BT Group Plc
Fourth Quarter Results
14 May 2009

Sir Mike Rake

Good morning everybody and welcome and firstly obviously to give you a bit of time to read something you have read before on our standard disclaimer. It's very clear that the world looks a very different place than it did a year ago and at BT we've had some significant issue to address, including Global Services and the Pension Scheme. These issues have overshadowed the good progress elsewhere in the group but I really believe that with the new management we have in place both at BT Group level and in Global Services we have made progress already in addressing these issues.

Ian will take you through the plans we have in place for Global Services which we believe will position the business for future profitable growth. In relation to the pension fund BT and the Trustees of the Pension Scheme have reached agreement the deficit contributions equivalent to £525 million per year per annum will be made in cash or in specie over the next 3 years. This agreement has been approved by the Pensions Regulator. BT and the Trustees have also reached an advanced stage in the completion of the triennial funding valuation being prepared by the scheme's independent actuary as at 31 December 2008. As the parties are at an advanced stage compared to other scheme valuations and given the uncertain market conditions the Pensions Regulator has indicated it wishes to discuss with the Trustee and BT the underlying assumptions and basis of the valuation. The Pensions Regulator has requested that the valuation and assumptions are not finalised or disclosed in advance of the completion of those discussions. BT the Trustee and the Pension Regulator are keen to complete this as soon as practicable.

In terms of the regulation of our industry, I believe that we have some real progress this year but we still do not have the level playing field that we think is critical to drive both investment and competition. The UK as you know is one of the most competitive telecoms markets in the world. We need a regulatory framework that moves quickly and allows equal access to all both networks and content, in order to prevent new monopolies developing and we will continue to engage with the Regulator, Government and Industry to ensure a level playing field both in the UK and in the European Union.

As you will hear more this morning we are determined that 2009/10 will be our year for delivery. Going forward we will continue to work in making BT a better business so as to ensure we come out of this downturn in the cycle as a stronger and more agile company. Customer service remains at the heart of everything we do and we remain committed to improving the experience for

all our customers both consumer and corporate and to help them meet their own challenges and needs in the current environment.

We are one of the biggest investors in the UK with our investments helping the country keep ahead of the game in offering unrivalled access to our networks. Helping to create a vibrant and competitive market place which is good for our customers and good for the UK. If we are successful in all of this we believe that the company will be well positioned to deliver value for shareholders and an excellent experience for our customers as well as ensuring that the UK is competitive and remains competitive in Broadband.

Reported Group revenues, in terms of the group results of 21.4 billion was up 3% over last year but without the favourable impact from foreign exchange and acquisitions underlying revenue was actually down by 2%. EBITDA before specific items and leaver costs and before the contract and financial review charges we have had to take in a relation to Global Services was down 6% at 5.6 billion as a result of the really unacceptable performance in that business.

This is obviously a huge disappointment given the solid results delivered by the rest of the group which together delivered EBITDA growth of 4% in the quarter ahead of the 3% we had predicted.

Profit before tax on the same basis was down 21% to 2.1 billion giving an earnings per share of 20.3p down 19% and compared with 25p last year. These significant charges in relation to Global Services have resulted in an overall net loss for the year.

Free cash flow for the year out turned at £737 million which is better than anticipated but Tony will take you through the background to this later.

Regards to our final dividend and dividend policy. The progress we have made this year and the agreement on the pension funding for the next 3 years have given the Board the confidence to settle on a dividend policy that will deliver attractive returns for shareholders as well as allowing us to invest, reduce our debt level and support our pension scheme. The final dividend of 1.1p gives a full year dividend of 6.5p which re-bases dividend payments to a level that we are confident is sustainable in the current environment.

The Board is committed to delivering attractive returns for shareholders and believes the operational improvements in the business will allow the dividend to grow whilst meeting our other obligations.

So I would now like to hand you over to Ian and Tony to go through these results in more detail.

Thank you.

Chief Executive Officer - Ian Livingston

Hi, good morning. Before I talk about the results I thought it was important to explain the core of what we are trying to do, and what we are trying to do in BT is first of all to build a better business, and the three elements are the same elements I have talked about before. Our customer service delivery, cost transformation programme and also next generation investments. What I intend to do during the course of today is talk about each of these and how we are progressing on them as well as the results overall. But I truly believe whilst this year has been a difficult, very difficult year that we have made some real progress and we are creating a better business and that business will indeed have a better future.

So that's what I am going to run through today, line of business results, obviously talk in depth about Global Services, explain to you what we are doing on customer service which has a big effect, not just on customer satisfaction but also on our cost base. Give a little bit of update on fibre networks, total labour resource and of course the pension fund.

First of all the line of business results. This is summary of the individual line of business and probably the numbered highlights as Mike said is that the businesses excluding Global Services grew their EBITDA 4%. So if you look over the last three quarters we have averaged around 4% EBITDA growth which is the best set of results for about 5 years and that is in the face of incredible competition but also recessionary head winds. Now a lot of that has been delivered by repositioning the business but also through very significant improvements and efficiency and customer service. As you see in the Retail business the EBITDA margin grew, it was broadly flat in Wholesale up in Openreach overall the EBITDA margins improved. Of course, on the right hand side is issue for us, the performance of Global Services and that is before of course the write-offs we will talk about.

But starting first of all with Retail. The chart on the right shows the rolling EBITDA, fifteen consecutive quarters of EBITDA growth and that is despite revenue being down, and down 3%. I'll talk about through some of the reasons of that, but how can EBITDA grow despite the revenue, the answer is significant improvements in our cost base. Underlying SG&A reduced by 14%. This is a continued performance and one that I think shows what can be done overall in our business and that delivered 19% operating profit growth, probably one of the best sets of results you are going to see in this recession from a division in any company.

Within that in the consumer we are unquestionably seeing line loss due to economic conditions. We said three or four quarters ago, less people taking up new houses, we will see line loss. In addition to that we are also seeing some of our competitors moving more in to lines so in addition to what they do in broadband and calls they are taking lines and that will have an effect on lines being transferred over to them. Against that we are seeing continued take up of higher value packages, up by about 50% year on year in Option 3.

That's not wholly surprising that because actually if you look 3 years ago we charged £15.00 a month for Option 3, Option 3 is 24/7 calls to any fixed line number in the UK. Today that £15.00 a month, £4.95 a month, very very good value and part of actually the reason why you are seeing the cost of telecoms calls fall since 1990 in the UK by over 50%.

Now it's not just we have offered cheaper prices but also now incorporating 0845 and 0870 numbers in that. Many of our competitors are charging up to 10p a minute for that price. We are trying to do other things for customers and it's important that we do re-invest for our customers. So for instance BT Basic. BT Basic is a service for customers who are on certain types of benefit. The charge per month £4.50 per month which is substantially less than the standard line rental. It's appropriate for people who just need the phone pretty much for emergency purposes, over 300,000 customers have moved on to BT Basic. In addition to that we have also, as I said, made 0845 and 0870 free but also calls from mobile 0800 free from BT consumer mobile offering which compares 25/30p for some of our competitors.

We have seen some positive effects, whilst we are losing lines. However Broadband 42% market share. Now this number will bounce around I always say that, I always put that caveat, but 42% is the best result for 5 years and it is amazing what a change of management can do in a business. But I think it shows you value add offerings, what it can do and how you can do things with it and we have kept 34% of the installed base.

On Vision 430,000 customers. I think what's really interesting is quality of the customers, 90% of new customers to Vision are now taking packages. We have seen a dramatic increase in ARPU, we have seen a dramatic increase to usage. We've actually got four times as many uses per day of Vision as we had the same time last year, about 300,000 a day for Vision which is a huge, huge increase and it shows its popularity. Probably many of our customers are spending a lot longer using Vision than using many of the main TV channels.

Overall, putting all that together has meant the consumer ARPU has gone up by 2% and if you look at the chart you see a continued pattern. For those of you with long memories you will remember actually it looked very, very different 3 or 4 years ago where ARPU was continuing to come down and rejoiced when we turned that round and now we have got that pattern of rising ARPU again.

But consumer only represents about half of Retail's business and something we, I think, often forget. What's happening in the other parts of the business. Well I think the SME sector, BT Business has probably seen more than anywhere else, any other part of our business the effects of recession. Because small businesses are deciding to move back into homes, so they are losing people so they need less lines and so we are certainly seeing some effects. That being said we are having some great success - BT One Plan now over 1 million lines of what is actually a really industry leading proposition bringing everything together for your customer, and actually BT Business is

very much becoming the brand for business and we think we have a great opportunity in that sector.

Something I said a couple of quarters ago in relation to Global Services was that the margin on Global Services customers on the small end was about half of what it was on the same sort of customers that were in BT Business. Why? Because actually the BT Business model was more appropriate to service these customers. So we are going to transfer about £200m worth of revenue in to BTB to actually service them. That's going to be better for the customer and I think better for our P&L frankly so we will see about £200m coming over. That will take a while to flow through to re-adjust these customers but I think that's absolutely right long term thing to do.

