BT Group Plc
Second Quarter Results
13 November 2008

Chief Executive Officer - Ian Livingston

Good morning and thank you for coming to a slightly earlier start than normal for BT's second quarter results. I am joined on the stage by Hanif Lalani who you will know as our ex-CFO, after today, and new Head of Global Services and he will be talking in depth about Global Services and covering the financial results.

As usual the forward looking statements read at your leisure and pleasure.

Group results overall. Revenue is up 4%, which is a somewhat better performance on an underline basis than before, albeit all of that rise effectively comes from foreign exchange and from acquisitions. On the other side we had transit revenue coming down, so it's at least a better underline performance than in previous quarters. EBITDA, a slightly decline of 1%, to put it in context that's a £19 million decline of which Global Services accounted for £65/70 million of that and that summarises our results for the quarter – three divisions performing at or better than expectations and the big disappointment of Global Services. As you go down the P&L that EBITDA performance has flowed down, but one point I should mention is free cash flow. Free cash flow is up almost £200 million year on year and I think that shows a bit of a rebound from Q1, and as you know, Q1 was not the best figure it should have been.

To put all this in context before I talk about the divisional results, if you look at the shape of our EBITDA by business, what you see is roughly a third from Openreach, a third from Retail, a fifth from Wholesale and then Other and Global Services make up the balance and we have real strength in what represents 85% of the business and the weakness being in Global Services, obviously I would like that 8% to be a bigger number in the future.

The issue with Global Services, and we will talk about it in a bit more detail, is not revenue, revenue grew 15%, the issue is EBITDA. That profit performance is not acceptable, is not good enough, and is not due to recessionary factors, it's about us, it's about operational delivery. It would be very easy to blame this all on external factors and we are not going to and I think it would be the wrong attitude to take. For Retail, flat performance, profits up. Wholesale doing better than expected, a little bit ahead of plan, and a very solid performance from Openreach, again showing if you are pro-active in cutting your costs, even with flat revenue you can delivery profit growth. What I am going to do throughout this presentation is focus on a bit of Global Services, but Hanif will talk more about it, talk about the other three divisions and their performance and also talk about what we are doing on costs.

So first of all, Global Services. Global Services starts with a good market position and it starts with growing revenue. That's very important because when I went in to Retail, revenue was down 5% and turning that business around with a revenue that's down is actually a lot more difficult than when the revenue is growing. It is achieving high service levels, we are winning industry awards and our customers are giving us good feedback, of course we are not perfect, but we are industry leading. We have good sales growth and a good order pipeline, but, and it's a very big but, we aren't delivering the bottom line. Why? Largely due to a failure to deliver the cost programmes that affects both the in period cost, but also the way we look at contract accounting and the profitability of the contracts. We have seen a decline in UK high margin revenue, that's not that unusual as it's part of this process of moving from traditional to managed services and IP, it was just a little bit quicker this quarter, and also we took a hit from FX, from the mismatch between costs and revenues, and that cost us £11 million in the quarter. I think we have seen very substantial FX movements, far greater than you would expect in a normal environment.

Revenue, up 15%, is split in three ways: 5% organic, 5% inorganic and 5% FX. We saw very strong growth outside the UK, although a significant chunk of that was inorganic, and strong growth in one of the key products, MPLS, which grew 44%. EBITDA was down 36% and a margin of 5.5%.

Everyone keeps on looking for elements of recession and what you actually see is that sales are ok, the order book looks ok, £1.8 billion of orders in the quarter, and if you look at 08/09 as a whole, the results for the order intake will be a similar level to 07/08. As we look at the pipeline, new orders are at the highest level for six quarters, over £30 billion. However, I suspect what will happen in these environments is that it will take longer for these orders to actually come through as people tend to take longer to make decisions, but there is certainly nothing wrong with the pipeline. Customers are saying that there are two things we have got to do, we need to cut costs and we need to expand in to areas where there is growth. Fortunately enough, BT Global Services can help with both of them. Hanif will say more about Global Services, so let me move on to some other areas.

Retail, a different picture. Flat revenue, Broadband net adds at 27%. As the Broadband market reaches more and more maturity and as the installed base gets bigger, this quarterly number is going to be less and less relevant. I'm actually surprised it hasn't bounced about more than it has done, it's been remarkably stable at somewhere between mid 20's to mid 30's percent and what we should increasingly be focussing on is the installed based number because I think that's the important long term number. We've also seen a good increase in a Network IT Services, what we are offering to the SME sector, and we can help them run their businesses better and let them focus on what they do best. One of key things Retail has done is margin, gross margin, that's about selling the right things in the right way, but also about cost management. Cost management is not just about SG&A, it's about costs of sales. What you buy, who you buy it for, how you buy it and how you use it, and that has come through in 190 basis points increase in gross margin. If I look back a number of years ago, Retail was actually haemorrhaging about 100 basis points a year in gross margin and that turnaround is the reason we have been delivering 7, 8, 9, 10, 11, 12% EBITDA growth quarter after quarter. The chart on the right hand side for rolling EBITDA looks like an absolutely straight line, it's not quite but it's pretty close to it, and that solidity we need to see in some other parts of our business.

Looking by the different customer segments. Consumer down 3%, now that's actually as a result in part because we are pushing people and offering them some really exciting packages as long as they stay with BT, and there is a trade off here. The trade off between short term revenue and long term retention of customers, so for free evening and weekend calls all you have to do is commit to BT. Not great for short term revenue, but I think it's better for customer retention. We are also seeing the ARPU rise, ARPU is up by £5 that's due to things like selling of Vision, selling of Broadband and that's a trend that we've been seeing for some time. Vision, 340,000 customers, I think it's fair to say that is a little bit less than we might have wanted, not a huge amount, but the quality of the customers is better. We are seeing a very large majority of the customers, close to 90% of new customers, choosing to take a subscription pack, so better quality and slightly less on the numbers.

We have also launched a new package, Mobile Saver. One of the things we have got to do is to try and see how we can bring people back to the fixed line. There are a number of things we are doing, including offering multi-line solutions, but pointing out to people just how much they can save in these times by moving away from their mobile phone for calls at home, to the fixed line. Give them more lines at home as well through, for instance, our VoIP product, that's another opportunity.

Turning now to the SME sector. Growing a little less quickly than it had done, but still solid growth, up 2%. We recognise that for businesses they don't just sit in the office, they have to be out and about and we have launched a very innovative product, a little dongle. 3G dongles are around, but what this does is combines wi-fi and 3G. It looks for the best network, it uses wi-fi if there is wi-fi available, it uses 3G if not and that saves people money because as we know, 3G costs can be absolutely extortionate, costing £15/£20 for an extra gigabyte and we include that dongle in our option 2 and 3 Business Broadband package. What we said is, we want to be Broadband anywhere and that's part of that proposition.

It's also worth mentioning when I talk about wi-fi, BT Openzone. 10 million minutes a week, doubled last year, growing phenomenally quickly. I remember when we reached 100,000 a day and we were quite pleased, we are now 10 million minutes a week and still growing strongly. Our number of hot spots is growing, you can now get BT Openzone or BTPhone in over 200,000 locations around the world.

We have also seen very strong growth on Tradespace, 96% growth quarter on quarter, 250,000 businesses using it. Remember what Tradespace is, it's sort of the combination of eBay on one side and Facebook on the other, but aimed at businesses. Not as sexy as consumers, but they need a place to talk to each other, to sell to each other, to share ideas and share thoughts and I hope Tradespace is going to be that place and 250,000 customers is a good number.

I am going to mention conferencing. Conferencing is a part of BT Retail, but the reason I am mentioning it is it's nice to talk about a Global business that does both well globally, but also delivers good profitability, it can be done. Revenue is up 78%, however, that includes an acquisition, so it was only 29% organic, but not a bad number, 29% organic growth. Customers such as Google, Yahoo, Intel, P&G, these sort of customers, are using it around the world and it's good margin, EBITDA margin of 30%, a very strongly growing EBITDA. We are now used by more than half of the Fortune 100 companies and we are the number one video provider in the world and the number three conferencing provider in the world, we were number seven. It's both something we use as a sell alone product, but also we use as a way in to actually sell other things to global customers. Unilever, for instance, will say publicly that they have saved £80 million by using BT Conferencing, Tesco's will talk about £10 million a year in savings. It's good for companies because it helps reduce their costs, but it also helps them on a sustainability argument, save on CO_2, save on travelling. It's selling around the globe and we are making good money from it, you can make good money selling to global corporates, no question about it.

