



Q4 and Full Year Results

Thursday, 13th May 2010

Summary for the Year

Sir Mike Rake

Chairman, BT Group

Welcome

Good morning, ladies and gentlemen, and a warm welcome to our quarter four and full-year results presentations, and to the first investor day we have done since 2003. The obligatory forward-looking statement, we ask you to read at your leisure.

Agenda

I will start by covering the Group results for the year. Ian and Tony will cover the quarter and our objectives for the next three years, both operational and financial. Then, each of the chief executives for the lines of business will take you through their business and future plans in some detail. We also have an array of product demonstrations that we have set up for you. They really bring to life what we will be talking to you about today.

Summary for the year

We said this time last year that 2009-10 would be a year of delivery for BT, a year when we do what we said we would, and I believe we have; at least, we have started to do that. We have made progress in Global Services, but obviously, we have a lot more to do. The rest of the businesses have performed well, while each have had challenges of their own. With a significant reduction in operating costs and capex, we have improved cash flow. This has allowed us to allocate cash between investment for the future, progressive dividends, net debt reduction and payments into the pension scheme – all while the regulatory backdrop has been evolving positively for the company.

Full-year results

The headline revenue was down 2% and underlying revenue was down by 4%; however, adjusted EBITDA was up by 6%; earnings per share, up by 16%; free cash flow, up by over £1 billion with a corresponding reduction in net debt of over £1 billion. Thankfully, it is a much better set of results than the last time I spoke to you.

Outlook versus outcome

You see that, because of our increasingly improving performance during the year, we were able to move up our original expectations and have come out ahead of our latest outlook.

Dividend

Moving on to the dividend, we indicated around 5% growth. We are proposing a 4.6p final dividend for the year, which, with the interim dividend we have already paid of 2.3p, gives 6.9p for the year, up 6%. After necessarily rebasing the dividend last year, we are now committed to progressive dividends over the next three years. This will allow us to balance our priorities for the use of the cash that we are generating.

Q4 and Full Year 2009-10 Results

Ian Livingston

Chief Executive, BT Group

Opening remarks

Thank you, Michael, and good morning to you. Thank you very much for coming. We appreciate your time today. We have a lot of interesting things to say. I will run through the results fairly quickly, not least because each of the lines of business are going to talk about what is happening in their business, what they have achieved and what they need to achieve. Then, I am going to talk to you about the key objectives and belief sets around BT, what we said were our key objectives and how we are going to take the business forward; particularly, the key areas of investment.

Lines of business summary results

Q4 2009-10

To start, this is a chart you see pretty much every quarter: line of business by line of business, year-on-year performance for the quarter. In the quarter, you see very much that profit growth was driven by significantly improved Global Services, albeit not from a great base, and continued improvement in Retail. Wholesale was flat and Openreach, although down 4%, we will explain. It has been a continuation of a stable position for both Wholesale and Openreach.

Full-year 2009-10

You see that very much in this picture: Global Services' EBITDA, 40%, really good progress; Retail, 12% profit growth, despite a few one-offs, but still strong progress; stable position in Wholesale and Openreach in terms of profitability. All the lines of business increased their free cash flow over the course of the year, which was a commendable achievement.

Divisions overview

Global Services

Underlying revenue in Global Services was flat in the quarter. However, there was a significant milestone. We delivered for customers early, which meant, in Q4, we recognised about £100 million of income that we might otherwise expect to recognise in Q1. As with everything we do, we want to highlight to you where we think there is something that is a one-off positive, to be very clear, when we talk about the underlying performance of the business. Bear that in mind.

Net operating costs were down 9%. Underlying was down about 6%. Again, we take out FX in particular. It carried on the same process of sequential EBITDA improvements. It was about six quarters ago that we had £7 million EBITDA in that division. That went from £7 million, to over 30, to over 60, to over 90, to over 120, to over 170 that we announced today. It is progress. It is always the case for Global Services that Q4 is the best quarter of the year, but we are seeing good underlying progress.

That is not only in profitability, but in order book. For the year, order book came in at £6.6 billion. We did £2.2 billion in the quarter, which is a rather good performance. It is still down year-on-year, but we are reasonably happy with it.

There are a few orders I would just like to draw to your attention. In Asia-Pac, which will receive quite a lot of mention later, we won an order with DHL to provide managed network services throughout the Asia-Pac region. It is a good example of helping companies to globalise. It is expanding in Asia-Pacific. It is a large customer of ours. We have to help it. Also, in other areas, we have seen our relationship with our customers improving and that leading to follow on orders. I will mention two of them: Sainsbury's and DWP. Both are situations where we have improved our performance significantly and are recognised as one of the best suppliers. In fact, DWP ranked us the best supplier. We signed a new contract, lowered costs for them, extended the contract. DWP has had great success in managing the rise in unemployment and the volumes that means for them. Why? One of the key factors behind it has been our IP contact centres that supported them. Therefore, good service for customers unsurprisingly leads to better contracts and more of them. We want to carry on with that.

Retail

Retail had a slight improvement in trends. We were a little better than the last few quarters, both in Consumer and Business. Consumer was down 2%. That is a few percent improvement on the previous quarter. Something that helped a little was the bad weather. We often have bad weather in the fourth quarter, but it helped by some millions of pounds in terms of people making more calls because they are at home rather than standing outside. That helped a little. Otherwise, underlying trends are a little better. Business was down 6%. We were running down 8%, so again, a little better. The ICT sector improved a little. There were a couple of large orders in there, but we are seeing some improving trends in BT Business. We have great expectations for that business. There is a lot we can do with it still.

Net operating costs continued. We are something like five years into reduction in costs now in the Retail business. Costs were down 7%. As they do, people ask the question, 'When are you going to stop cutting your costs?' or 'When are you going to stop being more efficient?' It is a strange question. A car factory does not start to say it will stop being more efficient. We are going to carry on. We are five years into it in Retail. Retail is most evolved. We will carry on being more efficient by improving customer service, by running our business better. Retail shows it can be done, and Gavin will tell you there is still more to do there.

Also, there are some fairly good market statistics. In terms of Broadband, we had a 44% market share in the quarter. That is our highest share of net adds for a very long time. In absolute terms, it is over 120,000 net adds, the highest in the market and the best we have had for eight quarters. It shows that customers want to pay not only for the quality that BT provides, but also the way we are marketing and the strategy we have with PlusNet on one side and the value-add BT on the other.

As I mentioned earlier, we have seen some improved trends in line losses and active customers, a bit better, but still down.

Wholesale

Revenue excluding mobile termination rates (MTR) and transit was down 1%, so the headline number really reflects the MTR and transit reductions, which of course have very little or no effect on profit. Net operating costs continued to come down, also helped by the MTR reduction, but net result Wholesale continues broadly flat.

I remember a couple of years ago when we declared double-digit reductions in revenue for Wholesale and terrible profit numbers. The Wholesale business has become a lot more stabilised. It is now investing, particularly in new areas of the business. Also, it has done very well at winning managed network services. £300 million of contract wins came in the quarter; £1.8 billion in the year. Since then, we have had a very significant contract win with Orange, which you will have seen in the press already.

Openreach

Openreach's numbers were probably those that were a little odd in this quarter, but if you look at the overall year performance as flat, that is probably a better reflection. What happened in the quarter was, on revenue: continuing trends, external revenue, i.e. LLU etc., was up, internal revenue was down. However, net operating costs were up rather than down. There are a couple of reasons for that. This time last year we had a rate rebate, which regretfully we did not manage to anniversary. That would, however, be expected. Also, we spent a lot of extra opex on the accelerated roll-out of Ethernet and fibre and that cost us some money. Again, I do not see that going forward. The message for both Wholesale and Openreach is one of stable business.

Pensions

Update

No presentation here today would be complete without talking about pensions. We do not really have a lot more to tell you, but we thought it was important to give you an update in terms of what has happened with the numbers. I do not think we have shown you this side-by-side schedule, but it might help you. This is what the pension trustees' valuation was in 2005 and then 2008. The reason we put it side by side is to show you the prudence that the trustees had in the valuation. They have moved the confidence level up from 65% to 69%. The life expectancy has moved up quite significantly. Also, the payment protection fund (PPF) is a really critical factor for the regulator, and I will come to this again. The liabilities as a percentage of the PPF has increased to over 100%. It went from 101% to 102%. The message, therefore, is that what the trustees did was not only prudent in its own right, but more prudent than last time around.

