, thank you very much and good morning everybody. I thought that I would like to surprise you with slides so let's start with this slide. You didn't see it last time and I got complaints about it, you said you have seen it so many times, why did you leave it out? And I thought it's a good idea not to leave it out because it gives an opportunity not to rehearse this slide over and over again but to show to you this version of it. This strategy is not a strategy on paper, it's a strategy of things that are happening right now on all four elements and I think that if you walk through this presentation you will see that we are hitting all the four elements at the same time. We are delivering a very robust defence of our traditional business and we are getting better at it. You will see that we have more of our revenues under contract and that we get better at it. You will see that we are delivering 21CN and that you will see more and more milestones being completed and at the same time you will see that our new wave is growing and it is growing fast. If you look to both slides for elements of strategy they have a similarity with the four things that we are delivering. We deliver, a growth in revenue and a growth of EBITDA, and a growth of EPS and growth in dividends. And those four elements coincide with the fact that as a company we have four units, four lines of business, that form a very strong group. The advantage of four different lines of business is focus, and at the same time the advantage of Group is our capability to work together where it makes sense, and be faster and better and cheaper than our competition. Each of those lines of business has their own task in life. Global Services allows companies to globalise and we are more and more successful in bringing that capability to the market place. Retail is selling more and more higher added value services on a nationwide basis. Wholesale is focussing more and more on a market of managed services. It's great to compete in this market but more and more customers, being in a traditional mobile space or traditional fixed space or a converged space, want managed services to form for themselves a platform for a faster go to market strategy. And Openreach I think is delivering an access strategy to the UK market that allows that market to expand.

So let's start with Global Services, the most important questions that people always ask is "Are you on track for further growth?" And, "How are you doing with your EBITDA margin at 15%?" Now in September, Andy and his team gave a presentation about where we are and to be on track is the right wording. Look to what we have done. In the Network IT Services space, we grew 10%. Just for the fun of it, look up what our competitors did, look where we are. Most of them you will find are minus before the number and a very few you will find that have grown in this space – low single digits. We are taking market share and are going to prove that to you, we are taking market share. Our EBITDA margin rose 16 basis points and every single step here is important, and at the same time our operating profit rose 16%. So I think we have strong financials. And we also have a unique proposition. We serve 128 countries and territories around the globe and we add to that every single week. We have a capability that makes us unique. Not just on a geographic territory, also on what we offer to the companies that are our customers. We have a service level capability that allows us to prioritise services that are crucial for our customers, second to none, six layers of services that we can bring anywhere on the globe and allows companies to do businesses in a totally different manner. And last but, not least, this is a market about value – value that we bring and that other people bring. The skill of partnerships is an essential ingredient to bring value to our customer base. To know how to partner with others sounds very easy but not too many people have mastered the skill and I think we are pretty good at it and getting better and better every single day.

Now to get recognition as a leader is important in a market. Two things here, first of all the industry analyst are unanimous about what capability Global Services has to offer and we add to that organically and inorganically, and the acquisition for example of Counter pane, was not significant by the size of it but by the depth of it. It will give us a unique security services capability for a market that is going in that direction. And last but not least, if you look to the future, we are growing faster in our non- traditional markets, we have a cost saving capability and we executed on that and we will hit the 15% margin.

And if you look around the globe, I said last time, it's not just the split in geography, it's also in sectors and it is a focus to bring those services where our customers want them to be, and this quarter we have added 223 new accounts, household names, and if you look to where they are coming from, out of the 223 more than 10% is now Asia, BT winning 29 important contracts in Asia. It is a phenomenal change over where we were even a couple of years ago and we have the capability here to bring added services to a scale that we weren't a couple of years ago. You have seen that Q3 started very well with two announcements that are extremely important and size wise very important.