Wholesale, if you look at the chart on the right hand side that probably tells you quite a lot, a levelling off of revenue. Year on year it's down 7%, but what we are seeing is a movement away from Broadband. LLU was going to have a big effect on Wholesale, expected by you, expected by us, but also transit as well. Transit is going to be one of these numbers that if there are cuts in mobile termination rates, that will effect Wholesales revenues, that may happen next year, but we are winning elsewhere, particularly in managed services. We are managing things for customers and around about a third of Wholesale's business is now in managed service contracts of some variety and that is about three times what it was a year or two ago, so Wholesale is having to change and has changed quite significantly. 3.4 million end user customers use Wholesale's white label platforms. Customers like Vodafone, for their fixed line services and Sky customers, that was a very good win for Wholesale and it shows we might not have some of these customers at a retail basis, but I am absolutely delighted to have them on a wholesale basis as we can make money and provide good services as well.

Similar story in EBITDA. EBITDA is down year on year, but a more flattening trend. The reason why EBITDA reductions have been held to only 12% is the 11% reduction in SG&A and it is important we carry on doing that. One of the things is Right First Time. Reducing the costs of servicing our customers by reducing costs of failure. We've seen, for instance, the failure rate on Broadband coming down, the first contact resolution in Broadband improving, so these things feed through to costs as well as improved customer service.

Openreach, solid revenue, but some big changes within that. Operating costs are down 3%, again same story, you've got to cut your costs in this environment and Openreach have done a good job. A lot of that has been through improving customer service, proactive work on the network, for instance we saved 140,000 repair visits this quarter, that means if you have got a line with BT whether directly or indirectly, on average, a line will go wrong once every 11 years. That's an improvement of once every ten years so we are improving fault rates and that is very important, and that meant the EBITDA has risen 4%.

I mentioned we look at changing revenue shape and I think, if you remember six months ago, we said to you the first place you will see the effects of recession is in new housing. You see it in the new housing market you see it in the new connection market, three months ago we said that was happening and sure enough if you look at these figures, connection revenue is down 15/20 percent. Rental revenue is pretty stable and that's what is happening and that's what's caused Openreach to have to work very hard. There is potential now for new services, one of the ones I would like to mention is Ethernet services. More and more data is being consumed by customers, whether that be in the mobile space, whether it be in fixed space, and Ethernet is an important product. We will be reducing the price of Ethernet services, why, actually we think there is a really good market opportunity, Ofcom also wish us to do so, so we will be giving something back to the industry. On the other side with the Financial Framework Review, looking at the prices of WLR and MPF, we expect, and we would hope, there would be some price increases and I think we would expect both of them to happen perhaps starting in the new financial year.

Global Platforms. I don't want to just talk about 21CN, I want to talk about platforms overall, if you recall three months ago I said the three things we are trying to do is Right First Time, customer service, enhancing our platforms and rationalising them and thirdly being more agile and we will talk about some of the cost elements of that in a second.

If you look at 21CN, progress has continued, we are actually slightly ahead on our role out programmes and we are seeing real customers buy real things from us. Whilst 21CN was always presented as a cost programme, actually it presents some very significant revenue opportunities and we are seeing real customers using it. In areas such as Ethernet, in areas such as 24 Meg Broadband, but also we are seeing corporate customers testing some of our software as a service. We actually launched some software as a service products as well in the SMB sector, so it is starting to become reality.

Superfast Broadband. Fibre to the premise, we've started that with customers, there are customers in Ebbsfleet who are getting 95 Mbits per second, close to 100 and something they are enjoying, but there aren't really the applications yet for that. We hope there will be an application, but as we stand today there aren't the applications to use that, but it's shown technically we can deliver it, and deliver it well. Fibre to the cabinet, we have announced two sites that we are going to have fibre to the cabinet to about 30,000 people that's Whitchurch in South Glamorgan and Muswell Hill in London. We will be doing that during the middle of next year and we continue discussions with Ofcom to make sure we can deliver this in an effective and efficient manner and I think in contrast to the rest of Europe, delivering it in a way that is open for other people to provide services and keeping the very strong competitive nature of the UK and also keeping the UK's lead in Broadband.

And also I should mention in a Global sense, MPLS services. We now have 1,282 points of presence in a 173 countries and 5,200 new MPLS connections per month. Why are we going to these countries? It's not so we can put flags on a map. It's because our customers want us to be there and when you set up for one customer then you can just leverage it off, so when you set it up for Unilver, then P&G use it, when you set up for Reuters, then Credit Suisse can use it, etc, etc and we've got this presence. I was with a major European car company recently, and they said we have got too much capacity in Europe and not enough sales and in places like Brazil and in Russia and North Africa we've got too much sales and not enough capacity. The great thing, and he said this to me, the CIO, the great thing about BT is you actually are there and have got the presence and capability and actually can provide us with the services and that's going to be really useful to us and gave us an order, so that's nice to see.

Now cost base. I appreciate that it's been difficult to tie in the gross cost savings with the net. Now, in one way we can say on a sort of high level that given our prices keep on getting cheaper and we have to sell more for less, the fact that our profits have either been up or stable has to be because we are delivering cost savings, and that is true. But, I want to try and give a bit more granularity about what we are doing to explain the ups and downs because there is a lot of ups and downs. There's acquisitions, so if you look on the slide you see on the left hand side, acquisitions and FX that increases our cost base. Against that, you see some improvements in transit which we don't count as a saving, and you see the big saving of a £161 million in there. Critically we are re-investing less of that. We did re-invest a lot of it as we expanded globally and we went to new products, we tried to cut that re-investment and hopefully this walk through gives you a better idea about what's going on.

And just to bring it to the real world. I wish there was a silver bullet, you know someone says, "what's the big cost saving idea?", the answer is there isn't a big cost saving idea, the answer is there is a huge a number.

I just want to give you a sense of a few things we are doing. We announced very recently something we have been working on for the last six, seven, eight months, a deal with Alcatel-Lucent, that Alcatel-Lucent would take over the running of our old legacy networks outside the UK. That will save us about £100 million over the next seven years, on average £15 million per year, bit more back weighted towards the end, but critically because they are doing that we can actually focus on starting to close down these networks and that's where the big saving comes. Sometimes people talk about changing the engines on a Boeing is quite difficult, well actually we will let them do the driving, while we do the maintenance and close this thing down and that's going to be important and give us a much bigger opportunity than the £100 million.

We are also in a number of areas and I have just taken one of them, carrier markets, trying to bring together overlapping cost structures, confused propositions, better for our customers and we will save money and we are doing that in the carrier market where sometimes selling to the same people, we will save, for instance, about 120 FTE. A number of other areas we are doing that, medium size enterprise market we will do the same, we have got a number of other areas and some of these save 10, 20, 30, 40 people, some 100, there is no 500 or 1,000 but there is certainly 100s and 100s to be saved from each of these overlaps and it makes us a more agile business as well.

Also, we are carrying through a programme that started in Retail and is moving throughout to the rest of the group, called Overhead Value Analysis. What happens is that we do a structured review of an area, cut out overlap, cut out non value add activities and typically we are picking up north of 20% savings in people costs when we do that. In HR when we looked at Retail about 28%, Billing 24%, Payphones 22% so a range of areas of the business and we are rolling that out throughout the rest of the group.

