BT Group Plc
Third Quarter Results
12 February 2009

<u>Chief Executive Officer - Ian Livingston</u>

Good morning and welcome to our Quarter Three results presentation. I should say we actually are trying to stop having Q1 and Q3 result presentations and get to more normal cycles that most companies have, but I felt given the results, given the Global Services things this was not the time to be seen not to be coming in front of you and giving you the chance to talk about the results and give the visibility that I think you want and we certainly want.

The usual statement regarding forward looking caution, which you can read at your leisure.

Now let me start here. I think I am going to start by saying that we recognise very much that the performance of Global Services this year has been extremely poor. We recognise that it's had a significant impact on BT Group as a whole. But what we are going to try and do as we talk through the business today is to separate out I think, two things that are happening in our business. On one side the rest of the business which is performing pretty creditably and doing I think most of the things that it should be doing, although not as much as they will be doing, and Global Services which unquestionably is not, but will change and will improve and will take the lead that the rest of the business has set. Now that is not to say when we talk about this that we think in any way that we are not a group as a whole and the results of the group are as a whole, but I think it gives a much better view of what is overall for BT Group.

Now just taking some, what I think the key topics for BT are and we will talk about some of these in depth and I'll just touch on some of them today but I think these represent the key topics.

First of all and probably most important, sustainable cash generation. It's why we put the comment out about next year that we expect to do more than £1 billion, that is in excess of £1 billion we believe is a sustainable level. We want to smooth things out, we don't want to have quite the same degree of very high Q4's, bad Q1's etc, of course we will be uneven, but sustainability, visibility, predictability that has to be the hallmarks, it is in the rest of our business, if we can get Global Services in the same place it will be for our whole business, and of course it is cash generation that pays the dividend.

Cost savings, we are going to move our cost savings and the way we express our costs savings from talking about gross cost savings, re-investment and all that sort of stuff, because many of you made a not unreasonable point, yes I can't see it. I mean a lot of the cost savings were absolutely there, the cost savings were there, but let's got to net and today we will show you the sort of net cost savings we are making. The fact that outside Global Services we reduced our net costs by 7%, Global Services are up 10%, that explains the fundamental difference in performance.

Global Services itself. Of course there is some economic environment around that, but Global Services is an operational problem with operational solutions, full stop.

The Pension Fund. That's something that's somewhat less in our control but we recognise it is a very big sum of money, it is a key uncertainty and I regret it something that we can not give you clarity until the Q4 results, and at Q4 in fact that's bringing it forward from what it used to be in previous times where you would often not get the actuary valuation until much later in the calendar year. But we recognise the importance of the Pension Fund and recognise it's size and we are doing that which we can.

Customer Service. Important to mention it, it is a key focus for us. Two reasons, the obvious one is because of what we can do for the customer and we are making really significant progress, lots more to do. But for instance we are seeing the number of abandoned calls, calls the customer can't get through, reduced by a third. We have seen our network quality improved through investment we have made. So it used to be, you would have a network fault once every 10 years, now it's once every 12 years, 20% reduction therefore in faults. We have seen the work stack, for instance, on Christmas day there was only about 4,000 people out of the whole country who had a problem with their phone line and about half of these actually didn't want us to repair at that point because they were away. That is a fraction of what it was a couple of years ago. Today with all the snow, we've got 11,000 people with a problem with their line. We were running at an average of double that just a few years ago, an average, and when things got bad it was 50,000 or 60,000. The reason I mention it, because I know you are all interested in Customer Service in it's own right, is also something else, cost saving. A lot of the cost saving we are showing today has come through that improvement, cost of failure, a big cost and you can see the reduction in the number of people we need in the call centres through getting less calls, because there are less faults and we are doing thing better right first time, and we have got a lot of distance to go.

Regulatory and governmental environment, it's sort of getting more interesting. We have got of course some big price movements, Ethernet for instance we've reduced the price, we have got Financial Framework Review, we've got the NGA discussions which are progressing and we have also got digital Britain. I think digital Britain is obviously in it's formative period but it presents a number of options and we will see how that progresses, it is very early though.

Finally the economy. I think most CEO's would probably have that up at the top and it wasn't last on the list because it's last. But it probably isn't our biggest thing because I think we can do a lot more operationally. We are seeing however some affects on the economy, not a surprise to us, not a surprise to you. We are seeing it in or SME business, we are seeing it in the consumer business and we are seeing it in number of lines, but a lot of the future is in our hands about what we do and despite seeing it in the SME business, despite seeing it in Openreach and number of lines, despite seeing it in the consumer business, despite the fact that Dabs.com has got double digit declines, despite the fact that our devices business has double digit declines, we have shown profit growth. That is because we are doing what we need to do, because we expected things to be tough.

These are our key topics, we will be covering a chunk of these as we go through but I wanted to give an overview of what I thought were the important things for BT.

The key points for 08/09 pretty much as we said a couple of weeks ago. Ex-Global Services best results for five years I think, haven't gone back beyond five, 5% EBITDA growth, if that was the only number we had to give you, life would be pretty good, it's not. I think the reason we have achieved that number is because in June we came in and said we need to assume things are going to be tough and let's take the action and we have.

In Global Services however I said very poor, extremely poor, take whatever word you want. It's a matter of great regret but that performance has affected the group as a whole. We are going through a process and this has to be the year that we clear up things and we start ourselves on a much more steady base and then you can start to see the affects next year. It's what I said, it's what I said a couple of quarters ago, the depth of the problems are greater than I thought, not greater than two weeks ago but greater than when we last spoke.

But I continue to believe this is a business that can generate cash and I think when Tony takes you through some of the costs and takes you through some of the actions we have done elsewhere I think you can see the scale of opportunity, and the scale of opportunity is significant. We are taking decisive action and I will say a bit more about that in a second.

The one-off charges £336m we haven't taken any of these as being specific, we said a couple of weeks ago that some of them might be specific, we have just decided in the interest of clarity we will make them all non specific, you can debate how much should be specific and not. You know in this environment we want to be very clear, very forthright, let's make them all non specific. In fact the only specific item we have in the P&L is a credit, there is a 40 million credit, everything else non specific. They are one off items but let's not try and call them specific.

So that's that performance and the thing I would say to you by line of business, is every single line of business except GS has performed above our expectations and I think above your expectations.

I'll go through them individually but I think I would just say solidity in Retail, Wholesale the trends are improving, Openreach a particularly good quarter and that will ameliorate a bit in the next quarter and we will talk about that. But good quarter but doing what they have to do and the performance on the right is self explanatory.

So let's talk about it. Remind you of what we said on 22 January. We kicked off, Tony and myself, Hanif and the new management team in GS, a number of reviews.

First of all financial review. Going through the balance sheet, making sure particularly in the light of the economic conditions that the balance sheet position was ok and was looking well as any adjustments you had to make, any sort of different views and we did take some different views.

We looked at contracts. We identified the 17 most risky contracts, the ones with some of the highest balances that we knew were more controversial so we tried to do a very much praetor on this so the fact that there are only 17 we did try and identify the, by far and away the biggest and most risky ones. 15 of those completed the vast majority no material change, some of them quite significant changes and two still outstanding, exactly what we said. We are in discussions with the counter parties in these contracts and there is a wide range of what might be the outturn of these, again that's not changed from a couple of weeks ago, and we expect reviews of all the contracts being completed in Q4, and also, to be completed in Q4 will be the operational review. How should GS be structured, what's the best way to operate it, is there any asset values that aren't right and whilst I expect most of the costs relating to that will be non cash, I suspect there will be some cash charges as a result of that.