Now this chart was shown to you by Andy when he had his Global Services day, and I wanted to repeat it. It's the road map to 15% and what it tells you is, it's not just better selling, it's not just the maturing of the contract or the ability as an organisation to organise yourself much more according to the new reality's of the market and being in depth on sector, it's the capability to execute the positive side of growth and a cost transformation that's going to take place, in Global Services and it gives us this road map and the feeling of confidence. This road map is a real road map that you can follow, quarter after quarter after quarter.

Not let's talk about Retail. Hanif gave you a lot of numbers, but 23% increase in EBITDA is a good number, it's a fantastic number, and it shows some of the discipline that we have today in Retail. Retail is a very very diverse business. Yes it's consumer, but EBITDA of consumer is less than 50% of that of retail. Its business and we talk about consumer and business but it's also enterprises. Very focus business on sectors of the market where they bring world class solutions and they are doing terrific. In Ireland, I believe, their market share of broadband in Ireland is 35%. It is a very diverse business that is delivering high valued services to our customers and they do a lot of innovation - I don't know how much time you have reserved in your calendar for a BT Podshow. You better revise again to your calendar, we have one million hours available to you today, people are producing content for it and if you do the calculations it will take you only eleven and a half years 24/7 to watch the library that we have here today. We have other great numbers. You may have seen this, our home hub. It's not to advertise this wonderful product to the Chairman, although he would love to have it, we sell 25,000 of these a week. This is Broadband at its best, with packages, its WiFi. We have talked about it many many times, where are the Wi Fi phones? Well, here they are, this is one, we will have three different Wi Fi phones in January coming, for finally the market has decided that it's not just enough to have it in the form that people can't use for too long with the battery issue or a price issue, we'll now have very attractive Wi Fi phones. It can work with your hub because it's Wi Fi enabled as you know and it will help us on Fusion. A lot of innovation, coming through, and I think that if you look to the retail performance, it's also those two elements, defending the traditional and growing the new. Defending the traditional – our price plan, our renewal price plan is really appreciated by the public, you can see that here, almost 400,000 Option 2 and 3 signed in quarter, and the flip side of that of course is that the number of active losses. This hasn't been as low for three years, we're really getting traction with our price plan.

Now let's talk about our new wave, our Broadband. If you look to Broadband, there are three things I'd like you to focus on and pay some attention to. First of all is our market share is 25% in quarter, second what we sold, 60% is the higher value packages. We said last time, the market will have two different corners, one corner is price and in the UK you call that free, and in the other corner is value, that's what we play. And what you find is that in the value corner people want the total value as much as they can, all those wonderful new services you get on top of your Broadband line. Sixty percent deciding Option 2 and 3 and that's not bad for our margin. If you look, how attractive is our offer, look to the right hand side of this chart, which are the orders. We have signed 350,000 orders in the quarter plus. But as you can see we have the largest install base – 3 million. So if you build from scratch you don't have the churn so the churn is here, but in total we have grown double the size of our biggest competitor which still is Cable. If you want to see that translated in to two things, into what it does for ARPU per customer, ours goes up. If you want to see this wonderful, colourful chart that we have shown many times, you see one thing, there is always volatilities in each quarter. It has been historically the case and boring, boring, boringly, BT remains around 25% of the total market. If you look at the total market, the success of some of the newcomers are at the expense of Cable, not so much at the expense of BT.

So let's talk about business. I am very proud to say that we are taking market share in the SME market. I love to say that because for a very long time I couldn't say that. And why are we taking market share in the SME market? Two reasons: we have a good price plan, like BT Together in the consumer market, the BT Business plan is really really attractive and it's even more attractive now it's a converged plan. It takes in the mobile as well and you can see 60% of our voice now under contract, and it adds new services to our capability. Second, if you look to Broadband in the business market, we are clearly the number one ISP, 46% market share. By the way that is higher than our market share on lines. It is a point that we have argued all along, that there is not a direct one and one connection between lines and Broadband - you remember that debate - here it's happening in the SME market. And you can also see that 40% of our customers signed long term contracts on Broadband. Two years is a long term contract for Broadband, and the add on services that they buy from us, more than 90% buys more than just the Broadband. I can tell you this is a good formula to grow this business in this segment.