Position with the Pensions Regulator

The Pensions Regulator's formal review remains ongoing. It continues to gain information from ourselves and the trustees. When it finishes that process, which I think will be in some months, it will then come to its conclusion and will come to talk to us about that. We will see where it goes from there. I would love to be able to give you exact dates. I cannot. We do not know them, but it will be some months.

Asset value increase and the deficit

Interestingly, since December 2008 and looking forward, as you may have spotted, the market has improved a little. That has had an impact. The asset value, not only from the markets, but also from putting in £500 million more, has seen a £4 billion improvement of the assets in the pension scheme.

That has flowed through to reductions in the deficit. It is not a one-for-one thing, because you would expect improvements in assets and you would expect yield to return some money.

Therefore, if you look at the key deficit valuations, taking the trustees' valuation as at the end of December, there was a £9 billion deficit. Flow that through to now, you have about a £7.5 billion deficit at the end of December. That is the latest we have. If you take the median estimate, which was taking the expected returns from the assets of £3 billion, that becomes about £1.5 billion.

For the PPF, which I referred to earlier, where we had 102% of liabilities, the deficit has come from £8.5 billion to £3.8 billion. Certainly, the regulator also looks at that one. On the flip side, the IAS 19 deficit has done the opposite. Despite asset values having risen considerably, the deficit has increased. Why? That calculation is done by discounting and the AA corporate bond rate.

The real rate after inflation of the AA corporate bond rate has fallen significantly. It has fallen from 3.6% in December to 1.8%. Now, that is one of the lowest, if not the lowest, real discount rate for AA corporate bonds that we have seen.

To put it in context, if the rate was roughly 3.2%, there would be no deficit. That gives you an idea of how it ends up being very sensitive to that rate. Assets have improved a lot but the deficit has increased. I know most of you had that sort of number in your calculations, but it is something that has a huge impact.

The other aspect on which it has an impact is, not only on the balance sheet, but increasingly the P&L. Now, to help you in next year's numbers, the pensions service charge is going to rise by £100 million, because of the IAS 19 changes, the rebalancing of what you have to do on interest rates. That is a £100 million additional cost to EBITDA and our EBITDA forecast includes absorbing that. That is part of it; otherwise the quarter would be £100 million better.

On the other hand, you see pension debt interest, which was plus £300 million two years ago. It went to minus £279 million last year. It will be roughly minus £70 million this year, so a £200 million improvement. Our reported P&L will, therefore, benefit by £100 million year-on-year. However, we tend to quote an adjusted number that excludes the pensions interest number for EPS, etc. Hopefully, these numbers will help you, but IAS 19 is not designed to help most people in most ways. It makes our P&L particularly volatile.

Building a Better Business

This sets out simply what we have been trying to do in the last 18-24 months. It is headed 'Building a Better Business', because that is what we are trying to do. It starts by improving our processes and customer service delivery, not only because that is important to the customer, but also because it is a huge driver of cost transformation. Cost of failure makes a huge difference to our business, so we use that customer service improvement to improve cost transformation. Then, cost transformation helps free up a lot of resources, financial and otherwise, that we can invest in the future of our business. That is the basis we are trying to create. We are trying to create a much sounder basis for our business. The purpose of the day is to talk about that investment in the future.

Customer service delivery

Measurement

The customer service programme has been core in everything we do. For every single manager in BT, a significant part of their bonus is dependent on customer service delivery. At the core

of that is a programme called 'Right First Time' (RFT). You will hear a lot of people talk about it today. This measures end-to-end customer experience, so when you phone BT to have a line repaired, which you will do much less often these days, because they are more reliable, it measures whether: we answered the phone; we then appointed an engineer to go and repair it in the time we said we would or the contracted timescale; the engineer turned up when we said they would; they repaired it during that time slot; they had any cause to contact us again during the following month about that repair. It is a real end-to-end experience and it measures that. This is what we call the trouble to resolve process. It is exactly the same for lead to cash. In every single process, we measure these points.

Not only do we measure the overall processes, but we measure them advisor by advisor, engineer by engineer, product by product, increasingly customer by customer, so we understand what is going on. Then, we try to look at the causes of failure and address one after another. There is no silver bullet in it. We have over 100 fixes that we will do over the next few months that will improve RFT by a few percent. We have been doing that month after month after month. As a result, we have seen the failures – not answering the phone; engineer not turning up; repair not being done first time of asking, etc., and the same on provision – reduce by two-thirds over the last two years. We had a two-thirds reduction in failure. We have a lot more to do, but it is a two-thirds reduction. We have seen cost reduction come out of that.

To give you an example, I go back to what I mentioned earlier. On network reliability, it was once every nine years that you could have a fault in your PSTN line. It is now once every fifteen years. As a result, that means we had half a million fewer engineering visits to make last year. That saves us money, but it is really rather good for the customer. That also means there are fewer phone calls, because nobody is calling up about the fault. Also, because we are doing the faults better, we are also doing them quicker, so we are seeing a large reduction in the time taken to repair a fault, which also means fewer phone calls in and fewer repeat visits, etc. All of these elements have flowed through to complaints. In the last 18 months, we have seen complaints in our Consumer Division reduce by about 50%. It is quite similar in Business and in other parts of our business.

We will talk a lot more about this, so you understand it is at the core of what we are trying to do, because it is important. I really must stress, as with so many other aspects, we have made progress, but there is still a lot more to do and a lot more that we will do.

Behaviours of Building a Better Business

Honesty

Underpinning those three points, customer service, cost transformation and investment, are two behavioural points. The first may surprise you a little. This is exactly as I show internally. What we talk about internally and externally is the same. It is the word 'honesty'. I do not mean people stealing from us. By honesty, I mean the openness, directness and way you look for improvement. I am looking for a BT in which people always talk about how they can improve, not how well they have done. Too often, and I know you felt it, BT always talked about how good it was, not what it needed to do. Therefore, the words you will hear often in this presentation is 'more to do' and there is a good reason for it, because we do not think we

are perfect. Therefore, we think we have a lot more to do. Honesty, internally and you will have seen by the way we have disclosed matters to you, is absolutely core in what we are trying to do.

Agility

The other part of what we are trying to do is have agility, move quicker. Now, that is important in everything we do, in what we call 'cycle time', but also in the way our employees act, the way we interact with customers, and how agile we are as an organisation. In terms of people, the idea of an agile workforce is very important. We have reduced our total labour resource by about 20,000 this year. However, the majority of that reduction has actually come from third parties and contractors, rather than our permanent workforce.

It has been very important to us and it is the right thing to do morally to try to protect our permanent people wherever we can. Therefore, you have seen a reduction, for instance, in offshore contract work. We have managed, though, to redeploy about 5,000 people within BT by retraining and reskilling them and putting them into a different part of the business. That has been good for them, because they keep their jobs. It is also really good for BT financially, because we are not paying people to leave who could do a good job for us, as we did in the past. Therefore, it saves us money on one side, but it is also the right thing to do and I believe we will do our best for our permanent people as we improve our business.

Also part of that agility is about being there when the customer needs us to be there, so we have agreed new attendance patterns in our engineering workforce that means they can work in the evenings and at weekends. Now, that is important. It is important for our customers, but it is also important for efficiency. If there is an hour and a half job to be done at 3.30pm, we can appoint an engineer to do it, slightly elongate their day and they will receive that back in terms of an hour another time. That flexibility means we can send out engineers, respond to peaks, serve our customers better, and be more efficient. It is agility helping the customer and again helping BT.

Also, we are training our people and that is very important. Multi-skilling is important so that we try to reduce the number of silos where it is, 'Sorry, I am an engineer that does this; I cannot do that,' or 'I am a call centre person who can only answer a question on this, not that.' 76% of our engineers are now multi-skilled. That will be added to during the course of the next few months to over 80%. That is going to be important. 5,000 of our call centre staff have entered a programme that will give them a nationally recognised qualification. It is part of a £10 million training programme in our call centres. We intend to have another 2,000-2,500 people going through that programme this year as well. Over 7,000 people will be receiving this nationally recognised qualification.

Also, our investment plans create new jobs for people. Being able to do part of this redeployment, we have now 3,000 working in our Fibre programme. Investment is helping absorb some of that surplus and that is something I meant by freeing up the resources we need for the future.

Building a Better Future

You have that stronger foundation of a better business. You have it underpinned by a different attitude in BT. Now, we go from that foundation. We carry it on with these. We do not suddenly stop with customer service, investment and cost transformation. You have seen that

in the numbers. £900 million is promised in cost transformation this year, but we build on that. We build on that in five ways. You will have seen us talking about these, but the theme of today is to go through these:

- Driving broadband-based consumer services.
- Being the 'Brand for Business' SME.
- Making Global Services into a global leader.