So we have seen substantial one-off charges in Q3, there will be more in Q4 and this is a year we have to get ourselves back on the right base.

That's sort of the quarterly performance and of course the underlying performance is pretty poor even forgetting the one-off charges. In fact it's very poor and the reason for that is pretty simple. We talked about cost control and probably I was being overly generous when I referred to it as poor cost, as not delivering the cost savings. A 10% increase in cost ex FX and acquisitions. Now the reason put in that context, revenue excluding FX and acquisitions actually is pretty much flat so that's effectively a 10% increase in cost base, and that happened through the course of last year and really in to Q1 this year. We started to roll back this and I think you will see the effects more next year but Tony will talk about some of the things we are achieving and some of the things we need to speed up a bit.

Still winning contracts. Why? Actually we are providing good customer service and customers still want what we have got to sell. Unquestionably we are seeing an elongation of the sales cycle and I expect to see that in to Q4 and next year. It's taking longer to close deals. The pipeline actually continues to look strong but if it takes longer to close deals I think you will see a lower level of orders next year but we are doing pretty well. I'll take something for instance, Lloyds TSB we have signed deals with Lloyds TSB and HBOS as was, very substantial deals, very good deals. We've done, together with Logica for the Dutch Government. We win some, we lose some, we are actually winning a lot more than we lose but we are also walking away from some contracts. There is one contract announcement by one of our Global competitors recently that was a deal, I can tell you, we said we don't want to do that, the margin, the cash flow forecast on it just wasn't acceptable and so yes we probably are being a bit more picky and I think you would probably appreciate that.

So what are the actions we are taking. Well firstly this started with a new management team, and whilst you know about the new CEO and new CFO probably what you don't know is of the people who started in the Global Services leadership team at the beginning of this year about two thirds of them are no longer in those positions. So that's a pretty radical change around the business.

A real focus on cash generation, sustainable cash generation, not doing something in one quarter, sustainability, reduce the capital intensity of this business, not just capex but actually particularly working capital. Too many deal we did had too heavy negative working capital for too long and we won't be doing those in the future. We need to make the cash profile less uneven and that's why we made the comment about Q4 this year. I made the comment at Q1 this year that there was something in excess of £300m that had gone in to Q4 and effectively come out at Q1. Remember how much you enjoyed the Q4 cash results and remember how much you didn't like the Q1 cash results and I felt much the same I have to tell you. There is over £300m that have moved. I don't want to do that, I want to get solidity in level, it's not about improving next year, it's about a sustainable basis, and GS is the key to that improving GS's cash flow.

We need to execute the cost savings. Tony will talk about that and talk in some depth and I think Tony's record and history will also give you a lot of comfort.

The impact of these actions, you will see some things happening but really it's a 2009/2010 you'll start to see them being affective that's exactly what I said two quarters ago, that's not changed. We will talk about the operational review, I know you will want to ask about it but I really want to do it in Q4 because it's very much work in progress.

Now turning to other parts of the business.

Retail, very solid EBITDA up 6%. It's revenue is down, actually excluding FX and acquisitions it's down 3% as you see we are taking out acquisitions, taking out FX so you can see these numbers very very clearly. You might say why is there FX in Retail, the answer is our conferencing business in Ireland has an impact on the FX.

SG&A down 7%, actually again if you take out the FX, down 10% that's pretty decent result. Again more to come, and we are seeing the benefits of the right first time and customer service programmes meaning we need less people in our call centres, it means we have less costs of failure, so it is improving things, but we are still on a journey.

In terms of the revenue position, they haven't shown here our enterprises bit and Ireland both had revenue increases, but in consumer we saw revenue down 6% and we are seeing some impact particularly in the number of lines but also in Dabs.com revenue comes in to there and certainly we are seeing the affect on that and devices, payphones, but I don't think that's an economic thing, so we are seeing impact.

On the other hand our customers are buying more from us, so broadband market share, I think was a very credible 28% in the quarter so we are still at 34%, that's an improvement on what it was the previous quarter and if you actually look at what's happening in that market place, Sky through their positioning and leverage of their Pay TV are obviously proving up a lot of net adds. Then you've got BT, then you've Virgin and a bit of Carphone Warehouse, a lot of people must be going backwards. So I think we are still a largest provider of Broadband in the UK and actually have increased our lead over the last year.

BT Vision, 56k net adds so we are actually now about 400k customers and they are using it a lot more. The ARPU's going up quite remarkably, the ARPU this quarter is about a third higher than last quarter and actually the ARPU of new customers is about 85% higher than it was a year ago, so we are seeing significant increases in usage and take up and I think that's pretty reasonable news.

Business revenue is flat, and we are seeing evidence of SMEs, well some of them are going out of business regretfully, some of them actually are de-camping in to the home, where they used to have an office and one of the ways to save money is effectively, they take a room in their home, they obviously need less lines in such circumstances, they are also laying off people so there is unquestionably an impact. So the flat performances is not too bad in that circumstance but we are seeing an economic affect.

Some other places in business we are seeing I think some good stuff. Well over 300k people are now using tradespace and that's a decent proportion of SMEs in the UK. It's becoming the place where people do business and we are pleased with that and continue to grow it.

In Wholesale. Wholesale has done better than we said it would. Retail mind you did better than we said it would. Wholesale we said you would probably see a significant improvement in the trends in Q4 well actually I think this represents a significant improvements in the trends in Q3 and Q4 will be fine in that sense as well. What we are seeing is the continued affects of the stuff you know, particularly the migration of broadband to LLU. On the other hand managed network services more than doubled. We are also seeing a slow down in the rate of decline in transit and things like that. Just a warning for next year, it doesn't affect the profit but will affect the revenue of mobile termination rate reductions. Now that is good news for our business mobile terminate reductions because it reduces the subsidy that our customers and BT has to pay to all the mobile operators but it does reduce the headline revenue.

Overall EBIT in Wholesale down 7% again an improvement on the previous trend and the reason it's held it to that was a 29% reduction in SG&A, so that's a pretty credible reduction but again is not the end of the story. That has come as well to the right first time programmes to reduce fault rates, improvement in customer service, reducing things.

Openreach. Stable revenue again of course external revenue up relative to internal. Operating costs down 4%, we are seeing again, apologies I sound like a broken record, but some of the service improvements coming through, access faults down by 21% that was the point I made about the improvement from once in every 10 years to once in every 12 years in terms of when the line goes wrong. EBITDA up 9% to £533m now that's a little bit of an exceptional number, got things like some copper reclaim in there and we expect in Q4 I think that will be significantly more stable to a small increase but the year to date up 5%, good performance. The reason why I expect Q4 to be not so strong is we have got the affect of Ethernet price changes. Some quite big reductions going through on Ethernet price changes, we won't have any benefit from the Financial Framework Review until April so Q4 will have that affect. Now the good news about Ethernet price changes is whilst there will certainly be an initial impact I think it gives an opportunity to increase volume. It was interesting that when we announced Ethernet price changes we got a complaint from one of our major competitors because they didn't like it because we were reducing the prices. It was interesting we had lots of customers asking us to reduce the price but this competitor and what it does to then suggest that was going to make our product a lot more competitive, I mean it seems to be in this regulatory environment that people think that the regulator should stop as being competitive and I am very glad to say that Ofcom took the right decision and said that we could reduce the prices, although it did delay the implementation a little bit.