Now talk about the other parts of Retail, the enterprises. As I said, very focussed businesses and a very diverse number of markets and they are in very different stages. If you look to Payphones, the name of the game is cost and cost control, that's why we took 20% of cost out because, that helps in that particular market. On the other hand look to BT Conferencing. We built a global platform and even by itself BT Conferencing is gaining customers around the globe. It is a very successful, very rapidly growing, a growth that you can see here that is over 29% , it's a very very good number, and at the same time we are focussing on segments of the market. If you see BT Expedite and the household names in the retail market, it is a very good performance, but I can talk about it rather than look to it.

"I'm at the stadium which is Arsenal's new home, we've moved here after 93 years at Hy***. Security is of paramount importance to us. BT Redcare provides us with the vital communication link that we need. On a match day we've got lots of people coming in very quickly and leaving very quickly, we have to make split second decisions and that connectivity is absolutely vital for us to liaise and communicate with a stakeholders. When we selected BT Redcare we did so because we felt they could delivery on time. The did that, we are very comfortable with the technology we've got and we are comfortable that in the future they will be able to deliver us what we want. BT Redcare is now a critical part of our operation and they have done a good job helping us get there."

VIDEO CLIP PLAYED – relating to the business services provided by BT Enterprises.

"Newco Solicitors, started in 1996, but we communicate with large files, we have to have reliable IT infrastructure and that's what we get. I've outsourced all of my telecoms and my IT to BT. I trust them. I don't just trust them because I've seen some adverts, I trust them based on 10 years of experience. I'm not someone that trusts easily because my livelihood is at stake."

"C**** Resort is 5 star luxury resort based at the gateway of ****. The main factors that contribute towards our choice to move with BT were the cost effectiveness of the services offered, the support offered from BT 24/7, and the reliability of the services ****** BT. The benefits of BT business plan with mobile to C****** Resort is that we can bring together our fixed and mobile costs and we're hoping for savings in the region of 24%."

And if you interested there is absolutely no reason why other football clubs cannot follow Arsenal, even if it's Celtic. You get more about Retail if you would join Ian and team in December when they have a more specific day to talk more about what Retail is going to do.

So let's move on now to Wholesale. I think it's an exciting story. The transformation in Wholesale is very profound because it is now capable of helping other people in the market to have a different level of performance. That's because of the innovation that took place in Wholesale itself. It has great financials, I think this is the first time that we have a quarter of extra revenue over one billion. It grew 7%, EBITDA grew 3%, I think from this chart the most important word to remember is managed services. The capability to take the hassle for other players in the market and let them concentrate on what they do best is a very attractive. A proven performance that you can see now is gaining momentum with other players and I think that if you see the next steps it's all about improved services and improved capabilities.

Now I know that lots of people have said, once LLU is growing, DSL can't grow. Now LLU has reached the status of one million; you could say that is pretty grown up. At the same time DSL is growing. If you look at 21CN it is a world first but it is also reality, today, here. It's not just Cardiff, we have prepared for 21C, in a hundred cities now. We had 75 million trial calls over the network and we're rolling it out, and we roll it out in a way that has advantages not just for BT from a cost perspective, more important, really more important, it has new service capabilities, it gives to customers new differentiating capabilities. It gives new capabilities to be faster in new services, so whether it's a new Ethernet, new IP services, 21CN will transform the way digital services can be brought to the country. If you look to the speed in which its happening, this is a chart that shows you that in four years time there is no digital divide in the UK because this will be nationwide. We've done that with Broadband. Today if you looked at Broadband, we have a 99.97% coverage and of the 5582 exchanges only 35 are not Broadband enabled. This goes even further, this is a total network spread, done in 2011.