We are a global leader in so many ways, but we are not in our financial performance. Certainly, we can increase our presence and capability.

- Being the wholesaler of choice.

Network has become more important. Our ability to become the wholesaler you would choose because you want to not because you have to is very important.

- Being the best network provider, particularly around the area of Fibre.

Underpinning those points on why we are choosing these areas are sound beliefs, beliefs about the market.

A better future guided by market views

Seven beliefs

These seven belief sets underpin why we are making certain of these views. They are not absolutes. There are some shades of grey, but these explain what we think about the market and our views, as well as why we are focusing on certain areas, therefore, and not on others.

Increased demand for network services

The first of those is that, despite the recession, the demand for global network services will increase in the future. There are a number of reasons for that. First of all, companies are recognising that they have to focus on what they are good at. Unless, those are companies like BT, running a network tends not to be that. It is being a producer of consumer goods, or delivering packages, or trading. It is not running a network. Therefore, more and more companies are looking to outsource.

Also, the need for speed has increased. This is a common theme. Data usage is going to increase and companies are becoming more and more network-centric. We will be a little unusual in this presentation by not having a section headed 'Cloud services'. Fundamentally, the reason is it is in so many of the other parts we talk about. In order to have Cloud services, you need a network. You need a network that can be controlled. A virtual data centre does not work, if there is no network, the capacity of which can increase in line with you taking on the service or software as a service. It is at the core. The needs of customers of all varieties, and particularly corporates, are becoming far more network-centric. That is great news for us and we intend to help them in that.

They are also globalising more, no more so than in Asia-Pacific, so we are seeing multi-nationals increasingly moving to Asia-Pacific. Why? Because the economics and growth patterns are a lot better. We expect to see the market in Asia-Pacific rise by about 15% per annum compound. It is not just the companies coming into Asia-Pacific, but also we are seeing Asia-Pacific countries grow regionally and internationally. I very much believe, and it is a view

held at BT, that this is going to be the decade of the Asian multinational and we are going to help them globalise, because that is what we do.

SME sector buying bundles of services

Moving from global multinationals to the SME sector, the SME sector is quite different from a number of other sectors. Again, something I do not think telcos or even BT have done enough is talk about anything in customer segment terms. Unlike the consumer and, to a degree, large corporates, SMEs have a preference to buy bundles. Why? The answer is because they are really busy running their businesses. They have neither the time nor the expertise or desire to buy a separate item from one company, from another company, from another company. This is shown by SMEs increasingly wanting to get a whole bundle of packages together.

Where do they find that? Today, mostly, they find that with a 'guy called Bob' who has a shop around the corner. There is no national brand for business. We think that the BT brand, and our capability and positioning, which is why we have been building it up in IT, combined with mobile, broadband, and fixed line gives us a great position to become the 'Brand for Business'. The position is vacant. We would like to apply for that position. We think our results and the capability we have makes us really capable of doing so.

Mobile broadband

There was a view for quite a while not to invest in fixed because mobile broadband was going to take it over. We heard about Telekom Austria, etc. For anyone who has had the experience of using a mobile dongle on a regular basis, clearly, it is not a replacement for fixed. Actually, it is becoming even less of a replacement. It is helpful and really important that you can have mobile access every so often, but we are seeing that the speed requirements of people mean it is not an alternative. It is complementary.

This chart from Ofcom shows the average broadband speed you have when there are 10 users using the same network together, i.e. something closer to a real experience rather than a theoretical maximum. As people want to watch more and more video, as they do, and have two-way, high-capacity services, they are going to want more and more fixed. It does not mean they will not want mobile, but it will be largely complementary.

One aspect they will want in mobile is wifi. We are seeing our wifi network really explode in terms of volume demand and more and more customers using it, particularly those on iPhone. While they may be looking at mobile and fixed as complementary, we do not believe consumers in particular will buy mobile with fixed in a big way. Some of the results you have seen time after time shows it is not a huge demand, but a different purchasing decision.

Television and broadband bundles

However, it is very different for broadband and television. Increasingly, people will buy television, voice, etc. together. The chart shows that increasing demand. It also shows that people are using on-demand services that rely on broadband a lot more: 40 views per month in terms of BT Vision. If that was a channel in your house, it would be the third most popular channel. It is really increasing in demand.

We think that will carry on, because not only has television today become on-demand, but increasingly the television of the future is going to be fully interactive and involve communication. Therefore, it is going to become more and more obvious that broadband and

television go together. Television is going to become interactive in very much the same way your computer is today.

Fixed network infrastructure through wholesale

I mentioned this theme of increase in bandwidth usage. With it comes an increased demand for investment in network and capability. A lot of people no longer see that only their own network is something they need to do, or is something that is sensible for them to do, in terms of the extra investment, because having somebody who can do it for all of them makes sense.

Whether it is an accident of history or whatever, we have a Wholesale operation as well as Openreach that is competition-ready. It is open to competition. It is used to being a wholesaler. It is one of the largest wholesalers in Europe. We can help them. You can see in terms of the wins we have had and the companies we support, ranging from the major mobile operators, through to the Post Office, where we provide the services. More and more of these people are coming to BT Wholesale to manage it for them, because they need to, because the demands on the network are becoming unsustainable on their own.

Higher speeds

Also, customers will want higher speeds. This goes back to what we said about the larger corporates, but it is very true for consumers. I am not sure I agree necessarily with the statistics from Ofcom about how much people would be prepared to pay for a doubling of their speed. However, it is clear they are going to have more requirements for increasing speed. We are seeing a large increase in IP traffic, so higher speeds are going to be important, which is why investment in Fibre, backhaul and our 21st century network comes in.

Price matters

You may say it was always thus, and that is probably true, but price matters. First of all, in the UK, we have some of the lowest prices in the world. The bad news for investors is the UK is one of the most competitive markets in the world. The good news for investors is it is already one of the most competitive markets in the world, so we are already in this position. If you look, prices are cheaper than the US, Germany, etc. and you see the average price of a telecommunications basket fall by more than 50% in the last 20 years. Price matters.

It will continue to matter. It is not the only aspect that will continue to matter, but that is also why we must continue to be more efficient, because we are going to give our customers more for less. However, as a result of price mattering and price coming down, that pushes demand up. That is why there are so many broadband customers. There are great prices in the UK, so more people buy it, and we are looking to encourage demand. That is going to be important for our investment.

Investment

That investment is around a number of areas: in fibre; television broadband-based services and sport; different broadband-related services, for instance where we made an announcement today regarding OnLive, an online gaming company; in SME growth; in Asia-Pacific, which I talked about; and a whole range of new products and services, which you will hear us talking about from network-based services to consumer-based services. Also, importantly, in systems and network improvements, all of what we are doing in terms of efficiency, customer service and investment, relies on us having the right infrastructure and platforms. That investment is

part of what we said we would do. That will mean about £200 million of incremental EBITDA expenditure in the financial year we are now in.

To be very clear, the forecast we have given you absorbed that. Otherwise, again, we would be looking for a higher EBITDA, rather than keeping it flat. Therefore, we are absorbing that and delivering a consistent performance.

It will also mean we will continue to spend capex at around the current £2.5-2.6 billion level that we are at today.

Fibre

Announcement

Where I want to talk in a little more detail, because it is a major announcement, is fibre. We are announcing today that we are intending to roll out fibre to two-thirds of the UK. That is a major increase from the 40% we talked about before. The reason we intend to do that is summed up here: while the costs of doing fibre per household increases as you go to more and more households, because of topology and houses are further apart, etc., it really dog-legs at about 65-70% of the UK and then it starts to become a lot more expensive. Therefore, if the economics work as we think they do to cover 40% of the UK, we think it should work to do about two-thirds of the UK. Beyond two-thirds becomes a lot more problematic. That is going to mean a total investment in fibre of £2.5 billion.

Now, we are going to manage that within the current capex levels. How? The answer is that, instead of the £2.5-2.6 billion level coming down when we finish the existing fibre programme, it just carries on at that sort of level. It is going to be a programme that will run to about 2015. It will be dependent on the appropriate investment environment. Today's investment environment is okay. We are happy to open the ducts. However, overall, we are assuming there is not some negative lurch in any variety of our environments.