Enterprises are sort of stand alone businesses, things like phone books and phone boxes and Redcare and also BT Conferencing. BT Conferencing revenue up 98%. Now part of that was due to some acquisitions but even then, organic profit up by two thirds. A global business, in fact the number one in the World for video conferencing services and that the business actually that benefits from both technology and recession because actually people are travelling less so what they do, they need more video conferencing services in particular and we are doing very good business there. So very encouraging.

BT Directories, which we don't often mention, that went from a standing start to number two in the market, overtaking Thomson. Its online business is growing dramatically, it's grown by a factor this year, a really strong growth. But of course the listings business is obviously difficult in today's environment, but a solid number two now.

And Ireland. Ireland - we cover in the Irish part of our business both the North and the Republic. The financial problems in the Republic are well known, yet this business, in fact all parts of BT Retail, increased their EBITDA this year, so - this quarter - so that was an encouraging overall performance. Again through efficiency, serving the customer better.

Moving on to Wholesale. The chart on the right shows the EBITDA decline and it's really the story we said would happen. What we said would happen we would see a flattening off of the revenue position. It's still the same trends, down 2%, it was down 2% the previous quarter, we are still seeing LLU migration, seeing some effect of transit. Against that we have seen it almost doubling in the business managed network services business. It represents, I think, now close to a fifth of Wholesale's business. Profitable business for us and I think it's part of Wholesale's movement, we are no longer the wholesaler because you have to use us. Today, Wholesale is a company that other network operators, mobile and fixed are choosing to use and choosing to take advantage of Wholesale skills and capability and I think the repositioning of Wholesale has been both very necessary but very important.

But also efficiency drive. SG&A down 7%, a consistent theme. EBITDA however has dropped 3%. That is a substantial reduction in the rate of decline from previously as you see it in the chart on the right.

Going in to next year, you will see probably some effect on the revenue from the Mobile Termination Rate reduction, has zero margin effect, good for the rest of our business but it will affect the headline numbers in Wholesale in particular and also we are expecting to lose some transit traffic, very low margin but again it will affect the headline revenue number and that's one of the things affecting that overall group revenue number that we talked about in the outlook.

Openreach. Revenue down 2%, part of that is obviously lower internal revenue but also the other part of it is the graph you see on the right. Lower LLU net adds. Now the reason that has a negative effect at the beginning on revenue is connection fees. When LLU spiked, Openreach revenue spiked, because of connection fees so that's good news in the long term but has some short term effects.

Operating costs down 5%. Really Openreach is trying to accelerate its costs programme and a lot of these improvements are coming from improving the customer service and the right first time initiatives we talk about. To give you one number, we've reduced the number of faults in our network by investing in our network by a third, so on average your access line will go down, you will have a problem once every 13 years and I apologise to those people who are the wrong side of that average. But that once every 13 years, 3 years ago was once every 9 years, in fact 2 years ago was once every 9 years, so a 30% improvement in the position. What's that mean in cost terms, roughly a million less repair jobs being done this year. That's how I mean that customer service improving our service and capabilities can actually reduce cost and that is one of many, many examples and I'll talk about a little bit more later.

That means that EBITDA in Openreach is up. There was a bit of a positive from a rates rebate that was in these numbers, against that it had two months of the big reduction in Ethernet prices which hopefully will come through in volume in later times but that affects the P&L.

Now I've talked about where I think we are doing the right thing and good things. Global Services we are on a journey and I appreciate it is a painful journey. But let's talk about where we have got to so far.

Revenue is up 6%, underlying revenue however is down 5% or 6%, we did have a strong quarter this time last year if you recall. The difference between underlying and total is mainly foreign exchange differences and acquisitions and we are trying to be very, very clear about what the underlying number is.

We are seeing acceleration in cost savings. For instance, whilst we had reduction in our total labour resource of just over 3,000 for the full year, 2,500 of that came in Q4 and again we have made another good strong start to this year.

EBITDA of £43m, that includes an FX, negative FX, of about £19m so the underlying position is a little bit loose and also some negative one-offs. So the underlying position is a little bit stronger than that, but not dramatically so. But the thing I must emphasise before we go on to talk about the write-offs and how we are going to restructure the business, is it does have a strong proposition. Just recently it was awarded the highest ever award from Telemark for customer satisfaction, the highest ever award for any telco. It's doing a good job for our customers, obviously it has to now do a good job for shareholders as well.

Now on that with customers you can see that in this chart, £8bn, £8.1bn of orders in the last 12 months. That compares with £8bn the previous year, that remains a strong order book, pipeline continues to be strong, over £30bn pipeline. However, we are employing very strict financial criteria about the deals we do going forward and as I said last quarter as well, it is taking longer to complete deals so once we had a good Q4, I would expect next year's order book to be somewhat lower because unquestionably people are taking longer to complete deals in today's environment. But some great names, Syngenta for instance, Emirates, you know some really great names that we continue to win and continue to do a good job for.

But of course the results are somewhat overshadowed by the one-off charges. Now two parts to that. First of all the contract and financial review. We've announced a £1.3bn charge in respect of the contract and financial reviews and that basically finishes the exercise. I appreciate that is a bit higher than you would have expected, we talked about some hundreds of millions for each contract and I think it's coming a bit higher than that. But it normally includes two major contracts but also sweeps up the remainder of some of the smaller contracts we are reviewing which had some costs of some tens of millions.

Now a very important thing. These charges mainly represent the write-down of costs we have already incurred, so when we talk about the effect on ongoing cash flow as pretty small that's the reason, we've already spent this money, it's either deferred costs on the balance sheet or it was fixed assets we're writing down, so there's no immediate effect on cash.

Also what we're trying to do is do this conservatively. I can't guarantee there will be no negative movements ever on a contract, ever again but we are trying to do this conservatively and I can absolutely assure you we are targeting our people to do better than we have got in these numbers. But I think it is appropriate that we account conservatively and we deliver aggressively on these items.

In addition to that we've announced for the year a specific restructuring charge of £280m. That's really getting the business in to the right shape and structure so Hanif and the team can take it forward. Again we indicated that we would do this. Slightly different make-up, we are taking a chunk of that charge now and we are going to take the rest of it over the next two years.

That will have a cash impact of our cash impact next year about £260m post tax which is a little bit more than we indicated to you. However, it doesn't affect our overall cash guidance as Tony will talk to you about.

On Global Services what we aim to do. First and most importantly deliver sustainable positive cash flow. This is a business we believe can generate cash, it hasn't done so, it needs to do so and it can do so.

Delivering customer service remains very important, it's something Global Services is good at, it's not perfect at, it's better than its competition it's going to widen that lead. We've got to focus, however, more in Global Services. Global Services unquestionably became too confused about what it was doing, it did it in too many places with too many different types of customers and did too many things. Focus is really important, on key customers, key countries, key activities.

Now we will continue to service our global customers globally but as I'll show later I think we can put some more focus. We can drive significant operational improvements and Tony will talk a lot more about them and I'll mention just a little bit and of course that will drive a significantly lower cost base.

We've done it in the rest of our businesses. As Tony will show we've had a double digit reduction in total costs in the rest of the businesses. We can make very substantial progress in Global Services as well.

So this is a journey we are on. I think 08/09 has been a bit of a fix and focus. Change the management team and we have done that. We've very, very few of the people who started the year as the management team of Global Services are still with us. We've completed the contract and financial reviews, we've started a cost reduction programme, we'll talk about what we have done so far and also we have put in a new contract management process, I'll talk a bit more about that. 09/10 has to be where we start to show it and that's what I mean by delivery, you start to show it, you start to see it in the numbers.

So one of the things we are going to do is we are going to change the structure of Global Services in to sort of three main business units, a bit like we do in Retail having separate business units. A UK Domestic business, an MNC (Multi National Corporation) business and what we call GS Enterprises and I'll talk about each of these. Now this is still all part of Global Services and there is a degree of inter-dependence, inter-relationship but we think this is a much better structure for servicing our customers efficiently.

First of all in the UK Domestic business and we will try and give you some guidance about amounts here. Revenue about £2.5bn in this business, 1,100 customers. Contribution and we talk about contribution here, this is before central costs and before some shared network costs. As you will see the total EBITDA contributions are higher than the overall EBITDA but it's to give you some idea of relative sizing, about £0.4bn for this business.

Two critical parts to this business – it serves, first of all, UK corporate markets, people like Sainsbury's for instance, the big UK national companies, it may have some international business but fundamentally our UK companies; and also the government, and for government we do not just mean network IT services but also we are one of the biggest provider of IT services, business processes outsourcing for instance for local governments. In fact, we are the biggest in the country doing that and that's a profitable and successful business and we will continue to do so.