Let's talk about Openreach. Openreach is very important because it's so different. I think that the Chairman and myself have been invited to have talks about why we have done Openreach in the first place in many different places in Europe. Other people have asked, what is this? Well the answer is, it is very good, that's the answer. It is very good for the market, I think it's very good for BT and most important it is very good for the end users because it has a very focussed set of regulations that makes the access market a real capability enabler for other players and other services. It has regulated returns and has therefore an enormous focus and it has the capability to allow new developments to take place with a certainty on the access. Access is, as Andy can tell you, one of the most important cost factors for anyone who wants to go to market. Yes we have increased activities and I'll show you that, but we are delivering and we are delivering something that is pretty unique. It is equivalent not just on output but also on input and we are delivering, I think, a service assurance to customers that is very very important.

So let's look to where we are. We had 263 undertakings. Of those 263, 146 are ongoing obligations, behavioural stuff that will never be finished because it is how you have to behave and what you have to do. But there were 117 very concrete deliverables and sometimes it sounds like that people think we are not delivering, well we have delivered, done, tick in the box, 87, most of them much faster than we anticipated, and we are working today on 30. I think we are delivering a very very good and robust system. It is true that you have to go back in the most painful detail of your organisation to make everything equivalent. We have to invest a lot of money to make sure that we have all those equivalent systems and sometimes we have to invest faster and more than we thought. Sometimes we have to invest in not just stuff but also in culture and people. But it takes two sides, and if you see what it means from a service perspective, I just want you to understand a little bit about the dynamic here. Two years ago the activity in this part of BT could be measured by, we call it jumpers, but basically what it means is making connections in an exchange. And we get 17 million of them two years ago, and the workforce was there and we had our patterns and everything was kind of okay. Today we have to do, not 17 million but 27 million activities, and the complexity of the activities has gone up. We have now increased 19% of cases - four different activities under that one umbrella because what we deliver is much more complex than we used to do. And you still have to do that in the same physical surround, we just can't pour in a truck load of more people. So you now have to work 24/7 in order to get the work done, so there is a total shift in work patterns, in skills, in volume and I think Steve is coping with that, and his team, pretty well. And we do it in a very transparent way with the industry.

It is not us designing a process, it is us together with the industry designing the process and it is done in a way that I would say with very good open spirit and cooperation. So this is the volume that they have to deal with, one million life and we expect the local loop unbundling to hit the one and a half million. Very important for us, it will give us more space as you know on the pricing level – one and a half million before the end of our fiscal year. So this will be on track and you'll see what it does for the volumes.

So let me try to summarise. We have a continued momentum in BT. All our four lines of business are delivering and they deliver it on an individual basis where they are focussed on what they need to deliver and they deliver it collectively where there is an opportunity to work together and to gain speed and momentum. We bring it together in a strategy which is focussed on convergence, innovation.

You know this chart, this will be up for a long time, the numbers on it will change, this is the 18th consecutive quarter on EPS and 11th consecutive quarter of revenue growth and 7th consecutive quarter of our improvement of EBITDA. Now what you see is we know how to compete, we know how to compete in the traditional market and in the new market. We are on track to delivering as we promised both on the top line, on the bottom line, on earnings per share and on dividend.

Thank you.

QUESTIONS AND ANSWERS

Chairman – Sir Christopher Bland

Questions? I'll go to the right, the centre and the left. Hanif thinks that Bulls, Don't Knows and Bears, but if you would like to identify yourselves, not under that category. Sir?

Question 1

Thanks. Paul Howard at Cazenove.

Just on the Broadband and markets the last two quarters for the UK market, as a whole annual growth in some net additions has slowed quite sharply, just wondering whether you think that's down to the provisioning issues some of your competitors have had or whether you think there's a slow down in the rate of growth itself. And going forward for your share, I think you're sort of saying you're still targeting around the 25% share of net additions. Given the ramp up in net additions that Sky are talking about, that perhaps Carphone are talking about, do you not think that that's going to fall in the next couple of quarters perhaps before things stabilise?