Platform strategy. Very much what we said last quarter, a couple of things may be to draw your attention to. Software as a Service and Enterprise Cloud Service. I think for a debut performance Cloud Services are mentioned, I am sure any of you who follow the software industry will see that mentioned a lot elsewhere and certainly we feel because it uses the network and the applications that we can provide, very much it fits in with our vision of the 21CN which is a network and an IT layer and an application software layer above it. So we will say more about that in the future but I thought I would just introduce it.

The other thing I would draw your attention to because most of the rest of the stuff is making the progress we said it would is Ethernet footprint. We were a bit slow with Ethernet and this year we have really increased the speed of

Ethernet. We have got a lot of investment in it, we now have the widest Ethernet footprint in the country also the 21C Ethernet gives more capability than the standard Ethernet and I think that will give us quite a potential advantage.

Pension Fund. Based at £2.4bn, I know some of you are surplus on that on this one and I wasn't quite sure why that is. I mean basically what's happened is you've got AA bond rate going in one direction, inflation going in the other, effectively good and bad they roughly offset each other and then you end up with the reduction in asset values and basically from £34 and a bit to £31.5bn and that £2 point odd billion, £2.5 to £3bn reduction effectively takes us from surplus to deficit. IAS19 numbers are notoriously volatile and I am sure would be a very different number again next time I see you. More importantly is actuarial funding. The actuarial funding will determine the cash we have to pay, the process we have got to do is work out first of all with the Trustees what the deficit will be and there is a lot of assumptions to put in there, working out the assets are almost the least of the problem, it's working out exactly what the liabilities should be and what the discount rate should be, and then when you come up with it then you have got to work out what should be the funding cycle that should pay off that deficit, particularly recognising where we are and I think in the economical cycle.

Just a couple of things to help you all to say about it, I can't tell you about numbers on it, but just some of the numbers I have seen in reports, any deficit if you divide it by 10 or 20 years you have got to remember you got NPV that and you know paying ten lots of £Xm doesn't come to 10 X because you have got it over a long period, so you have got to remember you have got to effectively, if you are paying it over a long period there is an NPV deficit we have got to meet. That's a negative versus, I think a lot of you just do a straight arithmetic calculation. The other thing, for some of you, on the other side of course anything we pay we should get tax relief on so we should be basically 28% less than whatever the amount you pay in. So you put all of that together and whatever number you come up, can you just remember both of those two things, and in Q4 we hope to give you the real numbers.

So the outlook. Well Global Services outlook is as we said. Q4 will be impacted by costs and one-off charges. It's a horrible year, enough said.

Retail, continued EBITDA growth, continued solid performance, yes the economy is getting worse but Retail is cycling that much faster.

Wholesale, trends should improve in to Q4 and in Openreach I think Q4 will be broadly flat, maybe marginally better than that.

Now all of that means that we are looking for EBITDA growth, ex GS in Q4 of 3%.

Now it's really unusual for us to give you a Q4 estimate in Q3 for EBITDA. The reason we are doing that is we want to say to you, that most of this business is pretty predicable, we've got it under control and there is visibility, and that's why we are saying here's the number. We need to do that in the rest of the business but we want to give that clarity and give as much certainty as we could.

In terms of cash flow there is no change to underlying cash profile and position of the group, we are going to effectively stop trying to push, you know we want the money that we can get but we really want to stop pushing for really hefty amounts in Q4 that I think is unsettling to the business and really doesn't help us in the long term. I don't think anyone enjoys quite the degree of uncertainty going in to Q4.

But next year we want to give you reassurance about the cash flow and we talked about cash flow of over £1bn. Now one question I have already been asked is does that incorporate any cash restructuring charge, well the answer is, I think we can absorb the cash restructuring charge in that number based on what we currently expect if we did a hell of a lot more because we'll have a hell of a lot more savings, life might change. All this can only be on the basis of where we are today. But we are expecting that before deficit pension fund and I stress the word over a billion, it's not, if I meant a billion, I would have said around a billion. So it's meant to be reassurance rather than anything else on next year's cash number.

So I want to pass over to Tony now. I thought because a number of you won't know Tony, it was worth me giving a little bit of a comment about Tony's background.

Tony before his current role of CFO and he's been in CFO for about 11 weeks.

Group Finance Director - Tony Chanmugam
75 days but who's counting.

Ian
He's spent 75 days – yes he's spent 5 years being CFO in the last 75 days.

Tony was the CFO of Retail for about the last 5 years and look at the Retail numbers and when Tony took over in Retail that was a business in terrible shape, profits were declining, revenue was declining and frankly it needed a radical shake up and Tony and I know because I was CEO, Tony was an absolutely critical part in that delivery.

Prior to that he was the COO of Global Solutions. Now Global Solutions effectively as a forerunner of the big contract business in Global Services and during that time he took that business from a business that was losing money and losing cash to one that was delivering cash, delivering profits and doing it and I know because I was Group CFO so I saw it and doing it on a predictable and consistent basis, and it is that background of delivering transformational cost change, predictability and stability was the reason I asked Tony to be Group CFO, and with that I will pass you over to Tony.

Tony

Thanks Ian. Morning. You can't see my blushing, one of the advantages of being the colour I am.

I want to talk about four key things. Four key things that make a difference to me and will make a difference to the business.

The first piece here is, Ian has already referred to it, it's about cost savings. But it's not about gross cost savings, it's about the absolute level of reduction, and unless we can identify the absolute level reduction and explain that to you we are not doing what we are meant to be doing. For me what we are going to be doing is looking at the absolute level of cost reductions that we generate quarter on quarter and making that information available to you with an additional degree of granularity.

The second is this business is about cash generation, and as Ian has said it's sustainable and it's predictable and that's how I want us to be evaluated. When we evaluate bids its' not going to be on gross margin, or EBITDA, or NPV, I mean they all have bits to do in terms of the evaluation process but for me two key components, cash generated, risk associated with that. Obviously you have the pay back period and you have the IRR but that's the way we will do business moving forward. Cash and risk in terms of bid evaluation.

I want there to be increased transparency in terms of what we do from the financial perspective. If we have increased transparency you'll understand what we are doing and if you understand what we are doing it makes it easier for us, you are part of our communication process and so I have no qualms about being able to give you more information as we proceed further forward. I'll live and die by that information but I have no qualms about giving it to you. We manage the business effectively we should have no qualms about telling you how we manage that business, and about giving you cash flow reporting is about doing that and that will be line of business level and that will be the first degree.

Ian talked about predictability, and predictability comes from close management of the business. If you manage the business well, you manage the business effectively you have a level of predictability associated with the results. We are talking about Q4 numbers at 3% growth. Now that's a degree of preciseness, that preciseness comes because we have an understanding where the business is going to land. We need to get that same understanding in to Global Services with a new management team led by Hanif in there we are starting to make the right steps. Between Hanif and Ray and the team there will be a difference.

I am going to talk to you with some numbers now.

The opening profile of the business that Ian has talked about, take out acquisitions, take out FX and if we were being generous to ourselves that rounds to a percent but in affect it's flat, it's a flat revenue stream and we are going to be managing our costs on the basis of a flat and declining revenue stream. I am not saying we are going to have a flat and declining revenue stream longer term, or medium term, I am simply saying that we are going to manage our business on the basis of a declining revenue stream.

In terms of our EBITDA, two key components parts of that. The GS business that has dropped £198m in the course of Q3. So in other words £17m EBITDA compares to £215m same period last year. Offsetting that, as Ian's referred to, is the 5% increase in the rest of the business, that's a material increase. We've talked about the one-off charges so let me move further forward to the second part of the P&L account.