Multinational Corporations. As you can see that's a bigger size, £3.5bn, it's the Fiats and the Philips, the Unilevers and the Procter and Gambles of this world. 400 customers, £3.5bn, a very different size per customer and obviously within that you have got some very substantial contracts. £0.2bn EBITDA contribution, and what we need to do here is not focus this business by country, that was one of the things I think that was wrong. If you are selling to a multinational corporation on a global basis, doing it country by country by country doesn't really make very much sense. So we are going to focus very much on both servicing and selling to a customer on a global basis. So you will see us focusing our direct sales teams on where these companies are headquartered. We will service them over the 170 countries they need to be in, of course we will because that is what our customers require, but we will focus our efforts, in terms of selling, on the countries in which they are based and we will have a service organisation that reflects the global nature of their business. There was a lot of overlap and lot of inefficiencies in our in-country operations, trying to service these countries, and we will try and remove a lot of that.

Global Service Enterprises. As I said this is a bit like what we did in Retail and the Retail Enterprise business increased its profits over a 2/3 year period from about £120m to £240m so it shows with the right focus what you can do with enterprises, and today it's a decent size business £2.8bn makes an EBITDA contribution of about £0.2bn. Two different types of businesses within this, on one hand there is what I guess you would call an Altnet business, so in places like Italy, Spain, Germany competing and selling to national players in the corporate and to a degree in the SME market and we will continue to do that. Also professional services businesses, particularly in places like Singapore, where we provide professional services with a linkage in to our network. But these businesses we can look at on a stand alone basis, we can look at and judge according to our profitability and delivery and we think we can make the sort of progress by real focus that perhaps it was hidden in the past. We can streamline the organisation and focus people on what counts, the customer service, the cash flow and the profitability.

Now whilst the main issue of Global Services has been cost but I want to remain clear on that. The fact that costs went up in Global Services when they went down the rest of the business explains so much of what has happened, it affects the contracts, affects online profitability. But also we have to ensure and I think give our shareholders confidence about our contract process.

So we set up a new bid response unit that is going to be independent and will have standardised processes that will work around the world. This will basically be the best practice that we do.

Also account start-up. What happens on a contract both financially and also in customer service is very often determined in the first 100 days, how well you do it and this having getting up to a very, very quick start, frankly before you've actually signed the contract, is absolutely critical to the right delivery for your customers. So a new account start-up unit.

Far more standardisation, particularly of solutions, and this is one of the important things about saying we are going to concentrate and focus sector by sector, rather than country by country. One financial services company actually often requires very similar solutions, low latency for instance, that another does. If you are a major consumer goods company operating around the world, you have many of the same issues, and we can provide you with configured solutions rather than customising everything from new. It's better for you as a customer because it's less risky, it's better for you as the customer because it's going to be cheaper and quicker and it's better for us as a company and us as shareholders because it will be cheaper and more profitable.

We are also going to have more stringent financial targets, particularly focussed on the right things. Focussing on the EBITDA margin has been a problem, focussing on cash, risk, return of capital that's the important things. The dividend is paid out in cash, shareholders judge us ultimately on the return that we can make.

So we are going to be faster and more efficient because of having these standardised and taking best practice we will be better in what we do for our customers and how we service them. Also importantly we will have an ongoing, more intensive ongoing, review process that will particularly involve Tony but also external assistance every so often taken sample contracts and looking at it. I think it's important to have confidence in that ongoing process.

All of that means, I think, that particularly with better costs, that we can deliver much better returns and improve customer service from our contracts.

On the subject of customer service. It is a critical part of what we need to do to cut our costs and I can't stress that enough. To give you some ideas, we have seen a major reduction for instance in some of the problems we have had in our Retail business and we have got a lot to go and we know in all of our businesses we still have a lot to go, so a lot to aim for. But that's meant that abandoned calls are down by three quarters, so the times that customers can't get through is down by three quarters. At the end of March it was about 3% abandoned call rate, may be even 2% but now that means that 97/98% of calls are being answered. Why are we able to do that, well the key reason we are able to do that despite actually our Customer Service costs coming down 19% is that less people need to call us because there is less repairs to do, we are doing them better, first time, bills are getting clearer etc, etc. So it is

driving a big reduction in costs and you can see that in complaints, complaints are down by a third. Again we can do a lot better, we will do a lot better.

In SME sector, I am just taking a few examples and things, bill enquiries down a half, really important. Again customer dissatisfaction costs for us. Failure is a big cost in a telco, reduce failure, improve customer satisfaction, reduce costs.

Corporates. Time taken to provide new MPLS, the sort of core of what we do in the big corporates, reduced by 43%. That means we can service the customers better, potentially win new business, much slicker processes, again we can do better still.

Networks. I mentioned earlier, access line faults have been reduced by a third over the last 2 years. But also the average time to repair a fault has halved over the last 3 years. We have today about 8,000/9,000 outstanding jobs and that sounds like a lot. It does until you realise we do 14,000 repair jobs a day and you get a sense of how we are improving it. So most customers would expect and will have in fact the fault repaired either same day or next day. Not everyone, occasionally we have to close roads and we make mistakes, but that is a major improvement.

So we are going to carry on doing that. Next year we are going to take from this improvement, I think we have had last year, probably the biggest improvement in customer service that we have had, but we know we have got quite a distance to go and that's a great opportunity for us both on the cost and also customer's point of view.

Fibre networks. Remember the plan, 10m households by 2012. Not all of it will be fibre to the cabinets, some will be fibre to premise but just remember what fibre to the cabinet does, 40Mb per second, actually in our labs today we are already doing 50/60Mb per second.

Put in context, one high definition TV stream takes about 7Mb per second, so not everyone will get 40Mb per second but it gives you a sense of degree of space. But critically and something often forgotten, upstream the other way 15Mb per second, up to 15Mb per second. More and more uses of Broadband are going to be more synchronous, ie the customer is going to be sending things back.

So for instance video conferencing. Small businesses or in fact people like yourself wanting to upload reports from home. I know these are many Mbs some of your reports. You do really want very fast uplink speeds and there has been a tendency to focus just on downlink but that 15Mb per second is an absolute multiple of what the cable networks are talking about. So it's important to look both ways.

Also within the £2.7bn capital expenditure we have talked about are looking to accelerate the fibre roll out this year. We expect to do something over 500,000 customers, make available to 500,000 customers this year, we are

going to more than double that, that's the intention, we can do that within our target.

Also fibre to premise is actually going very well, close to 100Mb people are getting. Worth also remembering we have got 130,000 businesses that are using fibre as well and they go up to 10Gb per second. So it's really not just the consumer question it's also business question, but a lot of businesses are already fibre based businesses.

Critical part of costs and Tony will talk in more detail about costs as labour resource. Most companies tend to talk about direct employees. As you know what can sometimes happen with direct employees is people announce there is going to be a head count freeze, a head count reduction, phraseology they use and so permanent people leave. What happens on the Monday, contractors come round the side door, cost reduction probably negative and I think some of you may have even seen that in your companies.

I am being very clear, we have to focus on total labour resource for two reasons. Reason number one is actually the cost is determined by total labour resource. But reason number two is, I believe it is very important where we can to protect the jobs of our permanent employees, if we can, and therefore to focus on redeployment and re-training, reduce the number of third parties working for us, for temporary employees, for contractors, and that is what we have tried to do. So of the 15,000 reduction in total labour resource, 5,000 of them were permanent. To put in context, actually we have over 5,000 people leaving us through retirement or other a year anyway. Of course, we also recruit people and have some other things but what we are trying to do, we are trying to re-train and redeploy people, whether it be for modern apprenticeships, whether it be to work in call centres, whether it be to take up new skills and you know, I have certainly seen examples of people who for instance who are network experts working in HR, or people who were engineers actually taking repair calls, and it's great because they have got the real knowledge of what's going on. So we are absolutely trying to redeploy and re-train our people where we can.

It's also an important part of that is flexibility and attendance patterns. For instance one of the reasons we have people working offshore for us, not the only reason, but one of the reasons is because customers not unreasonably want to call us in the evening and actually shift patterns were very difficult to match with what customers wanted. We are working very closely with the Unions and I would say they are doing the best for their people to try and get the right answer here, to try and see how can we move our shift patterns to actually have more people in the UK working in the evenings. But also we are doing things such as what we call home shoring. So we have got about 150 people who we have got today working from home, but able to work far more flexible hours but to take calls on a more of an as needed basis. It's people who don't want to come in to call centres every day, it's people who actually don't want to work full time. Good for them, far more flexible for us, makes sense all round. But also we recognise, we are a 24/7 business, so

attendance patterns and flexibility have to reflect that as part of the customer service, people want engineers on a Saturday, not unreasonably.