Programme update

How is the programme going so far? We knew we were not the first people to come up with a fibre programme. Too often in the past, we pretended that, somehow, we were the only people with a certain set of problems and challenges. Therefore, we have gone around the world and learned from other countries. I make no apologies about that. We have learned what they did wrong and we learned what they did well. We are trying to repeat what they did well and avoid what they did wrong. That has allowed us to go much quicker, so while we may be a little later than some others, the scale of our programme is one of the most ambitious in the world. Certainly, it is one of the most ambitious without central government funding and when you say it is competition-ready from day one.

Return

We believe pay-back will be low double-digit years. We have a range of scenarios. Probably the single largest factor, however, will be take-up. Take-up will be the driver in the same way it was for broadband. There are a lot of costs involved that, if you do not bring in any customers, you still incur. If you bring in more customers, more customers help, and we want to drive that. That is the key reason we have priced fibre and BT Infinity really aggressively.

This shows our broadband pricing today – great value and customers are taking it up a lot. However, we want to make it easy for them. If you are buying BT Total Broadband today, it

should be an easy up-sell to BT Infinity, because the price range is not dramatically different. We are not asking you to pay two, three, or four times what you were in order to have faster speeds. Compared to our competitors – for instance, Cable – it is a significant price reduction on where they are. With that pricing, we hope to gain both from Cable and new customers while moving existing customers up.

Outlook 2010-11

For this year, revenue outlook is around £20 billion. It will be explained how the £100 million has come forward affecting some of the year-on-year numbers. There are another £900 million of operating cost savings. That is lower than the £1.75 billion this year, but that included substantial capex savings as well. However, it shows we continue to run with substantial savings. Again, that is going to be this year's P&L compared to last year's P&L, not gross, but net.

Even though we are absorbing £100 million on the pensions and the £200 million additional investment in new services, we expect to have our EBITDA in line with the year just gone by. Free cash flow for specific items is £1.8 billion. It will be shown that the underlying £1.9 billion of last year was about £1.7 billion, when you take out items like the one-off tax credit and a few other items. Therefore, we say we are going from £1.7 billion to £1.8 billion, i.e. further progress on the cash flow despite all this investment. That will bring net debt down to below £9 billion – a major improvement.

Future plans

Looking beyond there, we are giving you longer-term guidance. We expect to see improving revenue trends from 2010-11 right through to 2012-13 with growth for BT Group as a whole over 2012-13. Therefore, in 2012-13, we look to return BT Group as a whole to growth.

In terms of EBITDA, we expect to see growth from 2010-11 to 2012-13. This is not growth on the top line without growth on the bottom line. We are looking for profitable investment and you will see it in EBITDA, particularly driven also by the cost efficiency programme.

Again, that will drive free cash flow. We talked about the £1.7 billion base going to £1.8 billion. We are saying it will move to around £2 billion in 2012-13 – continued solid improvement. A critical part of that is going to be Global Services. The question you have asked so many times, you have an answer to now. When will Global Services be cash flow positive? The answer is going to be 2011-12. We are clear about that. That is what we want to do. There was a large improvement this year; again, being cash positive next year is a critical part of our free cash flow improvement.

That means that dividends will continue to improve. There will be progressive dividends over the next three years.

Key messages

We are not giving up on continued improvement in efficiency. Please do not think that, because we are talking about the future, somehow we are swapping one for another; that remains the core underpinning of everything we are going to do. Service and efficiency gives us a better base for a better business. That will give us good cash generation. You have seen it in the numbers, quarter by quarter. That strong cash generation will allow us to invest in the business, reduce our net debt, support the pension fund and pay progressive dividends. Those

are our key messages. Otherwise translated, we are trying to 'Build a Better Business'. We are making progress. We are going to 'Build a Better Future'. You have seen the progress made, but our catchphrase today is there is 'still a lot more to do'. The good news is that there is still a lot more that can be done. Thanks very much.

Financial Review and Strategy

Tony Chanmugam

Group Finance Director, BT Group

Introduction

Good morning, everyone. It is a lot easier to present these numbers than it was last year. Let me take you through the financials, but before I do, as Ian has already indicated, today we are going to share with you not only our quarter four and full-year results, but also our strategy over the coming few years, which you will hear more about later. For now, I will run through the results for quarter four and the full year and then take you through our finance strategy for the next three years.

Before we get into the results in more detail, let me remind you that in Q4 last year we had the contract and financial review charges in relation to Global Services. Therefore, in order to ensure that we are consistent, last year's numbers exclude those charges. Also, last year's numbers have been restated for changes to IFRS2, which we talked about at Q1.

Income statement

Starting with the income statement, headline revenue for the quarter was down 3% at £5.4 billion compared with a decline of 4% in Q3 and a decline of 3% in Q2. The main contributors to this decline are the drop in revenue in our SME business, the expected mobile termination rate impact in Wholesale and being more selective on the deals that we have within Global Services.

Revenue excluding the impact of FX movements was down 2% in Q4 compared with a 5% decline in Q3 and a 6% decline in Q2. As I mentioned last quarter, the impact from our past acquisitions have now anniversaried out. This quarter has the benefit of circa £100 million of revenue brought forward from next quarter, primarily due to the early delivery of a significant contract milestone by BT Global Services. Headline revenue for the year was down 2% to £20.9 billion. On an underlying basis, revenue declined by 4% in the full-year compared to a 2% decline last year.

Adjusted EBITDA, that is, before the specific items and levers, increased by 16% over last year. For the full year, EBITDA has grown by 6%. The growth reflects the improvement in Global Services. Excluding Global Services, EBITDA for the rest of the Group was up by 5% in the quarter and 4% in the full year. Continuing the positive trend we have seen over the previous six quarters, the key driver for this improvement has been the continued cost savings that we have delivered.

Depreciation for the quarter was £788 million, higher than last quarter but in line with the prior year. For the full year, depreciation was £149 million more than the prior year, reflecting the

assets with a shorter life being brought into use during the year. This is in line with the indications I gave to you previously.

Adjusted operating profit was up 41% in the quarter and 7% in the full year, again reflecting Global Services' good performance.

Continuing down the income statement, the results are in line with what I have said previously. Net specific items before tax totalling £183 million were charged in the quarter, £52 million of which related to the restructuring of Global Services.

As I mentioned last quarter, we have reviewed the utilisation of our property estate given the headcount reductions Ian mentioned earlier. As a consequence, we are recognising a charge in the quarter of £121 million with further charges over the next two years bringing the total to over circa £300 million. These are non-cash for the quarter and recognise the net ongoing running costs, which we have minimised by subletting and mothballing properties.

Looking forward, I would expect the effective tax rate to rise from 22% to 25% over the next three years.

Reported EPS was 2.7p for the quarter and 13.3p for the full year. The prior year was impacted by the contract and financial review charges in Global Services. Adjusted EPS was 5.2p for the quarter, up 73%, and 18.6p for the full year, up 16%.

Free cash flow

Free cash flow was an inflow of £1,045 million in the quarter and £1,933 million in the full year. This is £1.2 billion better than last year. Let me draw out a couple of key points. On capex, there was a net cash outflow of £699 million in the quarter. For the full year, the capex outflow is £2,480 million, significantly lower than last year. Working capital and other reached £440 million inflow in the quarter, leading to an outflow of £635 million in the full year. This is £337 million worse than last year and reflects cash specific items this year. The cash outflows associated with the utilisation of provisions made in previous years, including those made at the time of the contract and financial review last year partially offset an improved working capital performance. Net debt of £9.3 billion shows a £1.1 billion improvement over last year.

Operating cash flow by lines of business

As I have said before, the operating cash flow by business can oscillate quarter by quarter. Overall in the full year, all the lines of business have improved, but specifically I would like to highlight Global Services where year-to-date cash outflows have roughly halved from £847 million to £443 million. Retail's year-on-year improvement is driven by improved profitability and working capital, the primary result of lower debtors, which we plan to maintain.

Financial strategy to 2012/13

Now let me take you through our strategy. Ian has already highlighted it, but let me go through it again.

We are looking to improve our revenue. At the moment, we are on a 4% decline. That is the underlying decline this financial year. We are going to get into a situation in 2012/13 where we will grow this business, we will grow our revenue, but we will do it in a long-term sustainable manner looking for profitable revenue growth. We are not going to chase after revenue for the

sake of revenue. It is going to be long-term, it is going to be sustainable and it is going to be profitable.