While on the subject of people, I know people have often wanted to say 'what's your head count going to move by?' and it's a good headline and I suspect that's a headline we are certainly going to get today. It's really important not to focus just on direct labour, and many people who have been at BT 20 years will tell you the stories of lots of permanent people leaving BT and then turning up as contractors the next week. If you concentrate on permanent labour, there is a danger of that happening and you also don't capture totality of your costs and you can also spend a lot of money on leavers costs. So what we have tried to do is focus on is total labour resource (TLR) that's direct labour, what you would recognise, but also indirect labour, things like agency, third parties, offshore, it's not a perfect number but it's a lot, lot better than just focussing on direct labour. We are looking to reduce that amount by 10,000 people this year. 4,000 have already left and the majority of these will not be direct people. Why, because what we are going to do is try and re-train and re-deploy as many direct people as we can. I think it's the right and good thing to do in this environment, but it's also better for leaver costs, you save more leaver costs in doing that. What's also important with that is it's not just about making sure that you manage your workforce, it's also about performance management. Something again BT hasn't been very good at, we've got some great people doing great jobs and we have got some people who aren't doing great jobs. We would like to help them improve and do better jobs, but sometimes people can't and it's best for them and best for our customers that actually they no longer work at BT and I would think probably in the region of 2,500 people will leave BT this year through performance management, i.e. there is not a leaver payment, they are effectively managed out of the business because their performance is not satisfactory. That was something that certainly we were doing in some parts of the business and for instance 3% of people in Retail last year left through performance management and we can roll that out, because we know we have some very very good people and some not so good people. But also for this, that's really important, is your control on what comes in, because I know we spent a lot of money on leaver costs and if they go out one door and come in the other then it's for naught, so we are putting much tighter controls on recruitment, and that's the reason you are going to see the big net drop in total labour resource. So we are trying to do it effectively, we are trying to do it efficiently and we are also trying to do it in a way that helps our people and respects them in this environment, which is important to me.

Related to that is Customer Service. People often say 'well how can you cut your labour force and improve customer service?', answer, I can't actually cut the labour force without improving customer service. A lot of what we are doing is a result of Right First Time activities. Less calls in to our call centre, less engineers having to go out, less things being re-worked, means actually you need less resource to do it. We are certainly seeing the affect of that in Customer Service, yes I know we have got a long way to go. We may be the best in industry but that's not good enough today. But we have seen for instance business broadband repair, dissatisfaction reduced by a half. We are seeing the abandoned rate on calls reduced by almost two thirds from 11% to 4% I want to drive that down lower still, I think the industry thinks 5-10% is a pretty good number, but we'll drive it down from 4%.

Repair lead times down by a quarter, actually it's down by about a quarter in consumer, it's down by about a third in business, so a big improvement and that is a similar improvement to what we did the previous year as well, so a big improvement, provision lead times down by a fifth. To put those numbers in context, today we have 11 or 12,000 repairs on hand, something like that and we typically do 15,000 repairs in a day. If you look back for instance, particularly in the summer, a couple of years ago, we could have 50,000 plus repairs on hand and you can see the difference that makes to the repair time but also shows how we are much, much better at managing our network.

I'll say something about dividend. We've held the interim dividend and what we said regarding the final is the Board will discuss in Q4 what shall be the final dividend and what may be the policy going forward. The reason we are doing that is not because we are particularly uncertain about BT's results, actually we think and I think we have given guidance in a pretty small range about BT's result, it's not about the internal BT environment. However, we are conscious that we are in an incredibly volatile time, externally. I think we don't actually know whether the FTSE is going to be 3,000 or 6,000 and perhaps what your dividend policy and what you do in dividends might change depending on whether it's 3 or 6,000, particularly if you've got a big pension scheme like us, and certainly the impact of the FTSE on the pension scheme will have an effect, although as Hanif will show that equity now only represents about 35% of our total base in investments. But the Board has talked about that and we feel very strongly that we should wait to Q4 and see that environment. However, we do recognise that a strong yield is important to BT shareholders. We do recognise BT has a strong balance sheet, we don't have to borrow for nigh on two years, so we can afford a good dividend and we do know how important it is to deliver and we also have confidence in the future of BT.

But the final policy of what we are going to do we will decide in Q4 and we will talk to you about it then, but I wanted to set that context, we thought it was important.

Looking otherwise on the outlook, Global Services, what we said for this year is a 7-8% full year EBITDA. There isn't going to be a very sudden quick fix that we can pull out and say 'we are back at double digits EBITDA percentage'. There is a lot to deal with, a lot of opportunities but it probably will get worse before it gets better and that's why we talked about 7-8% because based on the first half, I think you would expect the second half maybe to be better than that in total, so 7-8% EBITDA margins for GS.

Retail, continued solid EBITDA growth, might be a little bit weaker in the second half than the first half, I don't think that is particularly unexpected, but it will be solid growth in the second half as well.

Wholesale, very similar message to what we said last quarter and I'd quite like to get that drum beat of similar messages going on. We said that Q3 would be similar to Q2 and Q4 would have some better trends and we would start to see a significant reduction in the decline. We are a little bit ahead of that, we are doing a little bit better than we thought, but the same sort of shape.

Finally Openreach, a stable performance, revenue and profits should be pretty stable with effectively the cost reductions offsetting what is a difficult external environment.

All in all, that means we expect revenue to grow, we do expect for the full year a small decline in EBITDA. So instead of a small increase, it's a small decline and that's what we said a couple of weeks ago and of course that will have a consequent effect on EPS and on cash flow.

But, we feel that BT is doing the right things now, we feel it's very important we start to deliver and then talk more about the future I think perhaps, and I recognise this, we talk too much about the future and let down on delivery and we are going to try and change that.

With that, I will pass you to Hanif to talk more about GS but also the overall financial results.

CEO of Global Services – Hanif Lalani

Ian's shared with you the performance for each line of business, the outlook for that business and for the Group as a whole.

The topics I wanted to cover was a review of Global Services and some thoughts, to take you through the Group performance, the latest on pensions and then finish on liquidity.

So starting with Global Services. If I look at the business, it has a very strong pipeline, if I look at the revenue it is growing strongly. But, if you look underneath that and look at the types of companies and the brands that we have there, there are many global companies and quality brand names operating throughout the world. If I look at the service that our people provide we have very good people, the level of service has been improving. If I look at the execution on those contracts, we are picking those contracts up much better, much more quickly when we sign them and we are delivering good satisfaction for our customers.

If I look at the long term contracts, these average between 5 and 6 years. If I look at those contractors, a diverse portfolio of contracts by size, by geography, by sector and that gives us a lower risk portfolio across the globe.

But, if I look at the operating model we have, it is more complex. If I look at the IT, the systems, if I look at the way we operate, it's not easy to get to the cost base and to optimise it.

But there is no doubt that the cost base that we have is far too high and there is no doubt that we have to make a step change in that cost base.

If we look at some of the contracts what we can see is that there is a high level of customisation bespoke and for a company that is heading towards a platform environment what we want is fewer propositions and more re-use in that space.

So if that's what we've got, where are we going to.

Well as I mentioned earlier improving the execution of our cost reduction plans is important. It's actually about accelerating the plans we have in place, it's about aligning people to it, it's about holding people accountable and I'll have more of that in the next slide. But also in addition to that because there is an and, we need to improve the gross margin on those contracts, we need deeper relationships with those customers, we need to be selling more value added services to them and if I look at the quality of contracts we have signed over the last few years, I can see an improving trend in margins but we need to make sure that we need to continue with that and in terms of the quality of contract that we sign in the future.

We are talking to some of our major customers and on major contracts. We are talking about how we re-profile the payments that come to BT to align with the work that we have carried out. It takes a while, complex, focussed, yes. We are focussed on doing that and making it happen.

Then there are some of the nicer things that I would like to look at. The optimum route to market, direct versus in-direct channels. I'd like to talk about being proposition focussed, delivering fewer propositions to customers in the right sectors, driving repeatability and re-use.

But, before I get to those wonderful things about operating model, platform and re-use, there is no doubt that the first step has to be the bold step and it has to be about streamlining and addressing the cost base. Because without doing that you don't get the opportunity and the head room and oxygen to do the rest.

So if I look at Global Services cost base, these are the main types of costs that we have in the organisation. So there is a lot of costs around circuit capacity that we provide for our customers around the globe. We need to ensure that we have got the right capacity, at the right price points, with the right carrier, with the right term discounts, with the right utilisation and the right optimisation of those capacity. That would help drive the access cost down, not by tens of millions of pounds, but hundreds of millions of pounds in the future.