Also, we announced that in 09/10 we will also have a zero pay award. Inflation is declining, inflation is negative, RPI is negative, we think that's the right thing to do within that context.

Pension fund. First of all on the funding. As Mike said, the Trustees and the Company and the Pensions Regulator have all agreed for each of the next 3 years deficit contributions of £525m, that's before tax relief, and that basically takes us from now to the next expected triennial.

On valuation, again as Mike said and I don't really think there is much point repeating, we are in advanced stage of all of this but we are way in advance of where we were last triennial, about six months advanced and also way in advance of pretty much any other major scheme in doing this and the Regulator has said they want to take some time to have a look at this in that context and most have agreed to cash payments that they do want to have a look at the basis of assumptions and that's something we will work together with the Trustees over the forthcoming months.

IAS19, your and my favourite accounting standard. Deficit pre tax of £4bn, post tax £2.9bn. As you see from the chart on the right it does bounce around somewhat. Also, however, and something I want to draw your attention to and we have got in the release, there has been in previous years an interest credit related to IAS19, now I know a number of you add that back on the basis you said it wasn't real money and it wasn't cash, and it's not cash. But because of the fallen asset values, that credit becomes a debit so it goes from a positive £313m to minus £275m, that obviously has an effect on our reported EPS but has no effect on our cash.

So I talked today about starting by building a better company, building a better business. Hopefully I have shown you we are making serious progress in customer service delivery, we are making serious progress in cost transformation, double digits outside GS and we have talked about over £1bn, well over a £1bn of cost savings next year. We are doing that whilst we are continuing to invest in the future of the business.

Now by building that better base we believe we can have a better future. Today is not going to be the day to talk about it, but we are very optimistic with a good base, we can turnaround Global Services. Also in the SME sector we really can be and are becoming the brand for business and that is a big opportunity for us.

We can drive broadband-based services for the customer, particularly we think TV. You've heard about Canvas, we think that's a big opportunity and I think we are really impressed the way people are wanting to use interactive service and on-demand services on TV and we are just at the start of that sort of revolution.

We are becoming the wholesaler of choice and wholesale is a business that we think is a good business to do and it's an important business and it's a difficult business to do if you are not set up to do it. You can't sort of be an amateur wholesaler, we are not, we are a very professional wholesaler and a very good wholesaler and that presents real opportunities.

Also we recognise we are not the only network in town, whether that be mobile, whether that be cable, whether it be some competing networks. So we want to be the best network provider particularly through Openreach, particularly through our access network and what we can do, but it's not just about the network itself, it's about the service that goes around that and delivery. With all of those things we believe we can build on being a good company and a better business, having a better future, and critically we believe that actions we have taken will allow us to emerge stronger from this recession and with that I will pass you to Tony.

Group Finance Director - Tony Chanmugam

Thanks Ian. Morning. Judging by the front seat news of my cold and trip to Mexico seems to have spread, and you think I am joking.

I am going to run you through the headline numbers on the P&L, the cash flow, touch on liquidity and then spend some time talking about our cost reduction plans. The cost reduction plans are key, absolutely key to what we are doing.

So to start. Revenue for the quarter was £5,473m that's up 1% but due to acquisitions, FX and contract review adjustments the underlying revenue was down 5%. This compares with a top line growth of 3% last quarter and an underlying decline of 1%. This slight acceleration in the decline is primarily due to the continuation of historic trends and economic assumptions. The impact of £41m of revenue reduction which related to the contract review adjustments that Ian talked about before and a more selective approach to the Global Services business that we are undertaking. You know we are not going to be chasing revenues, we are going to be chasing margins, we are going to be chasing cash, it will have an impact on revenue, I'll talk a little bit more about that when we go through later on.

Revenue for the full year £21.4bn that's up 3% but on an underlying basis and the same basis I talked about earlier it's down by 2%. Next year I'd expect the revenue to be down by 4-5% and a key element on that will be a continuation in some of the low margin revenue reductions that we are seeing. Roughly speaking 2 points of that 4 to 5 will be straight flow throughs. So if you look at it in terms of the higher margin revenue streams the reduction will be round about 2-3% and it's important to get that split and it's important when we talk about cost savings.

EBITDA before specific items, leavers and contract and financial review charges was £1,354m for the quarter, this is down 14% and primarily it's down to the unacceptable position within the Global Services business. As Ian

indicated earlier the rest of the business has performed really well with growth in both BT Retail and Openreach while in BT Wholesale the rate of the year on year EBITDA decline continued to slow.

Last quarter I guided to 3% growth in these areas, we have actually delivered 4%. Depreciation for the quarter was £791m up 5%, this reflected the impact of the high value assets being bought for use in to the second half of the year. This gives 2,890 for the full year and it's flat year on year. In terms of the guidance for next year I'll expect the depreciation number to very much remain around this year's level.

Operating profit was down 31% in the quarter. On a leavers cost perspective at £61m for the quarter it was up 11%, this gives £204m for the full year which is up 61%. This charge reflects the cost of the direct labour reductions that have been achieved this year and effectively gives us a kick start in to next year because we have spent more at the later part of this year and you will see that manifesting itself in TLC reductions next year.

We expect leaver costs to be around £200m in 2010 but a key point is we will get more traction from this expenditure as we will continue with the actions we undertook this quarter in materially reducing the number of staff we recruit and you know that's a key point on that, Ian talked about protecting the staff that we have, our existing employees, the rate of reduction in terms of permanent staff recruitment from a couple of hundred was just over a few hundred was what we did in Q4 and it was five times that level in the first 9 months. Therefore in terms of bang for buck we will get a much bigger bang moving forward in terms of leaver costs.

Finance costs next year increased in Q4 to £151m, this brings the full year figure to £620m which is up 64%. This increase reflects in large part the decrease in the pension finance interest credit from £420m to £313m together with a higher average net debt.

As Ian mentioned we expect the pension adjustment and net finance costs in 2009/10 will be £275m. From next quarter we will now be showing EPS both before and after the effect of the Pension interest charge.

Profit before tax as you can see was £367m for the quarter, down 44%, for the full year it was £1,877m which is down 25%.

Specific items totalling £343m were charged to the quarter of which £280m relates to the restructure in Global Services as Ian mentioned. Specific items also include the £13m loss on the disposal of a business and £50m relating to asset impairment following the Group's review of its 21CN programme and associated voice strategy.

As Ian highlighted there will be a £420m specific item charge in relation to GS, they will be spread over the next 2 years, largely be incurred next year and largely related to leaver type costs.

As already explained by Ian, contract and financial review charges are £1.3bn in Q4, taking the total to £1.6bn for the year. These are obviously very large charges but are necessary to reflect the more conservative view of costs to complete, changes in the economic climate, and changes within the customer's own business environment. It's important to know, Ian highlighted it and let me re-emphasise it, we are accounting conservatively, we are not kitchen sinking but we are accounting conservatively and we are aiming to deliver aggressively.

Tax is a credit of £303m for the quarter, this reflects the tax effect on the contract and financial review charges of £1.3bn. The effective tax rate on the profit before specific items was 22.8%, the credit for the full year is £53m compared to the charge of £238m in 2008. We expect the tax rate to be around 25% in 2010 and trending towards a statutory rate after this.

As a result of the restructuring charges there was a loss of £976m in the quarter and a loss for the full year of £81m. The reported EPS is a negative 12.6p for the quarter and a negative 1.1p for the full year compared to 21.5p for last year.

Let me turn to free cash flow. Ian made the point this business is going to be measured on the basis of cash, it's the key criteria we are asking you to measure us, it's the key criteria we are using ourselves to measure our performance.

Free cash flow in the quarter was £1,134m, £571m worse than 2008. Full year free cash flow was £737, this is better than we had anticipated and better than the guidance I had given last quarter, due to the early receipt of £100m from a customer and improvements we have made in debtor collection. Now these improvements will continue and the focus on cash will continue. As I have said I am trying to even out the cash profile of the Group over the year and also aiming to give greater transparency. Consequently from next financial we will give you free cash flow by line of business from Q1.

Free cash flow is made up as follows. On interest the charge was £202m for the quarter, this increase primarily reflects that at the higher level of net debt. The interest was £937m for the for the full year and it's up 28%. We expect the cash interest to be in the region of £1bn in 2010.

Tax paid was £115m in the quarter, £228m paid for the full year compared with a receipt of £299m in 2008.

Due to the impact of the GS contract reviews and restructuring cash tax payments are likely to be minimal next year and that's a key point in understanding the cash flow guidance moving forward.

On Capex there was a net cash outflow of £701m in the quarter and £3,038m in the full year. Over £200m down on 2008. This is primarily due to a reduction in expenditure on exchange equipment and reduced provisioning

volumes in Openreach caused by a low level of house moves and lower LLU volumes.