We are also going to grow our EBITDA and we are going to grow our EBITDA on the back of that revenue growth. In addition to that revenue growth, we will continue to do the things that we are doing now: strong financial discipline, increased focus on cost savings.

On the back of growing our EBITDA we will grow our cash flow. We will keep the capital expenditure flat; we are saying £2.6 billion over the next three years, but we will also improve our working capital. That will allow us to go from the £1.7 billion free cash flow underlying that we have now to £2 billion in 2012/13.

If we do this, we will be able to invest in the business, reduce our net debt, support the pension fund and have a progressive dividend policy.

Revenue movement

Let me turn to the revenue numbers. In terms of our revenue, the underlying number that we have this year, after taking into account the impact of FX and acquisitions and taking into account the £100 million of one-offs, we are in a situation where we have a decline of just over 4%. Next year, we are going to turn that into a 3% decline and the phasing of that 3% decline means that in quarter one the level of decline will be materially more than the level of decline in quarter four. Thereafter we will look to grow the revenues so that 2012/13 will be a growth year.

Improving revenue trends 2010/11 to 2012/13

If I look and see how is that going to take place, what is going to happen – Jeff will go through this in much more detail; Ian has already hit a couple of the key points – within Global Services we are going to focus on network-centric services as well as growing Asia-Pacific. Within Asia-Pacific we are in a situation where the market is growing, we have a presence on the back of some of the major contract wins – Ian referred to DHL and Jeff will go through the detail. If you ally that to the fact that we have an opportunity, we have a reasonable product portfolio, we have a decent core business of over £300 million, we should be able to exploit that.

Within Retail we are looking to improve our revenue trends and we are going to do that on the back of exploiting the fibre investment. By that, we are going to improve the quality of the content through TV, which Ian has already talked about and Gavin will go through the detail, and also with gaming as well and again Gavin will go through the detail. We also have a major opportunity in the SME business. Again, I will not repeat all the things that Ian has talked about, but there are opportunities to fundamentally change the revenue flows within Retail to ensure that the level of decline we have starts to even out.

Within Wholesale we are going to be in a situation whereby the mix of revenues will change but the overall revenue will stay flat. There is an increased focus on managed network services, which will look to offset the declines that we are having on mobile termination rates and transit revenues. On managed network services Sally will talk to you about the evolution from white label services to full outsourcing.

On Openreach we will look to keep the revenues broadly flat. Again, Steve will talk you through the details of how we are in a situation where we have to have material price cuts and how we are exploiting the investment in fibre to offset those price cuts.

How BT spends its money

A number of you have asked me how BT spends its money. Let me go through the detail with you. We are in a situation at the moment whereby we spend £18 billion. Of that £18 billion, £2.5 billion is spent on capital of which one-third relates to work that we do ourselves and two-thirds relates to platform and networks and customer-specific spend. We spend about £6.1 billion on our labour force of which round about 70% relates to BT staff; the other 30% relate to third party, offshore and agency staff. We then spend round about £3 billion on other operating costs, which is split one-third, one-third, one-third between property and energy, network maintenance, and other. The remaining costs are the costs of sales, split between POLOs and direct cost of sales, such as access circuits.

Grow EBITDA Q4/FY 2009/10 group cost reductions

What are we going to do with that cost base? What have we done with that cost base? If I look through our cost base, we have reduced the level of costs that we have. During the course of this financial year we gave guidance of over £1.5 billion. In fact, we have delivered just short of £1.8 billion and that has meant a 9% reduction in our cost base. That £1.8 billion is split one-third between capital and two-thirds between operating costs. We had 9% reduction in the year and 3% reduction in the quarter. *Prima facie* that looks lower and it is lower [than last quarter], but the key facts are that underpinning that reduction was the fact that the capital – which we guided to £2.5 billion, we spent £2.5 billion – is very lumpy and so in Q4 we have some flow downs through timing from Q2 into Q3. The opex costs are about £100 million lower than the run rate we would have expected. That is primarily due to the fact that we brought forward £100 million of revenue through the early delivery of a contract milestone in Global Services matched up with £100 million of costs. The net position though is that the opex savings in the year are £1.2 billion.

Grow EBITDA 5-year revenue and operating cost story

In terms of the next three years, I want you to go back and look at the three years before the last financial year. What you will see is that the costs have run faster than the revenue numbers. The revenue numbers improved by £1.2 billion; the costs increased by £1.6 billion. Last year we reversed that trend, as you will see from the numbers and what we are saying moving forward is we are going to be in a situation where the £1.2 billion of opex cost savings we delivered this year, we are looking at £900 million next year because the capital will be flat, there will not be the same level of capital savings.

Now, the £900 million costs savings that we are giving guidance to for this coming year includes the fact that we are going to swallow £200 million worth of investment plus £100 million relating to an accounting change for the pension service charge. Therefore, the net-net position is that we took £1.2 billion of costs out in the last financial year and we are doing the same this year. The headline number will be £900 million, because we are swallowing £300 million on investments and the change in the accounting. Thereafter, we will look to continue to remove costs, because there are plenty of opportunities.

Grow EBITDA continued focus on costs

Let me run you through what we have done on the cost base. The £1.8 billion that we have delivered this year has not been rocket science. We have not done things that are

fundamentally different from what should be done in a good, well run, well organised business. Again, let me add this is not rocket science what we have done so far.

In terms of our supplier base, BT was a soft touch. How else could you get into a situation where you have different suppliers charging different parts of BT different rates for the same service? We were a soft touch. This is what happens. We are in a situation now where we have taken a programme of our top 40 suppliers where we made £250 million of annualised savings, £200 million during the year, and there are still plenty more opportunities which I will go through.

Ian has talked about the Right First Time programme. In its very simplest sense it is about removing the cost of failure. For instance, if I look within consumer sales at what has happened there, we have reduced the level of transfers on calls by the agents by about 12%. That was worth £4 million.

In terms of overhead value analysis and process re-engineering, it is simply about re-looking at the way we undertake our processes and it is by doing the simple things well. For example, within the Wholesale call centres we have been able to take out £4 million by looking at the resourcing profile at different times of day.

We have also undertaken what is basically good practice. An example is value for money analysis on our agency staff. We had over 600 agency staff in this company earning over £100,000. We now have just a little bit over 200. The majority of those agency people have gone, a few of them have been employed by the company, but effectively we were not getting value for money. We have changed that.

We have also reduced spare capacity. At the start of the year, as a result of the work that we had done in terms of being able to reduce the number of headcount we had, we had more than 2,000 people in our transition centre. That is, people who were waiting to be able to do a productive job within the company. During the course of the year, as Ian talked about, we have reskilled 5,000 of those people, because we have had people entering that transition centre during the course of the year. The end position is the 2,000 opening has gone down to 500.

What that means is that although we have delivered good quality cost savings there are plenty of opportunities for next year. I have already talked to you about the fact that we still have 200 agency staff earning over £100,000. We still have 500 people in the transition centre. Therefore, we will continue to do the things that we have currently done, but in addition to that we will do more.

I talked to you about the supplier base. You will be amazed that on our application support and maintenance-type contracts we have 25 suppliers providing us work that costs us £78 million. We are being overcharged. The suppliers are on notice about that and I will come back to you and tell you the level of savings that we will make next quarter, but it will not be £10 million and it will not be £20 million, it will be more than that, because the opportunities are there. That is simply one set of suppliers on one cost base on one degree of platforms.

We have 30,000-plus people in call centres managed in different ways by the different lines of business. We have best practice within call centres within lines of business. If we replicate that, there are material opportunities.

We are going to adopt a more forensic approach and I will give you an example. We spend something like £15 million getting train tickets. We do not order the train tickets in the right way. We can make £3 million of savings by simply ordering our train tickets in a better fashion.

There are plenty of opportunities. If we do not deliver, it is down to us, no one else, because the opportunities exist and it is not a one-year opportunity, these opportunities will exist over a long period of time.

Cash utilisation 2009/10

How have we used our cash? £4.4 billion delivered last year, £2.5 billion on capital, leaving us £1.9 billion. Of that £1.9 billion, we paid £525 million on the pension deficit. The dividend payments have been, roughly speaking, £245 million. This coming year we expect that to be greater; that was simply the way the cash profile worked. The key point is we have been able to reduce our debt by £1.1 billion.

Grow free cash flow

If I look at our cash flow, *prima facie* we have delivered £1.9 billion. It is important to understand that on a normalised basis that is too high a number. I do not want you to be seduced by the fact that that is such a high number. The reality is that inherent in that number we had the benefit of near enough a £600 million swing in relation to cash tax. In other words, we had a tax rebate when in normal years you would expect to be paying tax from a cash perspective. That benefited us by just under £600 million.