You'll see a depreciation number that's broadly flat and the guidance for you for Q4 is it will also be broadly flat. The leaver costs are up, they are up by £13m but there is a reason for that. We are removing people from the business at an accelerated level than we originally predicated and I'll come through to the numbers in that in a second. In terms of guidance for Q4 I have expected a number between 45 and 55 and uniquely 55 is better than 45 but it means we have got to kick start in to next year in terms of what we do.

The finance costs at £180m represent an increase and that's for two reasons. The level of debt has increased by roughly speaking 10%, a slight increase by about £100m from last quarter and we have got a reduction in the level of pension credits we received. In terms of the specifics Ian referred to the fact that we have got a credit in there, we are not putting in one-off we are holding it quite clearly as a specific item and it's our share of our associates assets.

If I look at the JV and associates, the key number in there is our share of Tech Mahindra profits and it's a big movement from last quarter and that's the biggest number in there.

As far as specific items are concerned, sorry I moved forward, let me part the specific items, that's the elements in terms of JV and associates. The piece I should have said to you on there was in relation to last year that we had two key components in last year, a restructuring charge and a provision in relation to some circuit inventory and that's the reason you are moving from a negative to the positive.

Tax rates at 22.8%, guidance is that it will be 22.8% for next quarter and be moving slightly upwards, we will give you full guidance in relation to next year at Q4.

Let's move forward in terms of the cash flow. Key components in there that we haven't really talked about is first of all is the interest and that movement is primarily a timing movement. It's timing on the coupons for debt and that will fluctuate quarter on quarter. The tax payment its a material increase from Q1 and Q2, Q1 and Q2 we hardly paid anything at all and that was primarily because we had over payments from previous years that could be netted off.

The working capital component, I'll come back to Capex. Let me talk Capex now, there is a reduction in capital and there will be a reduction in Q4. Your consensus was round about 3,167 I think and will be round about the £3.1bn mark. It gives you an indication of what's happened over the last couple of months and is an indication of what will happen in the future moving on, again we will give you full guidance in Q4. But the key point is that that is a downwardly moving number and it's not by simply taking out expenditure and not doing things that make economic sense, it's about being more selective in what we do. I'll give you an example when we talk about in cost savings.

On the working capital, let me explain that, that number there flatters us because effectively you've got in there the right down for the one-offs, effectively the movement in the balance sheet of the one-offs. If you take that out the working capital is only £88m so you are taking out £366m from that number there, it leaves you with £88m as a working capital improvement. That is partly down to two reasons, we have got a better management in terms of our creditors and the stock values are down.

In terms of the other components what you have got in there is last year you have got one off restructuring costs and in this year two movements of non cash, so it's inherent in the EBITDA number but it's coming out in terms of non cash, that's movement in terms of provisions and balance sheet evaluations in terms of FX. Hopefully that makes sense, I am sure if you need further elaboration then Catherine and the team can help you afterwards.

In terms of liquidity the net debt is at £11.1bn, compare that to this time last year it was about 10.2, last quarter it was about £11bn. Two key components, two really important points. One is there is no requirement for major financing until December 2010 and that's based on our current plans and the current profile of what we are doing. There are no financial covenants on the debt.

Ok, let me talk to you about costs now. If you look at our cost base for the rest of the business excluding GS, so this is Openreach, Wholesale, Retail, Operate, Direct the central business areas. On a like for like basis taking out the impact of FX and taking out the impact of acquisitions, we've reduced that cost base by 7%, £138m. That's Q3, playing Q3 now that's a significant movement, it's a movement that's in line with the previous trends, it's in line with what we need to be doing as a business moving forward.

Now how have we done that. The key piece here really relates to what we have done in terms of labour resource. Ian made a commitment in terms of removing 10,000 people from our business and by this it's TLR so as Ian talked to you earlier, just to recap, TLR means our permanent staff, our agency staff, contractors providing a service and third party offshore staff.

About a quarter of that's come from BT staff, three quarters of it has come from the other areas I have talked about.

Now in terms of where we are now, we have probably hit the 10,000 Ian has already talked about and the key really is how much more and above that we are going to go through to. But it's vitally important from managing our cost base that we will make further in roads in this area.

A key enabler for what we have done in terms of labour resource within certainly the Retail business and one or two of the other businesses has been, overhead value analysis, I'll refer to it as OVA, a very simple principle, very easy to adopt if you have got the right people doing it. You look at a process end to end, you understand what level of resource you have on that process, you put the volumetric associated with each component part of that process so it might be the number of calls that you go through, it might be the numbers of pieces of paper that's handled and you take out the overlap and you put the right level of resource within that element of that process and that has taken out thousands of people.

To give you a practical example, Nigel Stagg is over here, Nigel Stagg runs the Call Centres within the Retail business and in Nigel's contact centres these are effectively the service calls, in Nigel's contact centres his numbers have moved down quarter on quarter, Q3 this year to Q3 last year by 19%. Move down Q2 to Q3 by 9% that is a significant movement and you probably want to know what's the level of costs associated with that area, now it's just under a £100m. The sorts of things Nigel has done is he has used the OVA analysis. I'll give you another example, better utilisation of our procurement processes. So what we have done is we have sent that OVA team in to our suppliers in India that provide a service on a time and materials basis. Now not great to have a contract that's time and materials and we will change that to output based pricing, but we are on a time and materials basis with some of our contracts in India. Now where is the incentive for the supplier to reduce the number of people they have got, if they do, they lose revenue, they lose margins but what we did was we sent our team in there to look at how they did their processes, use the OVA technique, came out with a reduction in costs, put those reductions and costs and said if you implement it within a certain time you can take an element of that and we will take the rest of it you get a material reduction in your cost base. This is not rocket science but is an example of best practice that exists in all the businesses.

Within Openreach, Steve and the team looked at, and Ray Leclercq the ex CFO of Openreach is up there, they came up with a process which simply said we have got a lot of copper to be reclaimed based on the volume reductions, copper prices are up what can we do. Last year it gave them £7m for the first three quarters, this year it has given them near enough £22.5m an example of best practice.

The agency costs within Openreach have reduced by £6m in the quarter. The overtime costs in Openreach have reduced by £6m in the quarter, roughly speaking 25%. The contractors costs in Openreach have reduced by roughly

£6m in the quarter, material movements in quarter three this year to quarter three last year.

Within Wholesale the TLR resource has moved down by 13% in the quarter. The T&S costs have reduced by mid 40's in the quarter. These are material reductions. So you might ask; well where are we, can this be repeated. I would say that the different lines of business if you include Operate and Design and in the centre at different stages of evolution in the process and generally speaking it's reasonable. But if you ask me in the market I would say between 6.5/7 to 7.5 out of 10 within the businesses, there is still scope there, there is still scope for the whole of next year and there will still be scope in the following year. This is not a question of we have got to the bottom of the barrel, if we had I would tell you, but we haven't and these are the same sorts of comments I will be making to the senior management within BT, we have plenty of opportunity in relation to that cost base. The key question is do we have the skill sets to be able to exploit that opportunity and that's the question but look at the track record, look at where we have got to.

If you look at the GS cost base, quarter on quarter, Q3 to Q3 it's increased by 10%, no significant movements to date. The sort of delta we have got on that is, that if we apply the 7% reduction instead of a 10% increase the delta is £300m, not £300m in the year, £300m in a quarter, it's ok Hanif that's not going in the budgets, but it shows you the scale of what's available. I am not saying to you that's doable next week, next month, next year at that scale but it just shows you the scale, sure the business is different, sure there are different profiles in terms of some of the contracts but there is a material opportunity there.