Ben Verwaayen

I think I'll take the total market and maybe, Ian, you see about the Retail market share. The total market we have now 46% of households in the UK having Broadband and as we said before this is no longer just a service that has to do with your PC and getting the same services faster, it is rapidly expanding into a whole series of new services. Like VoIP, we were nowhere in VoIP half a year ago – 650,000 people now. So I think it is not true that there is a limitation to Broadband as we saw it a couple of years ago, I think there is room for growth because of the new applications that will come in, it will be an integral part for example in BT Vision and other services that we will bring to the market.

Ian

Actually I don't think.. I think the 627,000 extra Broadband customers is a great number and it wasn't that far below same quarter last year, so actually Broadband is still going very strongly Paul to be honest and it's if people are putting it down to problems with provisioning I think probably they should look in their own business, not elsewhere.

Paul Howard – I wasn't blaming you.

Ian

But some others might have done. I'm delighted to say 95% of our customers we provided in five days, not five weeks. We are looking to the highest possible share poll, it's a tough market in question, lots and lots of competition and I think we also reflect solutions in market share in net ads. Of course if we've got big installed base, we've got a market here that you've seen a lot more churn, no question about it, if you've got no installed base then it won't affect you. Whereas what we've done is increased dramatically ourselves, so actually gross ads are up quite considerably, we're going to add in BT Fusion, Wi Fi version will be coming next quarter, we're going to add in BT Vision which will be, before you ask, launched next month and so there's a lot of new services coming that I think will help support and the market has Ben said will bifurcate between I want a dumb pipe and those people that want Broadband to offer services that they can do.

Question 2

Hi Sir, it's Nick Lyall from UBS. Can I just ask two things, could you update us on your thoughts on distributions in Gearing and maybe give us an idea of timing when you might come back and explain your thoughts. And secondly, how long can the retail gross margin keep on improving, could you maybe expand on the strongest margin improvement you've seen yet.

Sir Christopher Bland

First of all distributions, we're on track to deliver our two thirds next year in terms of dividend and that is our declared intention and that's where we'll get. On Gearing, the overall level of Gearing is something that the Board looks at regularly; we need to remind ourselves and indeed you, that we've come along way, early on we were obsessed and, I think quite rightly, with reducing debt. We can still remember when it was £30,000 million. Now we have come along way and plainly our mindset has changed, so we continue to keep that under review and we've got a good record, since March 2003 we've paid out £3 billion in dividends, 0.9 in share buybacks, we've spent about a billion on acquisitions and we've reduced debt by £1.5 billion. So we've done pretty well, that's not to say that our present structure is set in stone and it is worth reminding ourselves that the separate existence of Openreach but within the structure of the BT Group I should emphasize, may give us additional abilities in terms of our debt capacity and indeed the costs of debt and that, along with our total options is something that we continue to keep under review, and that is a significant change compared with a year ago when Openreach didn't exist. Second part of the question, you've forgotten it… Retail margins.

Ian

I think we've done very well on value added services, we are focussed we have seen a big change in what people are buying in Broadband for instance, we've seen them taking up items such as BT digital vault which protects all your music and photographs as well as all your data on line, people really like these services, so we think by focussing on these services, we can increase our margins, we'll keep a very good eye on costs and particularly on botting costs of things which have also helped and I think you put two of them together plus be very aggressive on pricing, I mean these margin improvements have been at a time when they've moved the price of Option 3 down from £15 to currently in the market £7.95 for all your calls, anytime of the day to any fixed line. A real bargain. So we can be very aggressive in the market as well as increasing our margins and that's what we've done and I guess we surprised a number of you with a profit increase. I hope to carry on surprising you.

Question 3

It's Chris Alliott from ABN Amro. One first quick question on Wholesale Broadband pricing. I guess we're about 10 or 11 weeks away from potentially reaching the 1.5 million lines, can you give us an indication on how your thoughts are progressing on how that pricing might change and when you might be able to, be looking to announce those prices, and secondly just picking up again on the retail margin, do you in terms of subscriber acquisition costs, I guess your probably getting more 18 month contracts coming through, I just wonder how you account for those and whether that has any impact on the improvement in gross margin. Thanks.