Offsetting this was the fact that we had something like £100 million whereby we had to undo some of the bad practices of the past in relation to uneconomic factoring. We will not have to do that moving forward. We also had the hit associated with an increase in specific items cash impact during the course of the last financial year of about £300 million.

If you add all of that together, you are in a situation whereby our underlying numbers are about £1.7 billion. As Ian said previously, we are going to grow that £1.7 billion to £2 billion over the course of the next three years. The guidance for this year is £1.8 billion.

Liquidity

Let me finally turn to liquidity. We currently have cash and investments of £2.2 billion. We have available facilities of another £2.2 billion. We have debt maturity of £2.5 billion by March 2011. Therefore, for this coming financial year we do not need to go to the market to get cash. There are no additional requirements until January 2013, so for the next financial year we do not need to go to the market. However, we may choose to do so if the timing is right for us.

As a result of that profile our interest payments will fall during the course of 2011/12 and 2012/13 and the cash impact of that fall will broadly offset the increase in tax that we will have to pay as a result of our effective tax rate increasing from the 22% to the 25% I talked about previously.

Financial strategy

Let me reiterate we have made progress. We have delivered what we said we would deliver, but there are plenty more opportunities. We have to grow the revenues underpinning this business, but we will only do it if it is long-term, if it is profitable and it is sustainable. We will

also only do it by maintaining the same financial disciplines we are currently maintaining: the continued focus on cost, the continued focus on good financial practice. When we do this – it is not if, it is when we do this, because the focus will be on delivering this – we will be able to invest in our business, reduce our net debt, support the pension fund and have a progressive dividend policy.

Thank you.

Q&A

Paul Howard (JPMorgan): On the progressive dividend, I am just trying to work out what that means. You grew the dividend at 6% in the current year, but you are pointing to, I guess, £300 million improvement in underlying cash flow over the next three years, your pension costs are fixed, your debt is coming down to a manageable level. Should we assume that there is more of a step change in that dividend going forward or is 6% the place at which you will hold it for the time being?

Sir Michael Rake: Obviously, in terms of the dividend, we keep it under review each year. I think we have been very clear that we have moved to reduce costs, reduce capex, reduce our net debt, and deal with the pension fund on a rebased dividend to grow our dividend in line with our results and with our profitability and our cash flow. That is what we will do, so I would not want to build an expectation over and above what we are showing now, but we will have a progressive dividend.

Nick Lyle (UBS): Firstly, on fibre, you talked about the benefits of looking at other schemes, but your cost for fibre for homes is substantially below some others. It may be because of huge differences in network starting point or whatever, but you are below half, say, the rollout costs of fibre-to-the-cabinet of a KPN, for example, so how are you getting to those numbers? Can you give us a little bit more detail and do you worry that maybe fibre-to-the-home, for example, needs to be increased as a proportion of the mix within your rollout?

Secondly, on pensions, maybe I am wrong in the arithmetic, but it looks like your deficit has come down by £1.5 billion but your assets have gone up by £4.1 billion, so quite a big move in the liabilities there over the year as well. Have you been more prudent in your assumptions or the trustees' assumptions and does that have any bearing on what the regulator might think?

Ian Livingston: On the pensions question, no. It is because you expect to get some return in the pension scheme anyway and you effectively unwind the discount on the liabilities. It is mathematical rather than huge changes to underlying assumptions. It is very much more you would expect to get a return over that period and as equity values decrease the return assumptions, because the yield is lower, go down and the same the other way: if the assets fall, you would tend to get a smoothing effect on the actuarial calculation because it makes a different assumption about the return criteria because yields have changed. It is just an inverse relationship.

On fibre, it is very difficult for us to comment on other companies; we leave that more to you. We started the fibre programme and I am sure you can ask Steve in more detail later when he presents, but there is nothing we have encountered so far that causes us to feel that our

numbers are unattainable. In fact, we have even increased the fibre-to-the-home proportion within the overall base. Part of that I think may be because, of course, they are much talked about in the past and they will be talked about because it is just part of our business, but 21C, the 21st century network and what it provides in terms of our core IP network just underpins a lot of what we are doing. Clive will talk a lot about the processes we have for developing systems, but there has been a very speedy and effective development of fibre-based systems really from a standing start. In addition, we have a lot of technologies, and Clive may mention them as well, particularly around blowing fibre that helps us in terms of delivering an effective FTT solution.

It is early days. In the summer we will get to about 1.5 million; we are gearing up to get to 80-90,000 households a week, but there is nothing today that has caused us to think that we are significantly out of it and we will have to see as time progresses. That is the position today. Tony, do you want to add anything?

Tony Chanmugam: Yes, just a couple of points. The first thing is we have some history about what we have done so far. In relation to fibre-to-the-cabinet, 75% of the rollout is there; we have some history. Inherent in our assumptions we are expecting some unit cost reductions. Again, there is nothing there that says to me we are going to be wildly out on that.

In terms of fibre-to-the-premise, it is 25% of the rollout; we do not have some history. We have some estimates in terms of what we think it will be. Again, based on the evidence we have now, I think we can manage within that envelope. I do not have any reason to doubt why we could not manage, but it will mean that we will have to reduce our unit costs from where they are now to where they need to be.

Chris Alliot (RBS): Sorry to go back to pensions again, but on the December 2009 funding deficit and the PPF estimate does that include any benefit from the changes to the pension benefits that you mentioned that you have put through in March? I noticed there was a footnote saying that there is a change to the October 2009 assumptions.

Secondly, on fibre investment, you mentioned potential negative lurches in the investment environment. I just wondered if you could elaborate a bit on what you thought the greatest potential negative lurches could be.

Ian Livingston: On the pension, these are like-for-like things. We have not, between one number and the other number, changed the underlying assumptions, so in the best [median] estimate is some of the benefits of that [pension review]. However, there are no big changes in the underlying assumptions. In terms of trustees' valuation, for instance, it is very much a like-for-like.

In terms of negative lurches, I think we felt we just had to put the caveat there. When we originally announced the fibre programme we said it was subject to an acceptable environment. We are going through times of change and I think shareholders would expect us to be responsible and not say irrespective of whatever happens we will not change. I am expecting everyone to open their ducts, because that is what the Tory administration said would happen, but we are just saying as things stand and where we understand things to be that that would be acceptable. The only other factor, of course, might be if customers do not want it, which could be a factor as well that we have to consider.

John Karidis (MF Global): With regard to the 75%/25% split in fibre, will you carry that through to two-thirds of the population to 2015? Secondly, is it possible to break down approximately the extra £200 million investment per division? For example, how much of that will go to BT Retail?

Ian Livingston: On the £200 million, the majority will be in Retail.

Tony Chanmugam: It is 75/25.

Ian Livingston: Yes, in Retail. I think most of the rest of the chunk is in GS. That is why you will see an effect on Retail's EBITDA next year, because effectively it is taking the lion's share of that investment and you will hear from Gavin on that.

On 75/25, I think we will continue to fine tune. As we see the cost of FTTP, the changes it causes in the revenue or running cost then we may fine tune that number. It might increase; it might reduce if we find that it is a lot, lot more expensive. Certainly you get to the point in some places where FTTP is dramatically more expensive. In the denser areas it is less expensive in relative terms. Steve will talk through some of the FTTP/FTTC dynamics, because running an FTTP network is a bit cheaper, but at this point running at 75/25. We will update you if we move that percentage. We did start at 10/90 originally.

Nicolas Didio (Exane): I have two questions. First, you have not mentioned any M&A opportunities. Shall we consider that the £200 million at the opex level is replacing potential M&A? Secondly, do you have any view on the rating agencies' opinion on your full-year results and your plan?

Ian Livingston: I will ask Tony to talk about the rating agencies. I hope that they feel that the results that we have released are encouraging, because they are above market expectations and show that we are liquid and generating cash.

In terms of M&A, our strategy is not M&A. Our strategy is to deliver these things. If there are opportunities that help us along that route then fine, but it is not predicated on that at all. It is predicated on the fact that there is a huge amount of self-help and self-delivery. I can see that we might do the odd thing, but there is certainly nothing of any significant size assumed in our calculations or our numbers.

Sir Michael Rake: I think it is clear. The other thing we are trying to do is integrate the acquisitions we have already made in Global Services in past years and get the full benefit for the Group of what we have already spent. Gavin will talk later about what we are going to do with the money and how we can get benefit.