If I look at the external procurement, we currently have thousands of suppliers in our Supply Chain providing services to us around the globe and I want to get that down from 1,000's to 100's of suppliers and I want those suppliers much closer to where I am, where my customers are, again leveraging my buying power and leveraging their desire for bigger volumes and bigger margins for themselves. Again, in that space I believe we have big opportunities, again, in the same range as the access networks I believe that's hundreds of millions type of opportunity, not tens of millions types of opportunity.

Finally total labour resource. Ian mentioned it earlier, we have a revenue line that is growing and yes, we do need people to service our customers. But there is no doubt that we have a huge amount of cost of failure in the business and therefore I do want to reduce the total labour cost, I want to reduce the duplication that we have across the organisation, but not at the expense of delivering great service for our customers and increasing the loyalty from our customer base.

And finally, we have got platforms and networks and the core network which we run and there is a cost base there to be managed and really the trick at this side is as we move people on to IP and Ethernet networks, we need to turn off our legacy networks and realise those benefits. Some benefit in the margins in the short term, but savings in the longer term on that particular line.

So what have I been doing for the last 10 days. Focussing on pensions, focussing on finance, but there is no doubt that I have been focussing on Global Services and the quality of engagement with the leadership team, with the senior leaders, with every person in Global Services around the globe, has happened. They have heard from me, they have seen me, they have had emails from me and they understand the role that is expected of them, they understand the position that Global Services is in today and they understand what needs to be done.

So what is it that we are going to do. Well I have outlined to the team very clearly that we need to focus on a step change that's bold and is aggressive and that we want to get on to a run rate that's necessary for the following financial year and we need to do that in the next 90 days. It's very clear what those work streams are, they are around people, they are around circuits, they are around inventory and it's very clear that we need new blood, new people, addressing those issues. So I have taken 30 people, the best people we have in Global Services and dedicated them to this activity and they are focussed on driving that. In addition to the people in the programmes, we have also allocated another 50 people who will make and translate those actions in each individual country around the globe.

So are we aligned, yes, have we put in the best people, yes, and what have we achieved in those 10 days. Well we have gone through every discretionary spend that we have in Global Services and we will do that again tomorrow at 2 o'clock, every week, every Friday around the globe people will be dialling in together. Very clear accountability of what needs to be done. For those work streams that are behind, they will have the pleasure of working with me over the weekend to get it back on track for Monday and when we go through the work streams, our discretionary spend, we have already reduced that by £20 million from between now and the year end. On circuit capacity, we will be looking at a carrier per country, we will be completing all of our work analysis, negotiations, one carrier, one country per week and in the last two weeks we have identified and agreed another £20 million worth of savings associated in that work package.

So, opportunities without a doubt, plenty to do without a doubt, engagement of the people without a doubt and outcomes focussed without a doubt and as I go in to next week that's where for all of my time will be dedicated, other than pensions.

If I move on to the Group performance. Revenue has grown 4% year on year in the quarter, driven by Networked IT Services propositions, which have more than offset the decline in calls and lines.

Cost efficiencies of £161 million was below our expectation and as a result of that, EBITDA is down 1% year on year. If you look at the depreciation number, depreciation is down 1% year on year and is a fair reflection of where I expect the full year to be, a 1% reduction for the full year.

Interest costs, net finance costs are higher year on year driven by two particular factors, higher average net debt and a lower pension interest credit and again I expect the trend to continue to the full year. Effective tax rate at 22.8% in the quarter and for the full year, broadly the same number. So earnings per share at 5.9p was down 0.2p, it is down 3% year on year and I believe it's the first time in about 24, 25, 26 quarters. So it's a trend that we need to address and are focussed on.

Moving on to free cash flow. Free cash flow at £369 million, saw an inflow. That was the expectation I had created with you at the end of the previous quarter and it is £200 million better than last year. Three main factors affecting this, very tight control of capital expenditure year on year, 11%

down. Working capital, although an outflow, is £66 million better than the prior year and finally under Other, we had a much larger specific charge last year than we've had this year and that flows down in to the free cash flow number.

Let me now move on to Pensions. Really two messages from this slide, if we look at the IAS19 number it's a surplus of £0.9 billion pre tax. Yes, there is volatility in the market place around the AA bond rate and yes there is volatility around the inflation number. But the thing to take away for me are the trend over time. If you look at that trend over time, from £9 billion deficit, to a small surplus and as I look at the IAS19 number based on last week's number, it's still in surplus. So the first thing is, whilst there is volatility, it's heading in the right direction.

The second point to make is if you look at the asset values at £34.4 billion and compare it to the peak, the peak was around £39.5/39.7 billion, so the drop in asset values is much less than the volatility and that's an important point to bear in mind. As Ian mentioned, when we had the £9 billion deficit, that was the point in time when the FTSE was at one of it's lowest points 4/5 years ago.

So how can you maintain a strong asset base and strong asset valuation. Well, a number of decisions we made over the last 3 years have helped us to do that. Firstly, at the last triennial, December 2005, we made a conscious decision to move out of equities much more towards our strategic asset allocation number. So we went from 60% in equities, to 35% in equities and with hindsight, probably a good thing to have done. If you look at where we have moved those pounds, we have moved in to different asset classes, we have moved it in to asset classes that have a negative correlation to equities, make us a good return. If I look at the performance of Hermes, it's job is to make a good return to BT. If I look at the performance over the last 22 years it's delivered over 7% real return per annum and that is a good return, so they have a history of making very good quality moves in terms of managing that.

As we get closer to the strategic asset allocation and this is the thing that we all need to understand as we go in to the triennial, the closer you get to your strategic asset allocation, the closer you asset base matches your liability profile. What that means is much more predictability in being able to meet the needs of the pension scheme and it also means a much better rate of return is expected in the future.

Thirdly, pension review. So for the last 6 months we have been working with pension scheme Trustees and working with the Unions. We have been working on a range of proposals and those proposals vary from, increasing retirement age, changing the accrual rate, changing the contribution rates and a number of other things and there is an additional slide in the pack for you to have a look at and if you need even more information we have it on btpensionreview.net, it's an external web site available to you. So all of these changes, the Union's are supportive of, have recommended to their members and we are going through a consultation period with them. As and when that consultation completes in the middle of January and the recommendations and the proposals are implemented beginning April 2009, the impact it will have on our business is £100 million improvement in P&L and £100 million improvement in cash flow. The most positive thing about it is it creates a much more sustainable pension scheme and a scheme that is affordable and is modernised to reflect future risks, future exposures to mortality as well, so more information on that is on the web site and at the end of the consultation period and when we implement them, we will be talking to you in much more detail.

If I look at liquidity over the last 3 to 4 quarters, I've gone through liquidity but in less detail. Today, I thought I would just clarify because of the number of calls we have had on our liquidity position. June last year 2007, we decided to go in to the market place to raise long term debt. We raised around £4.3 billion, the majority of it in 2007, and what that has meant for us is effectively raising the amount of long term debt we have up to over £11 billion and we also have additional committed facilities of £2.4 billion. If I look at the funding requirements of the business over the next 2 years and project that forward, what I can see from all of the analysis and data that I have, is that the next time I need to re-finance is December 2010. So effectively we have 2 years worth of liquidity available to the company, based on it's existing plans. So not an issue for us in the short term.

With that I think we will head over to Q&A.

Ian Livingston

Thanks Hanif and as always with Q&A, if I could ask I would prefer one question but a maximum of two and that does include Part A, B and C as three and we will come back if we have got more time to take your other questions, so we will start over there... if you can mention your name...

QUESTIONS AND ANSWERS

Question 1

Ottavio Adorisio from Société Générale

A couple of questions. The first one is on, you talked about the sensitivity to mortality and to inflation thanks to the agreements that you reached with the Unions and that should be approved by the members is declining. I went to the web site I checked the forty pages but I couldn't really spot the sensitivity because you put the sensitivity, for instance to 1.4 to each year increase on mortality rate. Could you just give an update on that one?

And the second question it relates to cost savings on labour. Your target is 10,000 decline in indirect labour but today you give us a figure of 50,000 as a sort of potential pool. It's probably difficult at this stage to talk about beyond this financial year but how much of this 50,000 could actually migrate from indirect labour to direct labour? Thanks.