I'd like to give you an update on where we are in relation for cost saving activities and I will give you a frank view on that but you know, Hanif and I would like to sort of convey to you. In terms of workforce 1,500 people have come out year to date and that's a significant number, that's the new management team coming in, numbers from 1st October and that's a good performance because you have to identify the people, this is not random violence, this is about identifying where you need to take the people and removing them from the business. There are further people that are identified and there will be further people that will move out during the quarter.

External procurement. Now let me talk not specifically about GS but let me just talk generically about BT and give you an example of one opportunity that has been realised in the course of the last week. A contract again with an Indian supplier that we have just signed off. Previously there were numerous contracts with numerous suppliers, I mean it's costing us roughly speaking £60m a year. What we have done is, we have rationalised and consolidated that, it impacts Operate, it impacts Design, it impacts Global and the teams have worked together collectively and we have wrapped that contract out and what cost £60m now costs £18m. Now we are not going to do a lot of contracts like that but that one has just closed. It shows you the scale of the opportunity, both in relation to Global Services but also in relation, that was capital costs, also in relation to our capital expenditure.

In terms of access cost transformation we haven't made the progress that we would like. Access costs basically are the costs that we received in relation to things like our private circuits, phone lines that we have in the big contracts and the key piece here is to understand, what are we being billed for and is that at the right charge. Now we have started to identify where the issues are, we have started to put some of the savings through but neither Hanif or I are comfortable at the level of progress we made, but what it means is there are material opportunities out there.

In terms of other costs Hanif and Ray have introduced some controls and consultancy and Hanif has reduced the level of consultancy saving costs by £15m, Q3 to Q3, he has put in line some material controls again on the T&S and that's come down by a few million in the quarter. Expect to see more of this and we will give you an update on this.

I just want to leave you on the fact that for our business to succeed it's about the control and management of our cost base. We have the tools available, we have the opportunities there, the key piece is will we deliver on it and do you believe we will deliver on it, I think we have got a track record, the key question is can we take that track record and the rest of the business through to GS, I believe we can.

Ian Livingston

Well to finish off before question and answers, I just want to say 08/09 has to be the year we clear up, we get all parts of the business in to shape and you start to see the benefits in 09/10 and that's what we have been trying to do. I wish we had done it quicker on Global Services for which I apologise. But what we are doing will take us in the right direction and you can see that elsewhere. I can't guarantee I can give you a very detailed predictability in every single quarter's cash flow but what I do think as we go forward into next year this business will have more visibility and more predictability and more deliverability. I don't enjoy negative surprises and we are going to try and avoid it and hopefully today you will see a level of granularity and a level of focus that can give you some confidence in to that.

We will now go to Q&A. Is John Clark here? This is a real shame, I'll tell you why it's a real shame John Clark isn't here because this would have been his 100th consecutive BT Results presentation and I was going to give him the first question, but as such can you put up your hand and take the microphone and say where you are from, starting over there.

QUESTIONS AND ANSWERS

<u>Question 1</u>

Nick Lyall - UBS

Can I just ask on the line losses, line losses have accelerated this quarter, could you tell us a bit more about how much you think of that is economic and also with the line rental increase coming up in April are you concerned that the competitive environment doesn't improve enough those line losses might accelerate, could you tell us a bit more.

Secondly on the Openreach profitability as well, how much of that exactly as one-off's of copper claim back and is that usually classified as other operating income or is that usually in Openreach, could you just tell me if that's true or not. Thanks.

<u>Ian</u>

Ok, well Tony I think mentioned actually how much the copper was.

<u>Tony</u>

Yes the copper was £22.5m for the 9 months to date compared with £7m from 9 months the date the previous quarter.

<u>Ian</u>

And a fair chunk of that was in the quarter but I wouldn't over do how much that is. The major reason we had a good quarter all in all with Openreach and what we said is next quarter because you have got the Ethernet stuff coming in which will cost us particularly quite a lot at the beginning and there is no offset with FFR, you will see that number being flat to slightly positive I think in terms of overall EBITDA.

In terms of line losses, I think it depends on two different sorts of line losses, I can separate. If you are talking about line losses in Openreach and Openreach has seen some big line losses, a couple of places that's happening I think. I don't see it particularly being a loss to cable, I don't think that's what we are experiencing. Yes I think there is some, there is definitely an economic affect going in, if people aren't buying new houses, less household formation and I remember standing up here is Q1 and making a point the first place we would see stuff happening is household formations. Less household formations and also business formations are significantly reduced and you have a number of things that cause them actually to deform if there is such a phrase in that term, but you have got SME's going returning to home, you have got people who are moving back in to home and you've got actually I think emigration as well, outside the UK. We have a lot of people coming in to the UK and I think a number have gone back. I think there is some more mobile only households taking place particularly in some of the inner cities, I think we are seeing that. In the case of the Retail business with line losses I think you have got that affect and also Sky have started offering lines to their customers and you will see an ongoing affect of that. It doesn't make a huge difference to the profitability of the group but it does affect Retails' revenue effectively they start buying it directly from Openreach if that makes sense.

Nick

Sorry just on the line rental rise, are you concerned now as it accelerates the substitution or do you think competition tails off enough to maybe, for that to be a wash.

Ian

Not particularly, there may be some affect obviously there is some elasticity of price but I think the price of line rental and particularly what we are doing in reduction of packages should have a good offset to that. But of course if you put the price of something up it will have some affect but I think the economy will be the bigger item in that.

Question 2

Robert Grindle – Deutsche Bank

What's the order of the magnitude of the cash restructuring charges, your sort of braking in to the greater than the £1bn cash flow guidance for next year.

Then on Digital Britain there is some chat about free or even cheap mobile spectrum, if the spectrum was cheap would you think of rolling out your own mobile network.

Then just on pensions, on the assets was there any sort of increase right down on the assets perhaps some of the non liquid ones because the actuarial review is coming up with the assets hit unduly this quarter versus previous quarters. Thanks

Ian

I don't think so, one thing on the FRS on the IS19 charge however and again being very open, if we had actually taken the bond tables on December 31st I think the deficit would have been a £1.5bn less than what we are quoting, we actually took on the 1 January which technically actually is probably wrong but they issued a whole load of new set of bond tables on 1 January and we just took the 1 January number so it made it a £1.5bn worse and that's not on the asset side but that affects the discount rate used for the liabilities.

On the first question about the restructuring charge. We are still working on it but we said the restructuring charge would be substantial from that you can reckon and it may move, but £400m/£500m plus restructuring charge in total of which the minority will be non cash.

<u>Tony</u>

Yes I mean the cash component would be the minority and in terms of ranges £100-£200m mid point of that.

<u>Ian</u>

And free mobile spectrum. I don't think we would think of rolling our a full mobile network on the back of free mobile spectrum, I think the spectrum is the least of the worries in terms of building up a mobile business in that sense. We would look at WiMAX as an opportunity, we've got to decide whether it makes sense. We are actually doing not badly in mobile at the moment, 24% growth I think in our mobile business. We are doing better than a number of the mobile networks for instance in Blackberrys so it's ok in the SME sector we are doing pretty well and in the consumer sector we are sticking very much to broadband anywhere as our device but I don't feel the particular need to start rolling out a network and we will hopefully use the reduced MTR rates to offer even better value to our customers.