Paul

The Wholesale pricing, we said we would voluntarily hold prices until we reach 1.5 million, that's clearly going to happen in the next few months. We've virtually agreed a position and we expect to announce the new Wholesale prices next week.

Ian

On subscriber, the acquisition costs, unlike some other companies in the sector, are fully expensed so actually giving people free hubs like that actually hurts our margins … but we think that this helps our long time margins.

Sir Christopher Bland

Looks like we're having an operation review here. Question at this side. No. Sir?

Question 4

Thank you very much, John Clarke at Brewin Dolphin.

Just a little bit of clarification on the dividends situation. Obviously if we reiterate it your guidance to 1.5 times cover next year, but I note that reported earnings per share is to quite considerable effect, influenced by the vagary's of pension fund movements net income, hedge funds and all sorts of funds, I mean it wouldn't be unfair to suggest that reported earnings per share can swing by 5 or 10 percent around those figures that are totally unpredictable to an outsider. Could you give us some guidance on whether the 1.5 times cover relates to what you might call profit if you like, before vagary's of hedge funds, pension funds etc or after.

Sir Christopher Bland

I'll ask Hanif to talk about the vagary's of pension fund, credit and other. We won't give you specific guidance on what the dividend will be next year but I think we will take a fairly robust view of all the factors involved. Hanif.

Hanif Lalani

Well there's two things. What we've said is that we expect the pay out ratio to increase to two thirds by 07/08 and that's against reported earnings, and if you look at the pension accounting, the way the pension accounting works is in a very simple way. At the start of the year though our actuaries and through our auditors we agree the cost of servicing the liabilities, and we agree on the return on investments we're getting. That rate is consistent. For each and every quarter thereafter. So the pension interest credit coming through the interest line, quarter in quarter out is the same number, within the reported earnings.

Response (John Clarke)

Okay if one look at the net interest pay as well, okay but assume your debt's £8 billion for arguments sake, we assume that the gross interest you pay out is £480 million, 6 percent, okay it's back of the envelope stuff I know but okay half that it would be 240 and a half year, your actual charge for the half year I think is 100, so there's about 100 million in there…

Sir Christopher Bland

I think we should take the detail back of the envelope stuff off line with Hanif, if you wouldn't mind, the central point of your question is, is that included or excluded and it's included.

Question 5

Steve Malcolm from Arete

I have two questions, one is on ISP consolidation, I think previously you've been quite reticent but obviously we've seen some moves in the sector in the last few months, have your thoughts changed on that and the ability to gain greater scale through acquisitions? And the next is on Broadband, increasing the speed, I mean you mentioned in the presentation it was 24 meg, can you give us a little bit more colour on your plans, for rolling out max, 2 plus and possibly VDSL one or two year time frame and where you see the average speed settling in the next two or three years, thanks.

Ben Verwaayen

You will not be surprised if I say that we are always looking, you will not be surprised if I say that of course not to any price, we will look to opportunities if they may arise and we will be prudent on that. I think track record to make our decisions and to stick with them and then deliver and that should also be the case in this particular market, so we'll see. And on the speed of broadband.

Paul Reynolds

First thing I'll say speed isn't everything, it's not everything. We have a great 2 meg service across the UK, we have Max with goes up to 8 meg and service providers are progressively moving the customer basis where they take service from BT Wholesale and from Max service, over a million there already and progressing quite rapidly. Service is based on ADSL 2 plus and up to 24 meg, it's going to be much more important with bandwidth, hungry applications coming and Vision and other services like that. We're rolling that with 21C, we expect 24 meg services in the market place from January 2008, already our plans are very well advanced on all that and they are looking right now at VDSL type services but we've no commitments on that because we'll put it in when the customer demand is there to use it.

Question 6

Simon Weeden from Goldman Sachs. One question really relating to your comments about Openreach and the potential cost implications of what you're having to do to upgrade the sort of through flow. You've talked about moving to 24 hour working and increasing the staffing and engineering and I wondered how much of that was present in the numbers we've just seen for the quarter just completed and what sort of cost impact you expect over the next six months or so. Oh and also if you could touch on whether that's going to be capitalised or expensed that would be helpful, or both.