Due to the improvement in the controls across the Group and the way we procure and the effectiveness and efficiency of the activities we undertake capital expenditure will reduce to £2.7bn in 2010. I'll talk you through the detail of how we do that later on.

On working capital there was an £847m decrease in quarter compared with a decrease in Q4 last year of £1,195m. Although you will recall I indicated last quarter that some £300m of cash flow benefits have been pulled forward into the Q4 last year, helps to explain the movement and the variance. There was a £462m increase full year.

Net debt of £10,361m reduced in the quarter by almost £700m and we expect to continue to reduce net debt on an annualised basis. The sort of indications are that we will be below the £10bn within two financial years.

Net debt of £10.4bn a year represents a £900m year on year increase. This has been caused by a lower free cash flow and the payments for the share buy back in Q1.

Total debt and committed facilities of £13.2bn provide us with a strong liquidity in funding position. We have sufficient funding in place to Q4 2010 /11, that's quite a key point. As I said on the previous slide, it is our intention to reduce net debt over time.

Let me now turn to costs. This is a key set of numbers, it's a key figure. For the first time in I don't know how many quarters, I don't know in how many years, BT's Q4 costs have reduced by 3%, that's after taking in to account the impact of FX and acquisition but the costs have actually reduced and you know, we are focusing now, Ian's focusing now there's a transparency about net costs, not about gross costs and cost rationalisations, costs re-investments it's absolute cost reductions and there's a 3% reduction year on year in Q4. You know that manifests itself in many different things. For example if you looked at our total labour cost in Q4, you will see, and it's in the published results there, you will see there is a 5% reduction. So we have reduced our TLC costs by 5% in Q4. you compare that with the first 9 months and there was an increase of 4%, that's a material switch and it will continue and it will increase.

Let's look at the cost base, excluding GS and including GS. So if I look at the position excluding GS what we have in here is a 12% reduction in the cost base. That's Q4 last year to Q4 this year is down by 12%. Now it's slightly flattered because of one-off benefits in the quarter excluding one-offs, FX and acquisitions a reductions come to 10%. But effectively if you compare that to last quarter we've accelerated the impact of the cost reductions and it means that we move from 7% which is where we were last quarter year on year reductions to 10% now. We are moving in the right direction.

Some examples, how has that happened. Last time round I talked to you about end to end testing, this is basically testing of the software development undertaken by the Design business, undertaken by the Operate business and also within the lines of business.

As a result of what the teams have done I talked to you about how we'd started through that in Q3, we've got a spend materially in excess of £100m, that has more than halved. Now we don't have a lot of silver bullets like that to fire but there are silver bullets like that and they can make a substantial difference, they have made a substantial difference.

Another example within each of the lines of business we have best practice. Each of the lines of business do things that work. What we haven't been smart enough in doing is transporting what works in one line of business to another line of business. We are doing that now. So for example within the call centre environment we've translated some of the good practices in one area to another area. We looked at one particular environment within the call centre business, there were roughly speaking a 1,000 people in that environment, we've taken out 200 people as a result of that. It's all about replicating what we do and it's not one opportunity, there are a number of opportunities.

If you look at the cost base for GS. Now the situation here is the cost base has risen Q4 to Q4, it's moved upwards by 6%. The rate of increase has declined. Last time round we were talking about between 10% and 11% increase. That increase is now down to 6%. If I looked at that to see, well what's the trend, in Q3 last year, Q3 this year to Q4, you'll see that after taking into account the one-offs and the adjustments there is a slight movement downwards and the reason why it's only a slight movement downward is because it takes time for the activity to manifest itself.

Now let me just sort of talk you through the sorts of things that we are doing in this area. The first piece is Ian talked about and the actions that Hanif and his team have identified and started to deliver. We took out 2,500 people in Q4, the impact of that will start to be seen during this financial year.

You are looking at simple line and contractor rates. As a business whether it was within GS or in another line of business we didn't until very recently have detailed databases relating to all the agency staff that we have got. We had those databases and you may look quizzical at me, as one or two of you are, I would suggest that a lot of companies don't actually have that level of control. We have detailed databases for every single agency person, what sort of rates they are on and does it demonstrate value for money or not. The net impact of what Hanif and team have done within Global Services is use that data and for over 800 contractors they have reduced the average cost by circa 14%. Those costs and those reductions manifest itself from 1 May, it will start to flow through in the course of next quarter.

We have looked at the supplier spend within the GS area, roughly speaking addressed about half a billion of spend, come up with savings of 12%. I'll talk a little bit more about what we are doing in suppliers in a second.

We've also focussed in terms of discretionary spend, 9 key areas including travel expenses, consultancy and conferences and the savings that have been delivered have been round about 30% between Q3 and Q4.

Overall when I look at this moving forward in terms of next year we expect total GS costs to reduce by roughly speaking over a third of the total BT reduction and I'll come in to what our total reduction is going to be in a second.

Ok, let me explain that. What this graph shows is in the middle section shows the percentage reduction in green that we together in the total BT have reduced. In other words we reduced our costs by round about 3% in Q4. Q1 to Q3 you will see it was for all intense and purposes flat.

If we are going to hit our targets for next year and what I am looking for is cost reductions well in excess of a £1bn and I will go through that in a second. We have to get to somewhere around 5-6% reductions in our absolute cost base. In terms of where we are on that journey you will see that in Q4 we have started to make the progress. We started to move to the number we need to move to. It's more than green shoots, you know the fundamental shift in the business has started.

In terms of the Capex and what we need to do the key point here is that we were at £3.3bn, we moved to £3.1bn for this year and we are looking to reduce to £2.7bn. It's vitally important that in terms of the capital expenditure that we get to, that we get to that £2.7bn. Well, how are we going to do it, how are we going to reduce the Capex.

The key areas of reduction are going to be in terms of what we do and how we procure it. As I said earlier round about £600m or so of the Capex is down to our own activities and we can change the way that we undertake the processes for our own activities. We can reduce the unit costs of doing that, it will manifest itself in terms of lower costs. If you also then say, you've improved the processes, you've improved the procurement we are going to ensure that we invest on the basis of where we get financial returns. It means that some of the capital expenditure that we have incurred in the past, those sorts of programmes will not be undertaken. We will improve the timing of our capital, so the Capex is only invested in relation to customer demands. The timing will be that the capital investment and the pay backs will be much shorter and we will do all of this, without changing any of our strategic goals. Ian talked about how the fact on super fast Broadband we are actually doubling what we said we were going to do.

So you know, we are going to take money out of our Capex but we are not going to stop doing any of the things that we said that we were going to do strategically. It's all about doing things more effectively and more efficiently.

Let me explain the total cost reductions. Overall cost reductions we are talking about are well in excess of £1bn, and two splits associated with that.

First split is Capex to current, on the Capex spend we are talking about roughly speaking a third and two thirds on P&L type expenditure. If you then look and say well, give me another split, because they key component part is how will we get to that number, why will be get to over £1bn.

The first component part is revenue related. I talked about a reduction in low margin, transit, mobile termination type revenues. Those low margin fall through of revenues will have an impact in terms of the costs because the margins are low, roughly speaking just over a third of that cost reduction will come from the simple flow through of revenue reductions.

The other two thirds will manifest itself from what we are doing in terms of TLC and labour costs, and I have talked to you a bit about that and how we are on the right road now, and what we are going to do in relation to the supplier base.

If you talk about the supplier base and just talk about the activities we have undertaken so far, I'll give you one programme. We've got a programme which is based on our top 40 suppliers. You know the way we have handled our suppliers hasn't been as smart as it should be, each of the lines of business have conducted negotiations with the suppliers so we are in a position whereby we've got separate contracts with different durations for effectively the same type of service. It's manifested itself on the basis that actually some suppliers charge different rates to different lines of business for the same service, we are fixing that.

Over the last 10 days I personally have met with 5 suppliers, total spend worth of £1bn, a lot of the people around in this room are doing the same thing. We'll get it in to a situation whereby we have single supplier deals, with single rates at economic levels which are materially lower than what we are doing at the moment, and give you an example on facilities management, basically for the cost of upkeep of our building portfolio. We've taken out double digit savings for this year, we'll take out a further double digit for next year the contract is signed, the spend is over a £100m so it gives you a flavour for what's been done and what will continue to be done.

I'm very comfortable, by nature I am conservative, Ian told you that last time, I am very comfortable that we can do what I say we are going to do on our cost base.

So, let's look at next year and the outlook. Let me just sum up some of the things I have talked about.

I would expect our revenue to reduce by 4-5%. Key point to remember though is, 2 points of that relate to the flow through of simple low margin revenues.

I would expect cost savings well in excess of £1bn, around a third of which will be Capex. I would expect and to re-confirm our Capex spend to be no more than £2.7bn.

I would expect free cash flow, excluding the pension fund payments and including specific items to be in excess of £1bn in 2009/10 and beyond. This underpins our dividend policy, this underpins our commitment to reduce the level of net debt. 2009 will enable us to emerge much stronger from the recession.