<u>Question 3</u>

Paul Howard - Cazenove

A couple of questions, on Global Services clearly very cash negative this year but you are targeting a free cash flow positive position in the future. Any sort of indication of timeframe and given that you can see that big turnaround in cash flow from Global Services will your dividend policy look through that and reflect the cash flow from your core business or will it be depressed via the cash flow to Global Services in the short term.

Then just a more detailed question on Global Services. You indicate cost inflation of 10% on flat revenues on an underlying basis, what's driven that cost inflation is it volume, is it the mix of the business, I guess I am trying to work out how quickly it is, how easy it is for you to turn it around.

<u>Ian</u>

Ok, do you want to talk about the cost inflation and I will just do the first. The improvement in the cash position in Global Services. We will make a decent indentation in to it next year, I am not predicting next year is going to be cash flow positive. I think we have given you an idea of what we believe is sustainable level and we will set the dividend with that in mind. I guess we are going to have the dividend question asked in many and various ways to which I am going to say, tell you later, but we recognise that dividend should be both a good dividend but also something that is not just sustainable but seen to be sustainable but we will have to wait to see on the Pension.

With that Tony do you want to say about how the costs came up.

Tony

Yes basically the costs have increased because we hadn't managed them as effectively as we should have done, putting it very simplistically we had too many people doing the activities, we have a cost of failure built in to the processes that we are undertaking, some of the contracts are too complicated in a sense that we are not undertaking replicable solutions to make the business work effectively you have got to have your back end processes replicable, your front end processes customised so the customer gets a customised service offering but with replicable processes in the back end so your inventory management is done the same way all the way across the piece. We are not about stage of evolution that's what Hanif and Ray and the team are looking to bring in.

Ian

And why they go up, they went up particularly through the course of last year and in to the first quarter of this year and I think we have started to get some stability. We didn't have the control we should have had, full stop.

Question 3

Felicity Smith - Bedlam Asset Management

Just a continuation of that, you've got a division that has grown through acquisitions, how much of this cost escalation was because when you bought those businesses enough due diligence wasn't done and how much of it has been you over estimated your ability to cut costs when you priced those contract and so as we go forward are you confident that you can now price contracts correctly so that this doesn't happen two or three years down the road.

Ian

I think the acquisitions made it more difficult to see the underlying position rather than anything else. In terms of our ability to cut costs, I want to separate off something about the way we are accounting. We want to account conservatively but deliver aggressively and a lot of people got a little bit confused about what we said, about we are not saying that we don't think we can actually cut significantly more cost and perhaps the management that was there, and I know that's Hanif's view the management was there before. But I am not prepared to account for it in advance and I think we have got to have a record of deliverability and credibility and then you can do it, so we actually will aim to deliver significantly more aggressive. We are as the contracts come in and Tony said that making sure that we are I would say particularly in relation to the capital usage in the contracts, the capital intensity of the contracts were too high. There was too much upfront cash flow, there will always be something in a number of contracts but we can do a lot better in terms of having that profile and the cash and the profitability of the contract being much more related to each other. Hanif do you want to add anything.

<u>CEO BT Global Services - Hanif Lalani</u>

I think the point to make is as Tony shared with you, if you look at the impact we have made in the last three months, the vast majority of the people savings have happened in the last three months, the vast majority of the procurement savings have happened in the last three months and I think what we have been very clear is that given the current economic environment you are not going to trade and sell in to margin and profit, you are going to manage much more effectively and simplify the way you work and drive your cost base, so the focus for us very clearly is end to end delivery and on the cost base and I think that if the last three months are an indication I think there is the momentum and the focus on driving those costs for a long time to come.

<u>Tony</u>

One point you raised about was the pricing and key piece here is not the price per se but it's the T&C underpinning that price because the deliverability of the profit is very much associated with the Terms & Conditions that you sign the business at and if you get the Terms & Conditions right the profit will follow.

<u>Question 4</u>

Maurice Patrick – JP Morgan

Of the 10% cost increase, is that also a 10% increase in the cash costs as well and of that increase is that mainly an increase in people costs or is it other costs as well.

<u>Tony</u>

Yes it's primarily an increase in cash costs, it's not the provision movements you can virtually negate that. The people are a component but it's all say if you look at it in terms of the network costs, the access lines that we are doing, and we have got an opportunity because of what's happened in terms of the controls.

Maurice

And just a quick follow up. Of the cost increase how much of that is contracted under contracts, you know 12 months or above that you can't cut in any term.

<u>Tony</u>

I don't think there is an issue in terms of if it's in to a contract whether you can cut it because the key is if you look at the processes it's how you improve the processes and you can do a lot of that as Hanif has shown, 1,200 out of 1,500 since Quarter 3 started. The key piece there is to understand exactly, to take out that thin veneer first of all because there is a chunk of costs you can take out with fairly blunt instruments, if you only need to use the more forensic tools as you go further in to the evolution scale. When we talked OVA, Hanif's done this not with the detailed forensic tools because he understands the business, the team understands the business, identifies where there are areas of opportunity and take that layer out. Well use the forensic tools in terms of the second tranche of activities.

<u>Question 5</u>

Steve Malcolm – Arete Research

I guess none of us really like negative surprises, I am trying to iron out or rule out another couple possibly. One is just on your debtors and looking at specifically Tiscali trading at about 40 cents against the markets price in a reasonable expectation, they have got some pretty chunky trade creditors, a large portion of which are to you. You may not talk specifically about them but can you give us an idea how you are kind of tightening up your credit controls for large counter parties. In the risk of bankruptcy or liquidation or whatever.

Secondly on capex can you just give us an idea how you source your capex in terms of currency. I guess most specifically on Global Services what proportion is sourced in dollars and euros and how do you safe guard yourself against some pretty strong currency head winds in those areas and also apply that to Group. Thanks.

<u>Ian</u>

Ok, on capex currency I'll get Tony to give you detail but I'll just make an overall comment. Yes, bank stuff in dollars there is a push for increasing that price and that's a challenge. I'll let Tony talk about it a bit more in detail. In terms of debt management and as you are quite right I won't speak about individual company, however we have with some and I must stress it is not that company that you referred to but we have had with one major customer who, whether couldn't or wouldn't pay is another question but we were within hours of cutting them off and I will be very clear, we are not bank of BT, and if there is a small suppliers who have a problem then we will try and help them, genuinely we try and help them. We had a supplier in Openreach who got his credit lines from Icelandic Bank, suddenly they didn't have any credit lines, good business, doing nothing wrong he was a victim, we helped that company through, we actually paid them some stuff up front to try and help through. However we have had some network companies who I think just feel that they should keep the money in their own bank account rather than giving it to BT. We've made very clear that we will not maintain service in that situation and with some companies that have gone bankrupt we have also made it clear with the Receiver that if they want their ongoing provision of services then we need to come in to some agreement. You know it's possible that somebody can get caught with a very big debt, it really is possible we will try our best to avoid it and I think we are being a lot tighter but you could have issues. But we are being very tight. Sally do you want to add anything to that.

CEO BT Wholesale – Sally Davis

It's clearly an important issue for us in these times but we manage this daily and as Ian said we are not bank of BT, we have been making that very clear to our customers, but working with them in a positive way so that they know what to expect as well. So this has got a lot of focus.

Tony

The first piece is in terms of debtors and suppliers we have got specific debt and supplier watch programmes in place for our major exposures in that area, and with suppliers we will have alternative supply facilities that we are looking at, so that we have got alternatives. Not for everything but for a lot of what we are doing.