Steve Robertson

Certain part of it will be capitalised, part of it will be capitalised, a large part of it is expensed and they should expect that night time working, 24 hour working to necessarily cost more, a lot of that is done on an agency basis and there's also significant efficiencies in working 24 hours as well, because rather than people coming and going, they go in to the exchange and actually get on with the work and we probably are almost operating at the peak levels that we expect to be operating in, probably a little bit more in terms of mass migration over the next few months but it's basically on target.

Response (Simon Weedon) – We don't know what your target is.

Steve Robertson

That it what the target is, basically our results reflect exactly where we expected it to be. There's going to be some incremental costs and also incremental revenues.

Question 7

Laura Mills from Merrill Lynch

I have a quick question on your EBITDA, and one of the reasons it came down last year was a pretty significant increase in research and development spending I guess, due to a lot of the products launched in retail. Can you comment on how R & D is trending so far this year, if possible, and then one final clarification on the dividend, the two thirds of EPS is very clear, but should we conclude from your comments then that if the EPS gets inflated at the end of the year because of the pension again, you're happy to pay out a dividend that's higher than your free cash flow.

Hanif Lalani

R & D first. On R & D last year we spent on developing new product services, I think when Ben spoke this year he talked about Vision, he talked about Wi Fi handsets, if we're looking at Global space, there's innovation going on there and in Openreach and in Wholesale, so we continue to spend on R & D, and I think for those who are observers of the 20 F and study the 20 F you'll note that year on year R & D costs have gone up. That's been more to do with the fact that how we capture the information and show it than in actual cash terms, so we've continued to invest in R & D in the same rate. In terms of earnings, we've said that we're going to pay dividends out on reported earnings.

Sir Christopher Bland

And we will be robust but not foolish.

Question 8

Jonathan Groocock from Oriel Securities.

Quick question on 21CN. I noticed it goes out to 2011, now does that mean there's 3.1 billion capex envelope will now stretch out towards 2011, whereas some of us might have had it coming down post 2009?

Ben Verwaayen

I don't think there is any change in what we have given you before as a guidance, what it does is, it gives you a good insight when to expect what. I mean some of the rollout is going to, as you can see here, to the major areas and then you have to fill in the other parts. So I would not expect any change on that.

Question 9

Christian Maher from Investec

Just on the debate around Gearing which is probably going to get more momentum I guess, the triennial pension fund review is going to be out by the end of the calendar year, is there any more colour you can give us on that in terms of how the process is going, the possibility of what the crown guarantee may or may not mean as well.

Sir Christopher Bland

Erm, no. That's the problem with coming last. I'll give you a little more colour, that's a bit of a mean answer. The Crown Guarantee is not going to be of significance in its impact on the result, it's a back step , it's very nice to know if you're a member of the pension fund and I think in broad terms all I would say is we expect to reach a conclusion certainly by the end of the calendar year. We also don't expect it to have a material P & L impact.

Question 10

Stephen Howard at HSBC.

If you were to break out the one-off revenues that are related to competition so I'm thinking there are things like ULL connection fees and so on but there may be obviously other items as well, at what roughly to you suppose that is contributing per quarter in terms of revenues at present and perhaps the outlook over the next couple of quarters, and one quick supplementary, I gather it's a later Autumn and BT Vision launches next month, but can we have a bit more detail on how ambitious or aggressive a launch we might expect, we might look forward to.

Hanif Lalani

On one off fees I think it's a very simple thing. If you look at last year we had WLR, the year before that we launched a carrier preselect, we launched lots of other products, they have a connection fee, they have a migration fee, they have cessation fees, so every time you launch a product you're going to get an uptake of that. You also look at the cost space and the cost space also has one off costs opex and capex. We've launched new products in the past, we expect to launch new products in the future, so I can't see that as being material issue, I think that there will be new products and fees will be whatever the fees is. If more customers want to buy LLU they'll be more connection fees, the more PoPs we launch there'll be more connection fees, if they decide to cease there'll be cessation fees, so from my perspective both significant on either direction.