I'd just like to leave you with one thought, 2008/09 has been a tough year, it's been a year of change. 2009/10 as Ian has said will absolutely be a year of delivery.

Thank you.

Ian Livingston

I'm sorry this is a bit longer than normal, as always we are delighted to take questions if you could say name and company you are from and we will start over there and if you could give the microphone to somebody over there as well.

QUESTIONS AND ANSWERS

Question 1

Mike Williams – Citigroup

Just a couple of questions, firstly I'm interested to know how you arrived at the £525m annual deficit payments and specifically whether that is a clean number or includes any component of tax optimisation relative to the estimate of the underlying run rate. Secondly I just wondered whether you could update us on where we are on the Openreach financial framework which seems to have gone quite recently and specifically whether you have gained any traction with your arguments regarding the allowability of pension deficits in the ROC calculation, thank you very much.

Ian Livingston

Yes £525m, yes that's a clean number what we have said in the document is in cash or in specie, so it is possible that there could be a small element of which we could provide assets rather than cash, but I would work for the moment as cash and we'll update you if there's an element of it that's otherwise. In terms of the FFR, yes it does seem to be one of these things that I say is coming shortly, it's coming shortly. Have we got traction on the pension? - we'll see. I think they may even consider the pension issue as a separate issue to the FFR when they actually publish the FFR, but I don't think, I finally can say it, I don't think it's that many weeks away but I've been

surprised before about timing and yes we will be very vigorous on the issue that you can't have a network and you can't have the people without the pension that goes with it.

Question 2

Darren Ward – Liberum Capital

It's a question, the difficult year you have described has basically wiped out the shareholders funds and I'm interested in the dividend implications of that – can you pay a dividend if that number were to go negative, do you think it could go negative?

Ian Livingston

We've got in BT Group plc Topco we have £10bn roughly distributable in reserves which should keep us going for a year or two so we are in pretty good shape.

Question 3

Nick Lyall – UBS

Can I just ask on dividend sustainability please, you have got about £1bn of cash flow or over, so a £1bn of cash flows but no cash tax this year, fair enough cash charges for the provisions and others but if we add in let's say £350m pension £500m for the dividend there is not a lot falling at the bottom for debt reduction at all, let's say around £100m. Why is the dividend considered sustainable and why are you talking about debt pay down on such a small amount if that dividend is sustainable. Secondly also on future risks, it seems like Sky with your current product in Retail it seems like Sky can just turn off, line gains, voice line gains on and off pretty much as it pleases, could you mention how you might try and fight back versus voice line gains by Sky.

Ian Livingston

I'll ask Gavin in a second to talk about Sky and Mike can say something about dividends but Nick I think it all depends where you start some of your numbers. We said over a £1bn of free cash flow, you have then got the pension payment and we think it's certainly, I'm not going to tell you how many hundreds of millions I think it delivers in net debt reduction because that rather informs you, given you know the other numbers, as to what the reduction debt is going be, bear in mind next year the dividend that we will pay will be the 1.1p we have announced plus the interim for next year so there will be a big reduction there, so it's not that the dividend announced will be the cash dividend, and then going forward, apart from some of the things we are doing in the business and the flow through of that, obviously we have got lower specific charges going through as well, but Mike do you want to say something about sustainability.

Mike Rake

I think it's a good question, because I think the board has been very concerned for several months now to make sure before we decided on the dividend we had a very clear idea from management on sustainable profit and sustainable cash flow and we dealt with and understood the pension fund deficit payments, we'd understood the problem with debt, the bottom of the problem hopefully on Global Services and understanding that we believe that when we talk about £1bn of cash flow that's a minimum. I think also we believe very strongly and I believe very strongly that the debt level is too high in the current environment, notwithstanding that we are well covered until 2010/2011 and we believe it is very important to make a start in principle on debt reduction, so the amount we will achieve remains to be seen but we are determined to see the beginnings of debt reduction during the current financial year and we hope to see that accelerate as we get the operational efficiencies, we get the profitability we think we can get in cash flow on Global Services, get Capex under control and really manage the cash flow as Tony was talking about, so I think it's a beginning that we need to accelerate.

Gavin Patterson

And fighting back against Sky I would probably call out three things. I think on regulation you'll see us take advantage of the deregulation in the narrowband markets this year which means we will be able to offer more compelling bundles for our customers and that is where we have been weak in particular recently against Sky, so stronger, better value. I think on TV you will see us continuing to strengthen our service there. We see Canvas as a big opportunity to fight back against pay TV in general, both Sky and Virgin by providing a fabulous free to air plus on-demand service using the power of BT, the BBC and ITV and that will come out next spring and on top of that taking advantage of fibre. I think we can push that even further if we get access on a level playing field to Sky's bottlenecks when it comes to premium sport and premium movies and we continue to be optimistic that we will get that. I think in terms of currently we have demonstrated with the 42% market share this quarter in Broadband that we have got a very compelling Broadband offer that is demonstrated that we have got almost 100,000 net adds in Broadband alone this quarter versus 130,000 for Sky I think, that we have actually got a compelling Broadband service today that people are choosing as well.

<u>Question 4</u>

Maurice Patrick – JP Morgan

Question on Global Services, you've given long term margin targets in the past you made write downs throughout this last year, you've had a look at the cost base, you're addressing that. When do you think you will be in a position to indicate longer term cash flow, EBITDA margin targets for Global Services or perhaps give some colour on that and just one more question. You haven't

given an EBITDA guidance for this year, is there a reason for that or perhaps help us get there. Thanks.

Ian Livingston

Well we don't want to do all your job for you obviously; we've given you cash flow which I think is the real focus on it. We've given you revenue and we've given you cost, I think probably you can have a fair shot at that. On cash flow, on GS I doubt I'm in a rush to give EBITDA targets again for GS, I think that's been one of our problems in the past. Cash flow targets: to give you some sense that we, if you looked over the last three years on average GS had their cash outflow of about £300m, last year it was worse than that, bearing in mind we had that 300 movement and also trading was worse, but I think we can get and we think we can get to well under the £300m in average, so we are not aiming to get cash positive next year but we will make a decent stride on the way. Tony anything to add?

Tony Chanmugam

Just a couple of things the first piece is you do not measure a Global Services business on the base of EBITDA it is not the right measure, it's cash and it's risk and what we have said before, I think you have just got to ignore that and moving forward cash flow is the key criteria and that's what we will look at. In terms of the cost base rationalisation what I said was well over a third of the savings which are well in excess of a £1bn will come from the Global Services business and that will show you the level of flip that we are going to make on that business through what Hanif is doing.

<u>Question 5</u>

Nick Delfas – Morgan Stanley

On that subject of EBITDA, we were expecting some cash tax of about 150, Capex about 200 higher, so that would be about 350 that you are going to be better, but you haven't changed your cash flow guidance, does that mean that we should think that EBITDA will be down around £300m year on year and secondly could you just talk a little bit more about the strategy of the company when obviously now that we have moved beyond the kind of obsession about revenue growth and growing the business, you appear to be quite comfortable with the idea of the company as a shrinking top-line. Is that something that you are comfortable with or would you make acquisitions to change the orientation of the company either domestically or internationally.

Ian Livingston

Right, on EBITDA going down, no you shouldn't, we have also of course got a higher specific charge going through and bear in mind we said over a £1bn, over £1bn is not a billion and one, I think we might have said around a £1bn of free cash flow. Our aim was not to guide EBITDA lower, our aim was to actually give you a good underpinning and I think greater confidence in the

cash out turn for next year. So hopefully you've got that and shrinking company, I don't think we alone in talking next year about revenues being down, we are in a bit of a recession, we also have the effect of, which is a good effect in many other ways, of MTR rates and that will have an effect because we transit lock the traffic and transit revenues generally will be down. We do have a number of areas of growth in the future but buying things to increase the top line, it's one of the reasons we have actually concentrated on talking about revenue excluding acquisitions and hopefully you have seen we have been very, very open about that, it would have been easy to say actually we have grown the company this year and we have actually really concentrated and excluding acquisitions and FX and that's what we intend to carry on doing and look at the underlying growth and organic growth of the business and at the last slide I gave, I think, indicated some of the places we could do that. But next year, next year we will all be clear that there will be some revenue challenges but we don't think that we are without opportunities for growth going forward.

Nick Delfas – Morgan Stanley

Can I just ask one follow up on the Global Services, you said you reduced the cash out and then in addition there is the cash out for restructuring and that's the right way to look at it.

Ian Livingston

Yes

Nick Delfas – Morgan Stanley

Okay fine, thanks very much.