Tony Chanmugam: The finance team ran through the numbers with the rating agencies. I do not think there were any surprises, but based on what happened previously with S&P I do not have any skills to judge reactions.

Ian Livingston: Yes, we seem to get better but they do not quite recognise it at times.

Stephen Howard (HSBC): I have two questions. Firstly, the growth target opportunity that you identified in Asia-Pacific, could you perhaps give us a bit more colour there so that we can be comfortable that there will be profitable growth? After all, when we have seen Global Services chase international business in the past, relatively infrastructure-light, I think we have to ask questions about how that can be properly profitable.

Secondly, just to go back to the earlier questions on fibre, I have to say again that it does look an extraordinarily light figure, especially if 25% of the extended build is fibre-to-the-premise as well, if I have understood some comments a moment ago. If you compare that with the Broadband Stakeholder Group's survey of the costs, for instance, it is not just comparisons with other operators that suggest that these are really ambitiously low capex numbers. Look, I could not even wire my own flat so what do I know, but let us say that your numbers are a bit too aggressive there, do you have the fungibility and flexibility in the rest of the capex line to flex things so that you can still do the build within your existing capex profile?

Ian Livingston: I cannot really say more than our experience to date does not suggest so. It may turn out differently and we are always open to that notion, but I think we have shown our ability to deliver overall and manage things overall in the business, so we will carry on being aggressive and managing all the other areas to help deliver. Tony, on fibre is there anything more you want to add?

Tony Chanmugam: The thing to add is it does not include the connection. I do not know the comparison you are running, but our projections do not include the connection [in-home].

Ian Livingston: Maybe some of the other comparators do. The Broadband Stakeholder Group one, I can understand more operators' individual experience, but we will carry on getting better, we will carry on getting more experience and we are making it a dedicated programme. It is a very large-scale programme and that helps as well, but we will see. We will report back to you how we are doing and if our opinion changes. Up to now, our opinion has changed positively and not negatively, but we will carry on looking at it.

In terms of Asia-Pacific, Jeff Kelly will talk about that. I hope you have seen a somewhat different BT as to how we are pursuing things. We have customers, we have a base there already, there is clearly a market and we are not interested in chasing after unprofitable growth, so probably that may be your best thing. There is no other way I can convince you other than we will produce the results. Look at the results today across the Group. In the end, we ask for nothing more but to be judged by our results. In advance, you can forecast what you wish; we just want to be judged by the results. One thing I can assure you is that we will be disciplined. We might get a couple of things wrong occasionally, it may happen, we are not absolutely perfect. However, we will be disciplined and we are chasing sustainable growth in profits and cash flow and the revenue growth is part of that, it is not an end in itself.

Sir Michael Rake: I would just add to that I think there are a lot of things we can do – and Jeff will talk about these – not only in terms of the cost of delivery but in terms of managing the proposal process, managing the contracts, managing engagements, managing the variations. We can do a lot better on those contracts as well as the upfront decisions on what risk we will take versus delivery versus the price. There is a lot we can do and have started to do.

Ian Livingston: We do have a multi-hundred million pound business in Asia-Pacific that is already doing pretty well, so this is not starting from afresh. We have people there around the whole Asia region and Jeff very much will talk about that. I do not want to spoil Jeff's thunder, so I do not want to talk too much more about Asia.

Steve Malcolm (Evolution): I will jump on the two-question bandwagon, please. One very simple one on POLOs, which seemed to drop down very sharply year-on-year in the quarter,

but also as a percentage of revenues I think fell something like 300 basis points. Can you just tell us what has happened in that cost line in the quarter?

Secondly, within Global Services can you give us an idea of the proportion of revenues that come from the government sector and what your assumptions are behind those revenues over the next two or three years in the back to growth guidance you are giving us?

Ian Livingston: I will let Tony answer about POLOs. On Global Services, Jeff will be going through a bit more on the divisional split. In terms of what will happen in the government sector, I think it is interesting. There are challenges and opportunities in the government sector. For instance, in local government I think there are a number of opportunities, because there is going to be a lot of pressure on local government. We have been helping to significantly improve both the cost and quality of service in places like Liverpool and around the country, Edinburgh as well. I think a lot of local governments will be looking for help effectively to meet their spending targets and we can assist them.

It is roughly the same story in government. I mentioned the DWP contract earlier. There are lower costs for them, good profits in the future for us, they are able to hit their targets and we have been able to get some benefit. It is a bit like every customer who has an issue and a challenge and something they need to do and effectively this makes government look pretty much the same as the private sector. They are going to be challenging us to reduce the costs and we are going to try to help them. Unquestionably, if they decide to absolutely cancel a programme that would not be good news, but I think a lot of the things present opportunity for them to consolidate spend, which we would feel to be in a good position. Therefore, there are some challenges with it. There might be some opportunities as well. Our job is to try to manage that and we will have to see what government policy is. We do not even know who most of the ministers of state are, so we are a bit early yet to judge it and we will, of course, be talking to them as time progresses.

Steve Malcolm: You are not expecting any dramatic change.

Ian Livingston: No, I think particularly one does not really know what the policy is going to be now we have the Liberals in together and we will certainly be showing them how a lot of what we do has saved quite substantial amounts of money. However, as I said, there may be some challenges, so we will just have to judge it as we go on.

Tony Chanmugam: On POLOs, basically, the vast majority of this is matched by revenue reductions, so it is fundamentally what has been happening in terms of MTR, transit and it is just a straight flow through. There has been a small element of reduction as a result of us re-looking through our cost base and being more effective in what we are doing, but the vast majority is matched by revenue reductions.

Steve Malcolm: The percentage on revenues has gone down quite a lot.

Ian Livingston: Yes, because you have seen the mix. Take Wholesale, for instance, it is roughly flat without transit and MTRs, so obviously that must mean that the flow through is in POLOs as a percentage comes down, because you have flat income effectively excluding it and all the weight of the reduction has been taken in POLOs.

Maurice Patrick (Barclays): A quick question on the cash flow improvement: you have done normalised cash flow around 1.7 this year. You have indicated that will grow to around about

2.0. Looking at your slides, Global Services was negative 400-ish this year. Presumably that turning to growth will be largely Asia-Pacific growth and cost-cutting. Therefore, should we think about BT as a Group as most of the businesses flat cash flow over the next few years with the growth from 1.7 to 2.0 being largely Asia-Pacific growth and cost reductions in GS?

Ian Livingston: I don't think the growth will be largely Asia-Pacific growth. We are making investments in Asia-Pacific and we hope that will return fairly soon, but I think that is asking a little bit much of it. It is a £300 million business today and that would be profits by anybody's standards. You have to remember we are making this £200 million investment, most of which is in Retail, so some of the investment we are making in other places. We have said Wholesale and Openreach are reasonably stable. Retail is going through an investment phase and if it was not then we would not be talking around £200 million, we would be talking a chunk higher than that.

Nick Delfas (Morgan Stanley): I might be the only person in the room who does not know this, which is embarrassing, but what is the Pension Protection Fund figure of £3.8 billion based on? How does it relate to the other pension numbers?

Secondly, just going back to what Tony said on connection fees and the whole issue of Infinity take up, presumably customers are not going to be willing to pay connection, so how is that going to be accounted for? Is it going to go on to the capex budget somewhere else?

Ian Livingston: Customers may pay connection, particularly if they are other CP customers, because they will have to fund that connection. It is pretty much like broadband generally, where we have connection costs, we have the subscriber acquisition costs. It is one of the reasons why you will get Retail investing in its business in EBITDA costs, so I think we will typically recognise that just as a subscriber acquisition cost effectively.

On PPF, it is the levy we all pay. When a company goes bust what happens to the pensioners? They do a calculation to try to assess how much deficit there will be if they have to pay out a certain level of pensions going forward, company by company, and then they make the levy that they raise based on that deficit. That is the best estimate the pension regulator has of how much they might have to pay out based on what you put in, based on returns and what percentage you have to pay. That is how it is based and, with luck, it will mean we might have a lower levy as well. Mike, do you have anything to add?

Sir Michael Rake: It is supposed to be an extremely conservative evaluation based on gilts, so what they might have to pay if an individual company went bust, you aggregate it all and provide a levy to everybody. That is what they are trying to do, protect the government from any failure of a company and its pension scheme.

Ian Livingston: By the way, you are not the only person in the room who is not an expert in PPF and I regret that I even knew that answer.