Ian

I'll answer the second and I would hate to take away Hanif's expertise on the pension scheme.

But on the cost savings we will always have indirect labour, it's not a bad thing actually I think you see some of the flexibility of it but also there will be some third party things that are right to provide so it will carry on, I think it will come down, we will see a change in that mix, particularly as we reduce our overall base. So I don't want to project beyond this year but I think you will continue to see a change in that mix and I think particularly reflecting the fact it, (a) I feel a certain responsibility about people, but from a shareholder point of view it's been really expensive to have permanent people leaving the business. I think that applies to all businesses, you know forget whether, we don't pursue redundancy programmes but I think any business finds people leaving to be expensive, so we have got more flexibility. A lot of it will be delivered by improvements in service I just don't want to go beyond this year at this point to say what will next year be. But will we have to carry on being more efficient, yes, will be carry on having controls to make sure we don't have lots of people joining the business on one end when other people leave, yes, absolutely, and will be carry on performance managing to make sure that our best people are rewarded well and the people who aren't up to scratch leave the business, yes absolutely, as normal businesses do.

Hanif

Sure on the sensitivities you are right it's on the web site, an extra year is 1.4 billion a 25 basis point movement on discount factor or inflation is 1.2. The key thing I think going forward is the following:

Firstly that our pension scheme, the number of members, both pensioners and deferred it's a larger sample size that we have in the UK of any statistics that's going to be pulled together and the way we look at mortality is to look at the actual experience that we have with that cohort or group of people and the scheme actuary is currently working on that and when they share the data with us we will then be able to look at future sensitivities on mortality. But for the time being one year equals 1.4 billion, will it change dramatically, I don't think so.

Ian

But congratulations having gone to the web site already. Can we down there.

Question 2

Nick Lyall from UBS

Can I just ask, I'm afraid two if that's ok?

On the profitability on global services, as part of the gross margin review Hanif could you say whether it would be an option to close, or sell off parts of the business if you found them to be low gross margin, possibly the International businesses?

Also could you give us an idea of the UK high margin businesses, what sort of margin do they produce and what sort of revenue growth? Thanks

Ian

Well I'll answer and then let Hanif talk a bit more in detail. We think the Global proposition is very important because actually that's what we are selling to Global customers. So I think the idea somehow that you say to Procter & Gamble, oh we will separate off the UK from the rest, that's not something that's high on our list of things to do. Will there be little bits that we can do better and may be have a slightly different model that may well be. In terms of the UK, don't want to talk about UK margins in totality but what I am very clear about is actually we can improve our margins in the UK, so something I said on the call 10 days ago, I don't know Nick if you were on it but to give you an example, and this probably says something about our costs and margin structure in GS, that the medium sized companies that operate part of GS basically look very similar to the medium sized companies in BT Retail, it's where the overlap happens and we compared the two sets of customers and the EBITDA margin in Global Services for these customers was 15%, it's more than doubled that in BT Retail because actually the way we sell, the fact we sell far more reusable components and the way we service it, all of which is significantly better and it's climbed a lot in BT Retail on the course of the last 3 or 4 years. So I think it shows us quite a lot of opportunity to do better in the UK and so we will do as well. So we are seeing the UK business maybe declining a bit, the International business improving a bit but of course that mixes and isn't ideal and that's one of the problems, but…

Hanif

Sure Nick, I think for me there are two things. I think moving to a quick discussion on future strategy is a bit early at this point in time. But do we need to address the most optimum way to get to market and deliver service for our customers? Yes.

Do we believe that we can be much more intimate with our customers and have fewer propositions and understand their businesses better? Yes. I think for me the first things is to take the quick wins and if we can do 40 million in the last two weeks there is plenty to go for over the next 90 days or the next 11-13 weeks and I want to get through that period first and understand how much of that benefit we can take for ourselves before having a much broader look. I don't want to take the focus off people, I don't want to take the accountability off people because the minute you start talking about strategies and different directions everything goes up in the air and people start looking at different solutions, and for me great proposition, customer's want it, strong pipeline, customers signing up even today, a big win yesterday. So what I want to do is keep focussed on delivering and getting the right cost base and taking the benefit of that advantage for ourselves.

There are some nicer questions that we need to deal with. They will come later on in the process. Can we improve the gross margins, without a doubt.

<u>Ian</u>

A very nice UK win yesterday I shall announce that in due course.

<u>Question 3</u>

Maurice Patrick from JP Morgan

Question on the Union's and the pension. You appear to have won a coup yesterday with the reduction of the terms for the direct benefit employees, you'll be consulting on that. I am unclear as to what direct benefit employees get out of the re-negotiation and you talk about £100 million savings. What will you do if, as a result of the consultation, many of the employees of 69,000 vote against it, and what is the quick pro-quo and should we expect a cash injection into the pension scheme as a result of it?

<u>Ian</u>

We haven't seen it as a coup, it's been a very serious issue that I think the Union's have taken very seriously. What's really important for everybody is a few things. One is protecting past benefits. Secondly having a scheme that is sustainable and deliverable and affordable in the long term and that's what our people want to see. They end up with still one of the best pension schemes in the private sector in the UK and I think that's what our people get and why people like it. Also if you remember the BTRP Schemes which is the new recent money purchase schemes, there's enhancement of some of their benefits, because what we have tried to do is actually close the gap a little bit in terms of that, so there is some benefits there and that's netted off in the 100 million. So that's what they get and I think it's a very responsible attitude and it's been a very tough negotiation but what's in everyone's interest is to make sure that this scheme is sustainable and delivered in the long term and gives really good retirement benefits, and I will tell you something it gives excellent retirement benefits and I think people would love to be in it today and protects the past benefits and there is 376,000 to protect.

<u>Maurice Patrick</u>

It doesn't touch the ex-employee though does it?

<u>Ian</u>

Sorry

Maurice Patrick

It doesn't change the benefits for...

Ian

It doesn't change past accrued benefits for anyone, so current employees what you have already accrued you have already accrued. Paul over there.

Question 4

Paul Howard from Cazenove

Just on the consumer trends which obviously turned slightly negative in this quarter. Any sign of any economic impact in that or is it just sort of the history of price changes and looking forward you talk about locking your customers in to lower prices in return for getting longer contracts. Should we think of a back book issue here where you are going to go through a period of low consumer revenues as you re-base consumers on lower tariffs. How should we think about the trends over the next sort of few quarters.

Ian

I'll ask Gavin to comment, I think just saying overall that there is obviously a bit of growth in these numbers and I think as unemployment rises you will see more of it, but Gavin.

Gavin Patterson

I mean just to repeat what Ian was saying. To date we don't see any impact in our consumer numbers, particularly around bad debt. We think the right thing to do for the business moving forward is to get as many of our customers under contract as possible and that's why we have invested in price and in return will get better loyalty. So 25% of our voice customers are under contract and that's doubled over the last year, so there will be a flow through we think for the next few quarters.

Ian

As I say we haven't seen it in bad debt, I think obviously we have mentioned earlier the new connections certainly are down, it must have some flattening effect on Broadband of some variety.

Paul Howard

I guess what I was getting at is the sort of delta from someone moving from out of contract into contract, what sort of revenue saving does he get, just trying to understand what impact it is going to have on customer revenues going forward.

<u>Ian</u>

At one case you could say evening and weekend calls, what £2.95 are they, £2.95 they get them for free, so that's £3.00 straight away off the top just to give you an example but there will be different things but…

<u>Gavin</u>

In return for an 18 month contract.

<u>Question 5</u>

Michael Kovacocy from Daiwa

Capital intensity moving forward, anything on that? You've done quite well this quarter in terms of Capex can we expect more of the same going forward?

<u>Ian</u>

I think you can expect more of the same in terms of real focus on Capex and Opex and working capital because that's a pound of working capital is pretty much like a pound of Capex. I'm not forecasting a big movement I think we will edge it down on Capex but really it will be an edge but we are going to be looking… We've been looking carefully over quite a while and we are going to carry on looking carefully to see if we can do it more carefully. I am not predicting unless we really change one of the major programmes whether NGA or something that there would be a major change in the programme but yes we will be looking carefully and obviously we expect suppliers in this difficult environment who are desperate for business to give it us on the right terms. But I'm certainly not going to predict a major movement.