<u>Question 6</u>

Steve Malcolm – Arete

A couple of things, first of all on capital expenditure and just sort of the implication is that there has been an element of inefficient spending, dare I say reckless. Can you sort of put a bit of colour on where the money has been spent badly and also can you update us on 21C and what today's announcements mean for 21C going forward, in particular the migration of voice to IP over time.   Just to go back on the dividend…

Ian Livingston

I think that sounds like three Steve, that sounds like three questions. Two will do. I'll ask Tony to talk about the Capex and no we would not say reckless. In terms of 21C, frankly, 21C is actually going really well, we are actually delivering, we are ahead of what we said we'd do on Ethernet and we have delivered what we said we'd do on Wholesale Broadband Connect, the core networks complete, the cloud-based services we are doing are going forward

at a good rate and the reason we didn't talk about it today, it was an hour and a bit long, and we just cut it from the slides, but no, 21C is absolutely alive, kicking and actually very critical for the future of NGA as well. What we are doing is focussing on the customer side of it, I think the major change probably is we are focussing the voice transformation 21C on fibre rather than on historic copper infrastructure because I think, I do see a world in which actually you have effectively next generation voice services provided over fibre and IP based and some of the things that that can give. That I think is a change we have decided to make and rather than moving customers twice into some intermediate voice product we are going to go for, and look to developed our fibre based voice product which I think will be very exciting for our customers. Tony.

Tony Chanmugam

Two parts of your questions. First part have we spent recklessly, no. Have we spent as effectively as we could have done, no. Being blunt about it, that's why we have got a £50m impairment charge on part of the 21CN asset base, a lot of other complicated pieces around it. But we could have done it better, could we have procured more effectively yes, that's why we are getting the sorts of savings we are. How comfortable am I that we can do £2.7bn, comfortable.

<u>Question 7</u>

Petri Allas – Redburn

Couple of questions, first on Global Services you obviously are improving the way you do businesses that you are in but to what extent have you found businesses that are, if you like sort of chronically unprofitable and might consider wind downs or disposals or otherwise in that part of the business and then secondly the discussion you had with the pension regulator obviously you can't go into too much detail, but is there any element of additional risk like linkage between dividend payouts and pension contributions being discussed and on the table or what kind of risks might there be vis-a-vis the dividend and 525 number that you have said from those discussions. Thanks

Ian Livingston

The dividend and the 525 are entirely consistent with each other, so that's as you say we can't really discuss it any more than that but they are entirely consistent with each other and both the regulator and the trustees are fully aware of what our dividend policy is in setting all of that. Hanif do you want to talk about GS businesses.

Hanif Lalani

Sure two things, firstly in terms of low margin contracts because there are a few low margin contracts those are getting attention in terms of can we be smarter in the way we deliver the services, can we change the configuration

of the solutions that we originally planned and can we actually create win-win situations with the customer, where the customer actually given the current environment wants to change the solution because it doesn't meet their needs of the organisation, so I think those contracts we have a swot team going through them and working through them on a regular basis just as we have on cost reduction. In terms of businesses I think its much more about small units of capability that really are not part of a networked IT services world and with those small units what we will do is actually either sell them or allow the management to take over those businesses over the year and when I talk about small items I do mean they are small in nature and size. I think the remainder of the units that we went through are core and have a very direct link to what customers needs are and we will drive those hard for cash and for profit.

Question 8

Damien Maltarp – Credit Suisse

Couple of questions, I guess just going back to Global Services and cash flow again, you are saying that we are still at this £300m cash outflow run rate. Costs savings for this year will be more than a third of the greater than a billion so lets say £400m cost savings, why aren't we therefore at a cash flow break even run rate at the end of the year. Is that just because the top line is under pressure, is there negative operational leverage or, I guess what am I missing there.

Ian Livingston

Right just on that, what we said is; we aim to do significantly better than the £300m.

Damien Maltarp – Credit Suisse

But not positive.

Ian Livingston

I said we aim to do significantly better than the £300m, that's what I've said.

Tony Chanmugam

Just the other piece though, I think that the piece that you are missing is there will be a level of revenue decline and that will manifest itself in that cash number.

Damien Maltarp – Credit Suisse

And the second question just on line loss, I guess are you saying there is an economic impact now – maybe as we go through the course of the year, Sky

goes to full LLU, how much worse could that get before we turn the corner because the numbers are getting quite big now.

Ian Livingston

I don't think you are suddenly going to turn the corner and then its LLU changes. I mean Steve you can talk about what you see in the LLU, the LLU market is slowing down, I suspect we might still see a shift, in fact, we will see more of a shift from partially unbundled to full. I think you are seeing some consolidation in the market, I suspect you are seeing Tiscali and Carphone Warehouse, Sky I think I've said that they are looking to move to full, so I think probably the bigger factor maybe a movement towards full but Steve do you want….

Steve Robertson

Sure I think it's an absolute certainty that there is going to be growth in full bundling, clearly it's Carphone Warehouse's position of choice, they've acquired Tiscali, I would expect them to begin to integrate and take advantage of that. Sky have publicly announced that they also going to be moving in the same direction from the summer, however what speed they move at is probably open to speculation, it depends on how they manage the customer services aspects of that I suspect. However, the pressure on the top line needs to be matched by focus on cost reduction, we have had adverse mix issues this year we have managed them effectively and we would aim to do the same next.

<u>Question 9</u>

Paul Howard – Cazenove

Just a couple more questions on Global Services, you've given a new divisional split in terms of how you run the business going forward by EBITDA, just can you give us some indication of what the cash flow characteristics of those three divisions look like and I guess the third division is the one that perhaps could more obviously be separated away from BT if need be, is that fair, is that strategic to BT, is that something that could be separate from BT in the future if that helped you reduce the balance sheet, leverage etc.

Ian Livingston

Okay, to answer the first question, no we can't give you more on the cash flow. It's a bit like Retail's business units we have given you some sizing of Retail's business units in the past but what we are not going to do is every quarter give you that sort of detailed breakdown, I don't think it's particularly helpful for us and in the competitive environment and also there is allocations involved in these things, it's like Retail, we will give you some idea and don't read too much into it. The reason they are split like they are isn't through some corporate finance strategy, the reason they are split like they are is actually to provide the right focus for the right sorts of customers. So the most

important thing with Global Services remains, and this is our focus, is operationally to run it better and that's what this is rather than anything else.

<u>Question 10</u>

Robin Bienenstock – Bernstein

I see that you are going to speed up fibre a little bit, I guess my question is were Virgin to start wholesaling fibre would that change your plan and make that more of an urgency for you?

Ian Livingston

Not particularly we'd welcome if they did finally wholesale it, I think they have talked about looking at it in 18 months which might be just to make the regulator feel a little bit happier, but the answer, no. I think it would be good to see Virgin sharing the value chain as BT shares the value chain with it's customers and it think creating a competition ready network, which is what BT does when it roles out fibre, is something that actually separates us from the rest and the reason why from a UK point of view that having BT as a provider of basic infrastructure is really important.

Robin Bienenstock – Bernstein

That wouldn't speed up your fibre role out at all?

Ian Livingston

We are going to roll out fibre as we have described it. I'm really not holding my breath to Virgin wholesaling it but we'll talk as they put it in 19 months.

<u>Question 11</u>

Simon Weeden – Merrill Lynch

When we look at your total labour reduction impact on the business can we assume that the people who are leaving, who are off balance sheet as it were, come at roughly the same per head costs as the people who are on balance sheets, so we can kind of get a view of what in the longer run 30,000 would save you in cost terms or are we looking at a slightly different mix, so we are looking at a mix that's richer because its lots of IT consultants or not so rich because it's more off shore type elements.

Tony Chanmugam

Yes it's a complicated set of algorithms here, if you look at the Global Services business for example, we are removing people from overseas the average cost per head on those overseas people are more. If you look at the mix elsewhere in the business it's broadly similar. What you will see is the removal in terms of some of the agency contractors, the average mix on there

will be that the higher paid will go. So you know it's a complicated set of algorithms, what I would say to you though is, Q4 we took out effectively, there is a 5% reduction in our TLC costs, that will flow through, the impact of the savings that we have made at the back end of Q4 in terms of labour costs, if you just see look at the labour resources in Q4 we took out 5,000 people out of the 15,000 people, obviously that gives you an indication of the faster acceleration of the levels of reduction that will take place.

Question 12

Christopher Nicholson – Oraca

Two questions for the team please, both Capex. I was under the impression that since 2002 all Capex development was essentially customer layered in Global Services and other divisions, so I'm just wondering if I can understand a little bit better how that's mixed if you are going to reduce proportion that you provide up front and then the second question is that are the gains that you are getting, if I can summarise it from a reduction in truck rollouts on maintenance of the network are they directly related to 21CN or should we expect something else on top of that in terms of maintenance Capex improvements from 21CN.

Ian Livingston

Okay on the second one, no they are actually due to creating a more resilient network. Steve, some of the facts and figures about just how much more resilient and waterproof, was it 828,000.