In terms of our capex and it's really a microcosm of what happens with our overall suppliers. What we will do is wherever possible we will contract in sterling to take the hedge automatically through there. It doesn't always work and when it does sometimes happen is the supplier comes through to us and says, well actually we are now losing money because the deal that we have got we are actually billing you in sterling and it causes them some issues and we have had to adjust some of our contracts on there. What I would say, in terms of specifics that's how we are managing it, it's effectively by looking at it on an individual supplier basis.

Ian

There is certainly a negative head wind in terms of our.

John you have missed it, this is your 100th BT Results presentation I understand.

John

Yes

Ian

You poor man, and I had said if John was here give him the first question as his 100th Result presentation. However I'll give it to Mike first and if you have got something pop your hand up and I will be happy to try and help. Mike.

Question 6

Mike Williams - Citigroup

I mean arguably a cash pension deficit is the result of a historic under investment to the benefit of the customer in lower prices at the expense of the pensioner. To what degree has this issue of an allowance for your deficit payment featured in your negotiations with the regulator on such issues as the Financial Framework Review, and what response has Ofcom given presumably when you have pushed this issue quite aggressively given the precedent that seems to exist in both the water and the electricity sectors. Thanks very much.

<u>Ian</u>

Do you have that written down Mike. From anyone in particular or. It is a matter of some discussion, we feel that there is a group of assets and liabilities that have been required to be brought to the customer, our people and with the people came the pension, good, bad and indifferent and our view is that therefore the deficit is part of the…In the same way if you want the benefit of the network you want the benefit of the people training, you've got the deficit and that should be recognised. There is some alternative views I have to say on that matter and I suspect that is an issue that we might well see different from the regulator but I think we are going to see the Financial Framework Review update in March and we will have to see then, but given the potential size of deficit it is a material item.

Indistinguishable question from audience

<u>Ian</u>

Well do you mean fight or….

I don't think personal violence in any way, I think we feel we have a case that we would push strongly on the issue.

<u>Question 7</u>

Petri Allas - Redburn

A couple of questions, I may have missed this but you gave some guidance on cash flow for next year but the Q4 of this year there are a few things kind of emerging around the charges, around the £300m being moved from this year to the previous year and so forth which would add up to about £500m worst cash flow this Q4 than what you had last year at Q4. Is that sort of directionally a fair assumption or how do you see this quarter cash flow coming.

The secondly if I just ask a sort of you gave some direction on head count and capex sort of potentially having, going down, how far down could they go and then in case the pension really ended up being bad was there a lot of capex flexibility that you could use to compensate.

<u>Ian</u>

We'll talk about capex in Q4, I think from what you said you can take the view that we are heading down on capex but we are going to carry on investing in the business, sustainable cash flow means you need sustainable business and that why we are going to carry on investing. So could one whack out a couple of billion, or a billion off capex in a year or something, yes I am sure you could, you might not have a huge business at the end of it so I think it's the wrong question and we will talk about that going forward.

People costs as well there was a time where I know BT cut 15,000-20,000 people in a day or something and it wasn't actually very good for the business. I think they recruited a fair chunk of them afterwards and I am going back 15 years or something. Therefore what you need to do is a continual process. People reduction should come from process, improvement, from focus, from taking out cost of failure, it shouldn't be the start of the process, it should be the result of it, it's a pretty good measurement when you actually do something right and the fact is the 9,500 that we have actually recruited a 1,000 close to it from acquisitions. So actually we are 10/4 if it was X acquisitions and there is more to be done in the fourth quarter, so it's not bad on the score card. In terms of the year on year cash flow well you have got the lower EBITDA and you have got the sort of getting things on an even keel and I think that's the two major items.

<u>Tony</u>

Directionally we are moving in the right direction, the way I would look at the cash flow on the 12 month figures are but it was £1.8bn post specifics last year. You've talked about the £300m, you have got a £700 odd million movement in relation to tax and interest payments, you've got the down turn in the GS, you know where you are heading.

<u>Ian</u>

Ok, and you know the number for next year because we told you it.

<u>Question 8</u>

Damien Maltrap - Credit Suisse

I guess a couple of related questions on cash flow, apologies. Your comments earlier about Global Services cash flow you said we would see a decent indentation in the cash out flow for next year. Was that relative to the £250 – £300 million outflow that has been the run rate or is that relative to this years figure which obviously includes quite a large working capital out flow.

Secondly perhaps related. On a kind of normal run rate basis for the business as a whole, how much should we be thinking about working capital, are you still absorbing it and I guess implicitly what's within your guidance for the £1bn for next year.

<u>Ian</u>

Ok I don't want to give sub guidance to the £1bn for next year, but what you say about GS, I mean the answer is both to the GS question.

<u>Tony</u>

Just to remember the numbers Ian talked about in the call a few weeks back was arranged between 250-300 was an average over the three years. Now effectively in years one and two it was not a significant a movement as in year three which is this year. So the average roughly still holds but what we are is a significant out flow situation this year and we will go through the details of that in terms of Q4. In terms of the level of movement we are not saying we will get to cash positive next financial year, we are not making or giving you any targets on that at all at this point in time. But what we all say is there will be a significant movement compared to this years' situation.

<u>Ian</u>

I think we want to be making good progress, given what we are doing I think we want to be making very good progress but we are giving an overall cash flow number, I suspect we might give you some more depth and detail next… I am very conscious I don't want to get in a situation where I start giving an individual guidance at this point, but if you can't see the affect of what we are doing next year then we have failed.

<u>Question 9</u>

Nicolas Didio - Exane

I have got two questions, first can you talk about the competitive environment at Global Services, do you see the Horizon or AT&T more aggressive in Europe and what about pricing pressure on contract renewals.

Second question concerns the Pay TV market, what are you ambitions in the mid to long term taking into account the ongoing review of the Wholesale framework at Sky. Thank you.

<u>Ian</u>

Well Pay TV, we have opened up our network to a number of players including Sky to allow them to offer a converged product as Ofcom have pointed out, it can not be a situation where someone has such a dominance of the Pay TV sector should not open up in the other way so we are certainly looking for Sky to wholesale their content, otherwise you will get the dominance of one sector being leveraged in to another and that can't make sense for anyone in the industry and would be the wrong thing and I think the initial statements Ofcom have made have been positive in that respect.

The first question you asked was about competitiveness in the market. I will pass over the Hanif, I mean I think I would certainly say AT&T are certainly active and we have seen some interesting interventions from Telefonica but I will let you talk about it.

Hanif

Yes sure. If we look at the competitive landscape, US, Far East, I think there is a big push from AT&T in the number of contract they are bidding for and are becoming a much more aggressive in the market place in that sense and also investing in assets. If we come in to Europe surprisingly it's Telefonica and it's push in to the enterprise market that is evident and in **** actually it's Orange so not the answers that you would have actually given a year ago but actually if you look what's happening in the market place those are the things that are happening.

In terms of customer trends in the market a big push for unified comms given the current environment, people are looking for video conferencing, conferencing solutions, faster communication whether it's email and a combination of all of these types of tools to help them run their business more effectively and efficiently. So I think that's one big trend and if you look at the order intake in the quarter we have been selling a large variety of propositions in that space.