<u>Question 6</u>

Will Draper from Execution Ltd

Just coming back to he head count reduction. You've talked about the scale of 10,000 people leaving but without mentioning what kind of charges you might have to take, either as a one off for structuring provision, or as an impact on your annual leaver costs if you could just cover that. Thank you.

<u>Ian</u>

Yes I could do. I think most people probably have in the mid 100's so 150, 160, 170 of leaver costs I think that number can be sustained. That was the point I was trying to make that actually by changing the focus to saying right, how can we redeploy our people, actually we can get more people out without …. You know normally 10,000 people net reduction of 10,000 people would be which would normally cost us £60,000 a person or something like that to leave, maybe £40,000 - £60,000 per person, a significant number. However by focussing on these other areas we can save some of the costs of doing so as well as I said, and it's important to me, doing the right thing for our permanent employees I wouldn't change massively your leaver costs if you are in the sort of 100s, 150 -170 region.

Question 7

Steve Malcolm from Arete

Two questions please. First of all going back to Global Services I just want to understand contract accounting implications of what you did.

Should we assume there is any sort of one off element in the margin hit that you took in the second quarter and if not should we assume there will be prior year adjustments because you have been over bookings profits for cost savings that haven't been delivered and if so when will we see them. Sort of one question.

The next one is on your cost to capital. I mean if we go back to the May consultation document from Ofcom they were arguing that your cost to capital has decreased since their last review of Openreach. I'd like to know your thoughts on the evolution of your cost to capital in the last six months and how you think that will play in to the decision on the price of copper when we see it over the next few months. Thank you.

Ian

In answer to your first multiple question. I think it was a bit like have you stopped beating your wife, when did you stop beating her and you may have to go to court as a result of it. I don't see it in the case of you know of course we are going to be looking through all the contracts. But as being over booking…? What happened is, we said, look at this quarter if we looked at the amount of cost savings we have actually got in the bag that actually we really should take very little extra profitability on the contract because there is not more coming. So in that sense it was you know very much in quarter but has a double effect both in the normal and underlying of the business. Rather than anything relating to the past I think from what we have seen, and looked at it looks ok in terms of the past.

In terms of cost of capital. You are absolutely right our cost of capital has gone up, look at our dividend yield, look at the volatility and be grateful if people would point out to Ofcom that that's the case, we certainly have, and of course our shareholders would demand a higher return for making investment in our access network. In these environments I think any sensible person would see that and so we are certainly making that point we will have to see how persuasive are our arguments are, but certainly it reflects the facts.

Question 8

Graham Ruck from Merrill Lynch

Just wondering the significant slow down in broadband net adds, is there an understanding of how much of that is economic slow down, how much is market maturity and how is your thinking right now on what does long term penetration of broadband could be in the UK, has that changed over the last few quarters in your thought process.

<u>Ian</u>

It's not changed. I found it very difficult to separate off. You'd expect broadband to be an "S" curve but we are now at total broadband penetration in the UK is what mid 60's percent? Which is actually better than France, Germany, Italy, Spain, the US or Japan and I think the cap in the meantime might actually be reflected by PC penetration which is mid 70's I think? So I think you know you can't …. It's difficult to imagine particularly you'd run more above that. Although I think if you take the long term. In the long term there is going to be broadband enabled devices everywhere and every home I think will have broadband in one variety or another. It will be the way you receive a number of services so if that being in the long term. But I think in the immediate future yes, you will carry on seeing a slow down in broadband and there will be a combination of the standard "S" curve and if more people become unemployed whilst broadband is really, really important, high up on the list of things they want to spend. I've got to imagine if you can't afford it, you can't afford it, albeit we have outstandingly good prices. So I think it will have an effect and you will see it slow down relative to where it is today.

<u>Graham</u>

And how about competition from wireless and dongles, do you think that is part of the reason why the fixed broadband penetration has slipped.

<u>Ian</u>

No actually I think recession is far more than the … I am sure there are some people if you are a single person in a house by yourself who does very little surfing and has a laptop I think you might choose a dongle instead, most people choose it as well as. The customer experience of dongles is not great. Certainly if you are a multi person household, if you see the dynamics I think it is unlikely. I know Enders I think recently said that they thought you know maximum 10% overlap but I don't know. Gavin do you want to add anything to that? We are not seeing it today as being the big factor to be honest.

<u>Question 9</u>

Damien Maltarp from Credit Suisse

Just getting back to the 10,000 again is this just to clarify, is this what you need to do to get to the 800 million cost saving.

<u>Ian</u>

This is not … Well, yes, to get to … this is not a new set of cost savings announced. I think we are trying to give some greater clarity as to how we are going to hit it because to be honest we are listening to what people have said and you kept on asking about it. We wanted to be clear about the way we are going to do this, so no, this is not a new target coming a new … and actually because Global Services didn't hit their cost targets in the first couple of quarters the reasonable question you could have said is, does that make the 800 more difficult, answer, yes it does. So we are actually going to have to pedal that much harder to get their, but no this is not new. But I hope we set us on a better run rate for the future because I think you know, I think you see real real cost savings and real reductions in numbers of people. This is a net reduction in organic number of people.

<u>Damien</u>

Actually my second question was going to be what should we be thinking about, as to what will be baked into next year because I guess the majority of these savings will happen in the second half of the year. Can we quantify the benefit for the March 10 financial year?

<u>Ian</u>

Too early. We will talk about that maybe in a couple of quarters time when I have done the budgets, but people know that they will have to carry on reducing costs but there is a fair chunk to go for still, we have got, you know certainly not a billion if you look at best in class to go for so it's not going to stop any time soon.

<u>Question 10</u>

Petri Allas from Redburn

Two questions of mine as well if I may please. First on NHS there has been all sorts of discussions about the challenges and the programme overall, not necessarily in the BT part but in the programme overall. Any reflections on that and your interests potentially, further still going to the South contract even though the margins might still be too thin how do you see that going forward?

And secondly you talked about mobile termination potentially having a negative impact on some of the transit revenues. At the same time it might improve your competitiveness versus mobile on the sort of Retail side and I am wondering to what extent you see the mobile termination actually going down being a big opportunity for Retail holding line losses down as they have done now. Thanks.

<u>Ian</u>

Answer to the second question, yes. But I may let Gavin give a little bit more depth in a second after I talk about NHS, but yes I do think it is ridiculous that fixed line customers have to subsidise the mobile operators by the amount to pay on termination and I think a bit of neutrality about this would allow for a far more effective and competitive market place but I will let Gavin talk about that.

NHS. NHS we are doing. Some of the contracts on NHS are unquestionably difficult. Some of them we are making good money on. We are certainly far ahead of anyone else in the London Service Provider contract, yes we have got a number of mental health hospitals and community hospitals that are rolled out. There's some acute hospitals. We have had some problems over the Royal Free, not particularly in the software but actually in the specifications and how it operates. We think they are quite fixable and after they are quite fixable then we will roll that out. On the right terms we would do the South business on the wrong terms, no we wouldn't and I think it's important to ensure that they are they right terms so we will wait and see. It's a difficult contract, there is no question about it. On the other hand it's also a very deliverable, I think if we get the right structures it's quite a deliverable contract. But Hanif do you want to say anything about NHS.

<u>Hanif</u>

No I think that the point Ian made is the key point for me which is do we have the capabilities, yes we do, and we will only enter in to that contract knowing that there is a good margin to be made.

<u>Ian</u>

Gavin do you want to say something about consumers not having to subsidise mobile phone companies.

<u>Gavin</u>

Yes, absolutely... stealing my line…

<u>Ian</u>

It's worth repeating….

<u>Gavin</u>

I mean it's fundamentally wrong, we think that fixed line customers subsidise mobile customers. So we believe that mobile termination has to come down, indeed there are many signs that it will come down, but what we want to do with that is begin to offer it as increasingly as part of fixed line packages because what we have learnt in the fixed to fixed world, is that's what people want. They want the certainty that a fixed line … a fixed subscription package provides and the more and more we can fold into that the better and we would love to put fixed to mobile in there but with termination rates at the rate they are at the moment it's just not possible.