Morten Singleton (Collins Stewart): Firstly, mobile operators are facing network congestion issues at the moment and one of their solutions is femtocells, which is basically piggy-backing off your network infrastructure. Talking to TalkTalk, they are saying that they can see that traffic, measure it, monitor it and are looking to charge for it. Are you likely to do the same?

Secondly, on Tech Mahindra, there have been a number of media comments in the last couple of weeks that you might be looking to sell out of that business, which would not really marry

very well with the growth in Global Services in Asia-Pacific. Do you have any comments on that?

Ian Livingston: I think you are making the wrong association. Owning 30% of a very good business that writes software and does outsourced services is not the same as running a managed network service. Quite rightly, as somebody said today, we acquired the moniker of an IT company and we are not; we are a network IT services companies. Owning a minority stake in anything does not mean you have operational control, so we would not see expanding via Tech Mahindra as the way we are going to expand in Asia-Pacific. Tech Mahindra is a very important supplier to us and we have been there right from the start and I know there have been press reports many, many times that we sell or do not sell or whatever and we will look at that over time. We are not making any commitment one way or the other. It is very, very different from where you are in Asia-Pacific, but the one thing I know is Tech Mahindra will remain a very important partner.

In terms of network congestion, I would turn it around a little bit and say the real way that the networks are trying to deal with network congestion is they are buying a heck of a lot of back haul capacity from us and also using our wifi network. You can ask Sally about that in a lot more detail; in fact she will probably tell you about it in a lot more detail even without asking. It is a real opportunity for us and we are moving as fast as we can. I referred to the Ethernet rollout and having to rollout Ethernet to manage that capacity. The wifi network, for instance, we have seen a doubling in usage, I think a billion minutes now we have seen in usage, which is remarkable. A lot of that is coming from iPhone and the first thing those companies who got the iPhone distribution rights did was to come along to us and said, 'Can we sign an agreement with you to use your wifi network?' We have 1.5 million wifi hotspots now and they have combined a capacity well in excess of a 3G network. They are not great, obviously, if you are travelling around the M25, but one of the things you could do is try just travelling through central London, for instance, or many cities around the country and you can pretty much pick up a wifi signal from BT. The BT customers get it for free. That is the way we see being able to use the mobile traffic and, as I say, I assume you will be there for Sally's presentation, so you can ask the question again.

Andrew Beale (Arete Research): I have a couple of questions. Firstly, on your £150 million of cash exceptionals which are below your £1.8 billion of free cash flow for this year what is the longer tail of that given the charges that you have already booked? Presumably, property is a long duration one. In your future restructuring do you expect that cash exceptionals will continue to be a drag on your £2 billion of longer term cash flow?

Secondly, on the fibre connections, I just want to make sure I understand this. The £2.6 billion of capex is a hard number that includes all the spending on all levels of take up that you can reasonably foresee and then within the £200 million of investments that you are talking largely in Retail, that takes account of any connection costs for fibre. Is that correct?

Ian Livingston: If demand is way more than we expect anywhere, I will not be embarrassed at coming to you and saying, 'Can we have a little bit more money?', but it is based on our expectations, absolutely, and we think that it is manageable, containable and I think we have been pretty good at managing increased demand in various areas and dealing with it within the overall envelopes. That is the aim of the way we are doing things.

In terms of specific items, I will let Tony talk about where we see the long tail of it, to the extent we can see the long tail.

Tony Chanmugam: From the stuff that we have at the moment it will be materially less than £100 million going forward after the next financial year.

Stuart Gordon (Berenberg): I have a couple of questions. First, just a clarification, because I am not sure if I heard you correctly. On the £2 billion, you said it would be substantially higher if it was not for the investment in Retail, but I thought that was just one year. Could you clarify whether it is just going up really from £1.8 billion to £2 billion, but the £1.8 billion included the £200 million and it will go on to £2 billion.

Secondly, just to go back to the investment in Asia, you said in your presentation about competitive networks and having an edge there was absolutely key. Could you elaborate on what network edge you see yourself having for this investment in Asia?

Ian Livingston: On the £1.8 billion to £2 billion, yes, we are going to carry it. This is not a one-off where we spend it in a year and then forget it. What we will see is the revenue will come up over time to meet it, so we will carry on. We are not going to do TV for a year or something and then stop it – well, I hope not. That is the same with a number of the other broadband-based services. Some of the things Gavin will show you later are not even launching in 2011. Therefore, we think we will carry on having a material amount of investment in our future, but it will be a step function: it steps up, but does not step down again. What you see essentially is the revenue.

I do not think particularly I made a big song and dance too much of the network, but we do have one and Jeff will show you a very pretty map of our network positioning around the world. We have real capability around Asia that includes the network, it includes people in delivery and it is not trying to be an in-Asia network where we try to sell to people in China consumer services. It is a network that is supporting multinational corporations in the sort of places they want to go and we need to make sure we invest there. We are rolling out new products and services there and people. Again, I do not want to spoil anyone's thunder, so Jeff can talk about it a bit more.

Simon Weeden (Citi): On exceptionals and as far as their impact on the cash flow is concerned, you showed us a chart which adjusted this year's cash flow for the exceptional element in it. Is there going to be an exceptional hit to the £1.8 billion next year? Are there any implications of the additional charges that you are taking for next year and the year after in terms of cash outflow of an exceptional nature as well?

Secondly, on the connections question, you have done a good job getting the fault rate down on lines to reduce the number of engineer visits and so and so on, but it sounds like if the fibre deployment is successful you will have a big increase in engineer visits. Can you touch on the operational implications of that as well as the financial implications, the need to increase your field engineering force if that might be necessary or how you are going to handle that?

Ian Livingston: I think it is more the other way: it can absorb the efficiency. Steve will talk and show you about the efficiencies in Openreach. I talked and I say again about freeing up resources by our efficiency to allow us to invest and that is a really good example. We have 3,000 people already working on our fibre programme, yet as you have seen our total labour

resources have fallen. A number of these people used to work in Operate, but the Operate division, which Clive Selley will talk about, has improved its efficiencies quite a lot so we have retrained them and they are working on this. From our point of view, freeing up resource and then utilising them in other ways is very helpful.

On the £1.8 billion, it is £150 million cash charge, so you have the £1.8 billion and the £150 million is the specific cash item to that.

Simon Weeden: Is there anything from the property stuff?

Tony Chanmugam: The property will be included in the £150 million.

Robert Grindle (Deutsche Bank): Is it possible to know the EBITDA impact of the super-fast rollout last year when you had costs but no revenues?

Separately, you have had great success making your workforce more agile, but if you read the press some of them are getting grumpy as well and you are getting some push back from the unions it seems. Have you built in enough flexibility in those cost-cutting plans should that push back be a bit more than you are reckoning?

Ian Livingston: In terms of the unions, we have had a good relationship over a number of years with our unions. We have worked constructively together to try to improve things for BT, which improves things for their members. We have also done a lot, I think probably pretty much more than any other company, to very actively try to retrain and redeploy our people, not have compulsory redundancies. I think our people and the unions appreciate that and they know things have been tough. We have a different view as to what the pay round is. They are looking for a 5% rise, we have offered 2% plus also a bonus that means for the lowest paid people they would effectively get more than 5% this year; potentially up to £500 bonus during the year. We think that is a good offer; we think it is very competitive. They think otherwise and, hopefully, we are going to carry on discussing and I hope the same which there has been up until now, which is the unions want to see the best for the company but they want there to be a different share of resources. I understand that, so we are going to carry on talking to them and I would hope we would come up with a solution, but I think people would recognise today that what we have offered is pretty competitive in terms of 2% plus a bonus offer.

On the EBITDA impact of super-fast broadband, what is included in the numbers and what we have talked about this year is the incremental over and above that, but Steve is spending quite a lot of money on fibre. Most of it is capital, of course, but there is some revenue expenditure as well and that will go into next year, but that is included in what we said. We had a chunk this year, it is in the P&L and what we said about £200 million is it is incremental, but that is mostly basically Retail and GS with possibly a little bit in Openreach, but it is mainly in the roundings because there is a lot this year.

I am under strict instructions to run to time, so we will finish there. Outside, there are demonstrations in various places with lots of very interesting things to see and play with. Our senior management team is around the place and a number of you will not have met them, so it will be an opportunity to chat with them as well. They are under instructions not to answer too many of your questions, but you can always have a shot. When we come back we will hear all about the wonders of Retail, so please be prompt. Thanks very much indeed.