I think the second thing that's happening is that a move from quality and network to a much stronger focus on cost reduction in everybody's business model so most customers out there are looking at running their businesses much more effectively and efficiently and rationalising what they have got and propositions that help and enable customers to do that are on the up. I think the key thing for us is to pick those that generate value for us and generate good positive cash and where we don't have that ability to convert a contract we are walking away, but where we can help those customers deliver, adds value to their business we are signing up for them.

Ian

And centennial man, Mr Clark.

Question 10

Mr Clark

Thank you Ian, yes I think 99 meetings ago the questions usually related to antagonistic relationship with the regulators, and things seem to have moved on a little bit since then. I am glad to say in line with more realistic rates in terms of perhaps going forward. Also I would be interested. Two questions really.

One is, it's very basic I am afraid, I certainly can't match the intellect of one or two of the others, on this side of the room these days.

Ian

Neither can I.

Mr Clark

I think in the case of Global Services and so on, was it a few large contracts that went wrong that let you down, it's looks to me as if you are replenishing the order book there and growing it pretty satisfactorily.

Secondly in the Retail area has there been a loss of momentum either at BT Vision or in some of the mobile offerings.

Ian

I'll pass the Retail question to Gavin.

Just on the first question. I think it's a bit of both but there certainly had been a few contracts, but the problem with the cost base is a problem with the cost base so whilst the right offs related to a few contracts the cost base issues is a general problem of a business that was, didn't control their costs in the way it should have done that was a two focussed on the growth engine, we need to be actually more focussed on the profit engine. But Gavin.

CEO BT Retail – Gavin Patterson

No, no loss of momentum in deed in the TV side of things in Retail, Q3 is better than Q2, higher net adds, we have now got 400,000 customers, ARPU is increasing and usage of the platform is increasing so it's the usage of the platform is now about twice of what it was in August last year for example. We are certainly putting much more focus on making sure that we are able to make a turn on the business and I think there is quite a few exciting initiatives coming forward. For example the canvas initiative that the BBC and ITV and BT signed at heads of agreement on before Christmas is the very exciting initiative which creates an open platform for the next generation of free view, it brings on demand services in to the home in to a free TV environment and that's very exciting and we are very supportive of that. So there is no loss of momentum and we see a very positive future going forward. In mobile, certainly in the business space we think we are doing pretty well, continued growth behind Dongles and we sell 30,000 Dongles in the business space in the second half of last quarter after we had launched it, so there is definitely a market for that. In Blackberry, as Ian mentioned we are doing better than certainly at least one of the mobile networks in selling Blackberry's in to the business market. Then through Oneplan which is our combined fixed and mobile offering for SMEs that's going from strength to strength and that had a very strong quarter as well, so there is momentum in both parts of the business in Retail.

Ian

I’ll take three more questions, one from each bit so from people that we haven’t had yet, down there, the lady there please and at the end there.

Question 11

New speaker

Can I have a question on Pensions. The first one relates to the latest agreements you have reached with your Pension members. It was announced just before the second quarter results. At that stage you couldn’t quantify or didn’t want to quantify the impact on the pension abilities. So the question is that...

Ian

We did say £100m a year. Sorry, I didn’t want to quantify the impact…

New speaker continued

The impact on the pension abilities by changing the retirement age for all the staff so you have quantified, how much will be the impact on the annual cash. So the question is that the pension abilities as of 31 December do they incorporate the impact on the change in retirement and the change on the benefits you provide your members are these basically open to negotiation with the actuaries and the second one is relating to basically you make sure that we don’t have to look at accounting and the IFRS is pretty volatile measure for your pension, therefore the actual will be the main matrix that is going to be funded. So could you just give us a bit of colour how the actual volitions is going to defer, I understand that you are already starting negotiations talking to the actuaries in terms of assessing your pension deficit. How is it going to look at the discount rate they are going to use, are they going to look at all the other matrix...

Ian

No, no I am going to stop you there, I am not going to go through every single thing with the actuaries on the… we are very early on in to the thing. What I will say to you is, yes it will reflect the agreement with the pension scheme members and what affect that has. What I said was in terms of the normal contributions will have an affect of give or take £100m per annum, it will have some impact on the deficit but of course there will be more offsetting factors. Discussion with actuaries we will be using, it is as it was before which is, we use our own cohorts on age, mortality rates, we will work through what the appropriate discount rate is for our mix of assets. It’s a very, very complex process, if it wasn’t a complex process we would have announced it by now and we are going to work very hard to have the answer by May and that’s a lot quicker than before. But I can’t really give you, I feel at this point, because we are working on it.

Question 12

Christopher Freemantle – Morgan Stanley

I just want to push you on the cash flow for this year. Can I ask you, you presented the cash flow for this year as somewhat as a sort of clean up, yes there is some working capital re-adjustments in terms of timing differences. Clearly I am not asking you to give an indication of the dividend as you have said but would paying an uncovered dividend this year be within the criteria that you have already set out.

Secondly on a non related issue, just on Global Services, you said the underlying revenue growth last quarter was around the sort of 5% level I think and this quarter you have said the underlying revenue growth was about flat, should we be expecting the underlying level of revenues for Global Services excluding the acquisitions, excluding FX to turn negative next year.

Ian

I am not giving a particular forecast but I think it will be what it will be, it's not the number I am going to be tracking, going to be focussing on the revenue growth level, I will be focussing on the cash. We are still going to win contracts, the tail winds are going to get more difficult in that but it is still winning, a good amount of contracts so we will see what the revenue turns out to be.

In terms of the... In any given year and uncovered dividend is not… is not the issue. I mean obviously we will look at our overall level of debt, that's important but in any given year, an uncovered it was this year is the ongoing sustainability, that's not a forecast about this year's dividend but I am just saying, you know if in any given year, it's a bit like making an acquisition. If you made an acquisition your cash flow goes out, it doesn't make any odds to… about from your overall level of debt so what is important is our future dividend is not only sustainable but seen to be sustainable and is a good dividend, that's what we are trying to do, as we said we will have to wait to see the Pension, I think the market volatility and the financial markets and probably would cope worst rather than debtor in terms of it's a lot more volatile than anyone expected even six months ago. So I am glad we said we were going to wait to see what the outturn was.

With that the last question.

Question 13

Robin Bienenstock - Bernstein

Two really good questions. First I would like to know, can you just tell me what the total head count is in Global Services and what percentage of that is indirect labour.

Then second related also Global Services question. It seems to me that one of the problems previously has been the contract review process that you have been carrying out in Global Services, so I would like to know, was the Group CFO previously involved in the contract review process and has that process changed, and will it change going forward.

<u>Ian</u>

To be clear on the contract review, we used external advisors as well as internally reviewing it and today they still say, yes the judgement that were made in previous years you could have made and forward and acceptable policy. We have made the decision that we are going to be more cautious particularly in light of the circumstances, and some circumstances have changed. I mean there is no question about it, you know maybe in Sandford Berstein that was the case but for the rest of us we didn't quite expect the degree of change in the market place, and so these changes have taken place. I think it's important we have and will tighten up on the review process, but you know big contracts were reviewed, including again getting external reviews and they were within acceptable policy. We have a definitive view to be more cautious on it and the other question you asked was about.

Robin

The total head count in Global Services and what percentage of that is indirect labour.

<u>Ian</u>

Do you have...?

<u>Hanif</u>

Sure we started the year at around 42,000 of which 29,000 were direct. We have lost as Tony's slide showed around 1,500 since then, I think the slide showed 70% of those were indirect.

<u>Ian</u>

Ok.

Robin

Thanks very much.

<u>Ian</u>

Right and thank you very much everyone, thanks for your time.