Petri

And can you in any way scale the size of the subsidy. Can you in any way scale the size of the subsidy you are providing.

Gavin

It's too early to say...

Ian

But it's worth hundreds of millions of pounds. It's also things like calling 0800 numbers for instance the mobile phone costs you 25p a minute, up to 25p a minute, we get customers saying you've made your service 0800 so it should be free and we are paying 25p a minute. There's a lot, there a lot still the regulator should be doing there. Anyway, in the middle there please.

Question 11

Nicolas Didio from BNP Paribas

Two questions. First a follow up on broadband market shares basically your net adds are 60% down compared to last year, this is worse than Virgin Media and BSkyB so can you just comment on your market share in Q2.

And on pension assets can you give us the value of pension assets at the date of yesterday for example and exposure to commodities and real estate?

Ian

We can pop out and find out what it is today. Pensions I'll pass over to Hanif if he has the latest one but I think 30 September might be the latest one we will see. And the first one, ours aren't worse than Virgin, Virgin I think was 65 to our 79 [CORRECTION – 56 to our 69] and…

Gavin

And lost 13 off net.

Ian

Yes that's including off net, so actually… so we have increased our lead over Virgin. Sky's were better than ours and building up of course leveraging off their dominant position in the pay TV market and no question that has been very successful in the market place and squeezing out a lot of small players, but BT has actually increased it's lead as the number one player so I am not sitting here going that's terrible and I think many people would have thought 27% share was actually not a bad share, it's just we spoilt people by being over 30% for quite a long time. So I am not that despondent about that in your terminology, if you answer the other question… Asset value…

<u>Hanif</u>

I think the best thing to do is to pick it up with the IR Team and they will give you the detail on a weekly basis as far back as you want to go.

<u>Ian</u>

I think in September we were 34 billion.

<u>Hanif</u>

It's 34 billion, I mean the broad numbers I have are it's as we said, 35% in equities, there is fixed interest is around 20% and then hedge funds is 5%, we've got lots in commodities and other alternative assets like private equity that's around 8% and we've got also a little bit of holding around 5% in cash as we came out of equities so we've got it in cash. So I think these change on a daily basis but I mean we can give you a full breakdown at a point in time…

<u>Ian</u>

We stood up well in this market place I think that's a really good performance from a peak of 39 billion to about 34 or something like that.

Anyway go over there.

<u>Question 12</u>

Christopher Nicholson from Oraca

Two questions. First one is should be assume that actually there isn't much room left to cutting Capex without making considerable withdrawal of service or at least your investment plans. I am thinking about keeping free cash flow in line with previous expectations, I think you suggested that it would fall back as a result of the reduction in overall EBITDA so I am wondering why you can't squeeze Capex further?

The second question is can you be a bit more explicit about the kind of problems you are having with the NHS and where that comes from? Is it that the NHS specification for example isn't actually the one that is needed or is it that you agreed to give a specification and when you went in you found out it wasn't the one that was needed.

<u>Ian</u>

No I don't want to talk about the NHS in depth. I think there has been a great deal of success with national programme for IT in the NHS and I think it's great always to focus on it but picture archiving for instance for the X-rays, a great success and it's really saving lives. The on-line prescriptions really saving lives, the N3, the network to the NHS has been really successful so I'd like to talk about successes. There's a number of hospitals operating with the new systems and like them. What we said is Royal Free when it went it it's had some teething problems and you know, it's a big system and we will sort these out with the NHS together, work out why some of them happened in terms of specifications and go forward and I think deliver real benefit for patients and that's what we want to do, deliver benefit for patients and do it in a way that makes for a return for our shareholders. But you know I think it would be absolutely wrong to go into depth on any particular contract, we are working very closely with the NHS.

And on Capex I think I've given an answer in Capex, you know we will be looking closely at Capex but don't expect a big movement this year I don't think in Capex.

And behind you.

Question 13

Chris Alliott from RBS

Two quick questions please. Firstly in Wholesale I notice that the managed services revenues popped up 20 million this quarter, I just wondered if you could give us an indication of the timing of the mobile contracts coming on stream and then the second question was. In Global Services you mentioned some impressive potential cost reductions, just wonder how long that could take to come through. Thanks.

Ian

Well we have given the full year forecast for Global Services in terms of margin and certainly one of the things I think Hanif's 20 million a week is not something you should extrapolate, albeit I've got it down for the next budget discussion. But Hanif do you want to say that and Sally do you want to talk about Wholesale?

Hanif

I think that the way I have tackled the problem is if I look at circuits as I mentioned earlier if I can do a country a week and cleanse the data I think there is a good benefits to come out of it. The real thing is you don't get the full year benefit this year, you get it in to your run rate for next year and my focus is to get all of the major countries done in the next 90 days, so that takes me to about the middle of February so, a big piece of work to be done and focussed to remain but the benefits flow through from that. What we need to do is to get a much more sustainable run rate rather than have one off benefits in this arena, I think that's the other critical part for me, which is to create a much smoother profile because companies in this sector and in this kind of business expect to have good growth year on year but also to look at growth on a sequential basis. So I think there is plenty to do, after the next three months I think we will have a good stock take every Friday as I mentioned, we are looking at it, a country a week there are opportunities.

Ian

And I remind what I said about the forecast 7-8% you would actually expect given where we have come from to be slightly better than that but actually we think there is more to do and more work. So I think it's going to get in the second half in terms of a run rate, worse rather than better… compare to because Q4 is normally a very good quarter, so let's start looking to next year and actually start delivering better than that.

I do apologise Sally I always forget Wholesale don't I….

<u>Sally Davis</u>

I think two points, one is of course our managed Service Contracts are more than just the mobile area but to answer your direct question we expect those to be coming on line over the next 6 to 12 months.

<u>Question 14</u>

Robert Grindle from Deutsche Bank

With regard the outsourcing of employees to Alcatel-Lucent within Global Services. Is there actually a cost saving from outsourcing per say or is it all about closure of the legacy networks and if there is a saving from outsourcing given your scale, you should have… can it apply to other parts of the business, can you think of more radical outsourcing plans within the group?

<u>Ian</u>

Well yes there is a saving from it, it's not a huge saving as it's 100 million. That actually comes to about 15 million a year so it's not a huge, big sum of money but it does come from, they will do it and manage it themselves. The bigger saving will come from closing the network. There's other areas we are absolutely looking at so some of the legacy IT systems for instance so we are looking at exactly the same way and really what we are doing is getting on the outsourcing either where it's not our core business or where actually it's legacy so allowing us to concentrate on the new stuff and develop that and that's the focus. We will also be doing something probably with our billing platforms, we have rather a lot of them and I think having someone focus on managing them to allow us to rationalise them is a sort of modelling structure we do. Back there.

<u>Question 15</u>

Michael Armitage from Blue Oar

Thanks very much. Two questions. One on pensions predictably. The Union's made much of it and they would wouldn't they of the ten concessions they managed to ring out of you and I wonder if relative to the 100 million costs savings you are claiming how much you might have hoped for, and I don't expect you to give me a real number but just a sense that the sharing of the pain between different constituencies.

Secondly a much easier question which is can you give us an update on WebWise.

<u>Ian</u>

I'll ask Gavin to give an update on WebWise and you are absolutely right I don't expect to share with you what we had put in… I think… you know I want to commend Connect and CWU, this has been tough, it's tough for everyone and what was really important for everyone is to get a sustainable pension scheme and also to protect benefits and improve the… reduce the volatility and the cost for the company and I think we have worked well. I wouldn't say it's been easy for anyone involved, but, you know our people and that's a really important thing. And our people have got, will have, some certainty and sustainability and have their past rights protected. But Gavin WebWise.

<u>Gavin</u>

WebWise for the uninformed is a behavioural advertising application we are running on our broadband service which has got some interesting press from certain parts of the Internet community. We are doing a technical test at the moment, we've got about 10,000 customers on it, they've opted in and we will be running that for the next 4 to 8 weeks and we will come to a decision on what we are going to do through this next stage in quarter 4.

Question from audience (without sound)

<u>Gavin</u>

Too early to say I think we haven't had any problems with it.