Steve Robertson

Yes about 828,000 open joints have been closed. I mean the vast majority of those improvements are based on the improvements in the access network because that's what drives the volume in terms of engineering activity, so you know sealing the network, improving the quality of workmanship has been the basis of driving the efficiency improvements in terms of the fault rates in the network.

Ian Livingston

In terms of customer led Capex you missed something, we can also do it more efficiently which is the other part, we can do it more efficiently and buy better but I mean it's also, I'll ask Hanif to comment and add anything but it's also what we do with customers, we comment about cash and risk being really important and with a past focus on EBITDA given the high EBITDA margin and high capital intensity or a medium EBITDA margin and no capital intensity you might have got more of a focus on the former where actually from a shareholder value point of view really you were trying to focus on the latter but Hanif…

Hanif Lalani

Sure I think the other thing that's happening in the market place is a shift in proposition. So whereas historically you may have invested in a lot of proposition that involved developing your own OSS stacks and developing your own CPE, what's now happening is people are moving to hosted voice, people are moving to, if you want to call them cloud services type activities where it's all provided as a service, a CPE is a service, it's either leased or you get it embedded in the network so what's happening is the proposition changes and therefore the intensity of Capex changes and you also get the effect on EBITDA margins, so it is a trade off about profit, Capex and the propositions but customers truly today want their services and their equipment as a service and that helps in managing Capex and getting a better EBIT.

Tony Chanmugam

I think the key point here is to remember that the capital consists of two component parts, when you say customer related; all of the deals that we do have CPE associated with it, now for me I don't really worry too much if its Capex or current, it's when is the customer going to pay for that, so if you've got CPE upfront, which is directly customer related, no risk and the customer pays for it, no issue, EBITDA doesn't come into, it's about the cash flow element. The second component part is if you've Capex coming onto a network, which is what we have done within GS, its how that network has been rolled out, what the customer demand for it is and what the lag time associated with it is. So I think the piece you've got to come back and refocus on here is; EBITDA for GS is not there, it's the cash impact and what we are talking about is reducing the level of cash outflow for the business that we are going to look and deliver.

<u>Question 13</u>

Will Draper – Execution

A couple of things, one on revenue guidance, am I right to assume that the vast majority of the 4-5% decline this year will be from a rebasing of Global Services and if that's wrong point me in the right direction in terms of other divisions and secondly on working capital there is still quite a big outflow for the full year. What are your plans to try and rein that in, in the current financial year thanks.

Tony Chanmugam

If we talk in the first instance about the working capital. We are going to smooth that out, it is a question of there have been a lot of peaks and troughs and you will see that manifesting itself during the course of the next financial year. What we are going to be ensuring though we are going to do things that are commercially and financially sensible, so we may need to just review what we have been doing on things like factoring and refocus that but what we will

have is a situation whereby our working capital will be smoother, I'm not going to say it's going to be perfectly smooth because it won't work out like that but it will be much smoother and the reason I am saying that is, based on the timescales for when you bill, when you pay your bonuses, there's a whole set of issues associated with that, but the end position will be a much smoother position on working capital. Can you just rephrase that first question to me please.

Will Draper – Execution

Well it was basically saying, is it right to assume that the 4-5% revenue decline is all about Global Services?

Tony Chanmugam

Right okay, no it's not solely about Global Services, you will see that there will be a degree of revenue decline within the Retail business, part of that is to do in terms of a continuation of some of the trends that we have seen within the consumer business, it's partly to do in terms of what's been seen in the recession and how that's impacted on the BT business side. What I see us in a position to do is that certainly for example, within Retail there will be a turn up towards the back end of the next financial and that's what we are looking at.

Ian Livingston

And the other thing is Wholesale, we've made it clear a couple of times that we expect to see a reduction in mobile termination rates in transit and that effects Wholesale and that's some hundreds of millions probably, so that's…

Tony Chanmugam

I mean those are the 2% that I talked about effectively, what we are saying is the rest of it, is the margin.

<u>Question 14</u>

Robert Grindle – Deutsche Bank

You've taken over some contracts from Fujitsu recently on the NHS, are you finding you are getting better terms on taking over contracts from even more distressed suppliers than yourselves, is that going to help you out. Some people might think it's more of the same old stuff, is it better stuff and that's my first question and the second question is the UK Government paid money upfront on those contracts, is that what helped you in the fourth quarter, is that the £100m that came in early. Thanks

Ian Livingston

Well on the £100m we have not said that where that came from but we want to highlight there was a £100m better, the cash generation in the fourth quarter came in substantially more than £100m better and we have not changed next years cash forecast either so you should be reasonably assured that the fact that we can do substantially better than expectations in cash flow and not change next year, that should give us some assurance. We would have only have done the deal to take over activities in the South if it was on an acceptable basis. Of course one of the things that helps everyone, the customer and ourselves is we are effectively rolling out on the same, having had the same development costs and we have I think 70% of mental Trusts for instance and community Hospitals are rolled out in London so we really have made a lot of progress so, no we did it on terms that were acceptable to both parties and that's the important thing.

Question 15

Richard Leonard – Cazenove Asset Management

Can you just go back, through Global Services you have written off £1.3bn can you give a little bit more colour on that, given that you have mentioned that you are going to have negative cash flow from the division and you are going to have revenue coming back, how can we be confident that there is not more to come, how can we be confident that this isn't an iceberg.

Ian Livingston

Well it is an iceberg but I think we've seen the whole of it; it's a big iceberg as well. That answer is, what we've done is gone through the top 40 most risky contracts and we've done that, you can never guarantee that there will never be another negative, you know something happen in a contract, like you know it does happen. When MFI went bust we did not have that in our assumptions that MFI would go bust, so there are things that can happen. However, we certainly believe that given the work and the detailed work that we have done, it's the work that Hanif and Tony really kicked off as soon as Tony came into the group CFO we have made a major change and we think as I said we are counting conservatively, we will deliver aggressively so we expect to deliver better than that but it's not right to account for things such as future contracts revenue you might get that hasn't been signed but you might well get it or cost reductions that we haven't really got provable for, but we will go for them. So I can't give you any guarantees in life but I would hope that we would do better than these numbers, I really would.

Tony Chanmugam

On the £1.3bn, £1.2bn related to two contracts and on that £1.3bn, £1.1bn of that related to costs that have already been incurred that were held in the balance sheet, so there will be no cash impact for the vast majority of that number.

Ian Livingston

It was items we had already spent which were a mixture of development costs and deferred costs.

Question 16

Ottavio Adorisio – Societe Generale

The first one is on the net debt reduction, it looks like the Board is not happy about the current level of debt. Which sort of level of debt the Board will be happy if you can just give some colour about credit rating you would probably aim for or sort of gearing and the second one is just on the working capital, I was just intrigued to the fact that you show £462m out flow working capital in the presentation but on the account it's £695m in flow of working capital. Its on page 25 so I was just wondering what's the difference of a billion between the two fields.

Ian Livingston

I think with the working capital its probably best let Tony just run you through how the working capital.

Ottavio Adorisio – Societe Generale

If you could just give us a bit colour for next year on working capital.

Ian Livingston

I think we have given you a cash flow, we have given you a cash flow target for next year and it's splitting every single bit of the thing isn't appropriate, we've said overall we expect to deliver over £1bn of free cash flow. That's what we expect to do, we'll see how the component parts end up splitting. In terms of debt I may ask Mike to say something, but it's not that we are unhappy as such with debt but we just think in today's environment it should be a bit less. Mike…

Michael Rake

That's exactly right I think the Board believes the debt level we have at the moment is manageable and that we took the right steps in late 2007 to extend and establish facilities, what we do believe however, that's why we set the dividend where we've set it, but we do believe in the current environment and given where we are it's important to start to reduce that debt level through free cash flow. Otherwise we take other steps but that's what we think at the moment that it's important to do that to have as an objective so we can deal with those issues.

Ottavio Adorisio – Societe Generale

When you say other steps what sort of steps are we talking about.

Michael Rake

Well no, no if we felt we couldn't, it's quite obvious that if we felt we couldn't support the debt we would have to take other steps, we feel we can support the debt, we're happy with the debt but we would like to see it reduced through free cash flow, that's what we're saying.

Ian Livingston

I think we've announced today the measures that allow us to do all of these thing and actually bring what was an appropriate debt level when the market was different from what it is today, probably, it's about trying to get down a few hundred million pounds at a time, it's not about some major movement, we are not a vast amount away from the right sort of debt level even in today's market and we are very well funded and expect to continue to generate quite a lot of extra cash to go in there, pay down debt, do what we need to do in the pension scheme so that's the plan. My apologies to the those people who I haven't taken questions, no doubt you will have plenty of time to talk to us over the next few weeks but thank you very much for your patience.