Ian Livingston

We're actually I think we're in mid Autumn at the moment, not in late Autumn, but anyway.. I've become an expert in the seasons. I'll give you detail next month. We are going to be very ambitious and you'll see some wonderful services, we're also going to ramp things up, you know we're not going to put our foot straight on the accelerator, we'll build it up, but you're going to hear some very ambitious plans, I think some very exciting plans.

Question 9

Michele Geraci from Pali International.

When other operators ask about Openreach, what does it do, where does it go, what's bad, what do they ask and what do you answer. Do you persuade them it's a good idea or do you tell them do it as late as you can, or do it only if?

Sir Christopher Bland

What they ask is how did you do such a brilliant thing in the United Kingdom and how can we copy it.

Ben Verwaayen

Most of the time they don't talk about the copying. I think the model as such is in a way a model that you can only arrive at if you have a balance between better regulation, more precise and deregulation on the other side, and in many markets they struggle for both to be honest, so it is probably that debate, how do you trust and verify on one side, and you don't because you can't verify upfront and how do you deliver, that's most of the debate. And I think that over time there will be a European model, that will probably not be the UK model which will be a good thing in a way because then markets can adjust to a kind of generic model but it will be pretty close, but it will take time.

Question 10

David Wright from JP Morgan.

I'm just trying to understand one or two of the revenue trends. In the traditional trends I think rental usage deteriorated quite significantly in Q2 but there was a sort of pop in private circuits which was up 5% and down 2% in the first quarter. Should we expect that to continue? Secondly, on the new wave I think other, was significantly better which I understand was some consolidation of DABs, if we could maybe understand what that contribution was and what the clean revenue, clean revenue ex consolidation affect, growth. Thank you.

Ian

Well DABs is going really well, it was business that was doing a bit more than 100 million when we brought it, it's growing very well, seen double digit growth which in the PC related services market is pretty special, that and very strong double digit growth so it's a success story and one of the reasons it's a success story is we're actually bringing together what we're doing in particularly BT business and increasingly in consumer, so will give them a converged proposition so BT IT Manager provide the PC, provide the accessories from DABs, provide the services from BT and bring it altogether for the customer, so it's growing both in its own right and also the growing converged services. So it's something over one hundred million. 120, 130 when we bought it for the year as a whole, but we've actually grown it significantly since then.

Hanif Lalani

On private circuits what you're seeing is a dynamic of different technologies, for old nets, for mobile operators and everybody else, you can use radio technology to do transmission, you can use private circuits, so what you're seeing is many of the old nets decided which technology they want to go with in terms of further all out or changes in resilience in their network. So that helps us and in terms of rental, it's all about special offers in the market place so I think that's a temporary effect that will reverse out later in the year.

Sir Christopher Bland

We've time for a couple more questions, anyone in the middle.

Question 11

Mike Cansfield from Ovum

It's quite some time since you've given us any feedback on how well Fusion is doing in terms of customer numbers. Can you give us any guidance at all on that?

Ian Livingston

It's slowed down a bit, as you would expect, because we waiting for the handsets. We're running at about 40,000 customers now. We said last quarter we'd hold back on the marketing waiting for the Wi Fi phones and I'm delighted to say they are just round the corner, the Wi Fi phones, and there's some very nice also personal organiser devices Mike, that sometime I'll show you and you can even buy, so when these come we've got a range of products. Then I think that's when we start putting our foot again on the marketing and that's in business, we'll do that next month and in consumer it will be Q4.

Ben Verwaayen

It may be nice to say we have signed our first contract for corporate Fusion, we launched it pretty recently. Leeds City Council and Mediaset in Italy will be the first who signed the contract so it is getting traction.

Sir Christopher Bland

Any other question. And nobody asked me why Postmen live longer, no? No one interested. Thank you all very much.