<u>Ian</u>

If you can pass the microphone to behind you.

<u>Question 16</u>

Stephen Howard from HSBC

Promise to only ask the one question, provided you answer it of course.

<u>Ian</u>

I always intend to give one less answer to the number of questions asked.

<u>Stephen</u>

Ok, Global Services the margin. I just want to try and understand the difference between a Global Services contract that is primarily International with one that is primarily domestic and try to get a feel of the margin delta between the two that results from the fact that Internationally obviously you are dependant on other people's infrastructure primarily, where as domestically you are able to piggy back off your tremendous infrastructure here in the UK. I would just like to try and understand what approximately is the delta that results from that, because obviously so much of your growth is coming Internationally at the moment in that division.

Ian

Hanif. Either with your Finance Director's hat on or your acquired knowledge of Global Services.

Hanif

Is there a generic answer to this and unfortunately there isn't. But what the experience and history shows us is that partly the UK margins tend to be stronger than the margins we get on contracts outside the UK because the UK has legacy services in there so they tend to have an element of calls, an element of lines and element of private circuits on top of having IP, so they have a number of legacy or traditional services in addition to an IP contract.

Globally and or nationally, or Internationally they tend to be much more new services and new IP platforms that customers are looking for so it's much more a transformation and step change that the customer is looking for and therefore the margins tend to be lower. But if you compare an IP service to an IP service the margins are broadly the same, what we have to do on top of that is basically is to sell additional services and to get a bigger share of those customers requirements and that's where you make the additional margin and in the re-use. So if you concentrate on a sector across the globe every time you sign a second, third, fourth, fifth customer it doesn't matter whether they are French, English, American you make much more bigger margins on the second, third and fourth customer because you have so many components and platforms that can be re-used. So it tends to be a much more of application but in terms of a broad similar type of contract, similar margins.

Ian

I think it is also fair to say that availability of access circuits at the right prices around the world is not as open as in the UK and you know for instance, if the same rates were available as in the UK I believe we can save more than £200 million in access costs and the US is probably as bad if not worse. So you know I think that represents a real opportunity because we should see you know a consistency of regulation around the world that would give greater opportunity so that does have an impact.

Stephen

Ok, so I appreciate that obviously so you have got two issues here haven't you. Firstly you are going to have less repeatability because your customers are going to be more diffuse over the planet than they are going to be you know concentrated here in the UK. Secondly you are dealing with access prices which lets face it are not, they are not fair. So is it really the case that you know, like for like, you know standard IP you know MPLS, IPVPN contract has the same margin here in the UK as it would if you were to sign it up in the States.

Hanif

There are other factors to bear in mind. For example the wage rates will be different in different countries. If you are delivering service remotely from Eastern Europe for the European languages and from India for other parts of the world you get different cost advantages that are associated with that. So I think that the more you move in to a shared service centre the less in country it is and you are providing it from the best location with the best price point. But the access circuits, the points are valid, but I am just saying there are lots of moving parts to the equation.

Ian

And also it is wrong to think of most of the Global Services contracts in terms of in country, and this country and that country because actually what you are providing is across on the global basis and what you look for is the averaging of the overall capability and performance. It's true if somebody was you know wanted 95% of their business in the US actually we find it very difficult to compete. If they are looking for 30% of the business in the US or 20% then absolutely we can do. So there is, you know, if it's very, very largely in country and a country that doesn't open up it's access that's problematical for us, there is no question about that and something obviously we will be telling the new Chairman of the FCC. Over there.

Question 17

Gadi Slade from Capital World Investors

Two questions. First on your average cost of debt as a percent of net debt, what should we expect for this year and next year.

And second on acquisitions in the past few years you've acquired roughly in the order of £300/£400 million per year and a £187 million in the first half, shall we expect a comparable run rate going forward?

Ian

Well we are not ruling out acquisitions but I don't think it's top of our agenda just at this moment particularly because Global Services was the driver of it. I mean there may be opportunities that come up because things do happen but it's not high on our agenda just at this moment.

Hanif

Yes, it's around 8.5% trending down toward 8 over the next few years, so that's interest cost as a percentage.

Ian

One of the things that actually happened on that is actually we have incurred extra costs for having borrowed early in terms of the fact that we have got cash on hand against having you know debt outstanding but, I think a lot less than we would be doing if we were trying to raise money in the markets today so, we are taking a bit of short term pain for a long term gain and certainly a significant amount of long term certainty and good sleep. Over there and there…

Question 18

Jeremy Taylor from Lazard

You reported 4.1% revenue growth and 0.9% EBITDA decline. What were those numbers on an organic constant currency basis please.

Ian

Well the revenue growth was slightly worse than flat but you have got to add back the, if you've got the constant organic then, add back termination as well then you would be back up about one and a bit percent. So the answer is slightly below zero or about one and bit percent something like that. On EBITDA it's not a huge delta and it's actually, it's very difficult to track the EBITDA at that sense except that we know that FX cost us £11 million so you can add back 11 million for FX.

Question 19

Mark James from Collins-Stewart

In terms of working capital management and cash collection, I know you have obviously got ongoing moves to smooth that and I appreciate that Q2 was better than last quarter and better than last year. Is there scope for working capital do you think to be an inflow in Q3 given that there is a sort of step change and all the changes afoot in Global Services. Do you think you have got more scope now to actually get cash in the door?

Hanif

I think there is no doubt that H2 will be better than H1, it always has been. How much of that benefit we get in Q3 will really depend on some of the negotiations we have on the major contracts so I think it's really difficult to tell at this point in time until I get my feet under and actually look at, and focus on those activities. They are happening, whether it's Q3 or Q4 it's in the balance.

Ian

I think plan for Q4, we did have a big outflow in Q3 and everyone said it was terrible and then we had a very big inflow in Q4. I wished in some ways we weren't sort of having to do these quarterly reports and things like that, second half will be better than the first half, I think it will be Q4 rather than Q3 I think that's a better way to plan.

Two more questions. Take one down here and there is a one over there we can… excellent… have I missed and one over there as well. That's it excellent and then we will finish.

Question 20

Darren Ward from Liberum Capital

Sorry it's another one about the pension. The £100 million you said it was EBITDA and at cash flow, is that net cash flow or is there tax to come off that, and the second thing is would you characterise that number as a 100 million sort of flat nominal number or will it grow over time, so is it basically 100 million real number, I'm trying to value the benefit in present value terms of that concession you've got from the Unions.

Hanif

It's pre-tax and I think the impact over time. There are two factors to bear in mind, firstly is that it does on an underlying basis it does improve over time. The thing that goes against it is the fact that the 2008 triennial review will change some of the assumptions which will have an impact on the ongoing benefit. So the best thing I would assume for the time being is just 100 million, I can answer that in much more detail and give you the right ongoing impact after the triennial because that will change a number of assumptions.

Question 21

Morten Singleton from Oriel Securities

You've highlighted to us previously that Global Services long term contracts the first 12-18 months might incur start up losses, so the profitability tends to come through towards the end of the contracts. To that end therefore intuitively one would consider that strong growth in that business hampers the margin. To what extent would you say that has been the case and where is your focus going forward in the medium term, is it going to be on absolute revenue growth, absolute EBITDA growth or EBITDA margin in that business, thanks.

Ian

I think actually our focus is going to be more on cash flow and I've got to be honest I said this three months ago as well that EBITDA for our capital intensive business, in fact business that can change it's capital is actually not a great measure. Now would I prefer to have you know double digit EBITDA and double digit Capex in the business or single digit EBITDA and no Capex, it's not that difficult a thing. So actually we won't come with new forecasts etc at this point, but I think what we are moving to…. actually delivery of net cash flow is the important thing and then you get away from discussions of how you contract account but it's absolutely true, the first 18 months is less profitable. We are certainly, the big new contracts we have taken have cost us, you know, because they would cost us money. On the other hand when we look at them actually they are much better quality contracts than may be a few years ago partially because we are actually now building on the foundation we set and so, and we are delivering them also well. So you know I am optimistic about the future but I think our focus is going to be on long term net cash generation because after all that's what we pay the dividends with.

With that I think it is a good place to end and say thank you very much to everyone, thank you for your time.