BT Q1 Results Conference Call

Attendance List:	**Ian Livingston**	**(IL)**
	Tony Chanmugam	**(TC)**
	Gavin Patterson	**(GP)**
	Jeff Kelly	**(JK)**
	Steve Robertson	**(SR)**
	Sally Davis	**(SD)**

Title of Meeting: **BT's Results Conference Call for the First Quarter Ended 30th June 2010**

Hosted By: **Ian Livingston (IL)**

CN

Welcome everybody. My name is Catherine Nash and I'm the Director for IR here at BT. On the call today we have Ian Livingston, Chief Executive and Tony Chanmugam, Group Finance Director. They will give a short presentation on the results and then we'll hand over to you for questions. In the room with us today we also have the CEOs of our operating lines of business. Before we start I'd just like to draw your attention to the usual disclaimer on forward-looking statements. Please see this slide that accompanies today's call and our latest Annual Report and Form 20F for examples of the factors that can cause actual results to differ from any forward-looking statements we may make. Both the slides and the Annual Report can be found on our website. Now I'd like to hand over to Ian, please go ahead.

IL

Thanks Catherine and good morning to you all and thank you for coming on, I know it's a very busy day in the Telco results world so we'll be pretty brief.

Let me first of all just run through the overall Group results and I think these results, as you look through them, are probably a bit better than consensus pretty much all the way through. Revenue was down 4%, of course that's a slight acceleration of the trends from Q4 but very much expected because of the £100 million shift we mentioned in the contract between Q4 and Q1. EBITDA up 6% and that's really driven by the strong performance in Global Services, we saw a good increase in EBITDA. Excluding Global Services the reported numbers are flat but underlying when you take off all the sort of one-off items and things like that it's about a 2% rise roughly excluding GS number and that's very much in line with the sort of trends from last year. Earnings per share up 16%, that's again an underlying number.

Reported is up 32% and probably a number that is the one that's the biggest variant from what you might have had, free cashflow at £415 million, that's up over half a billion year on year and an even bigger change if you look a couple years' back in terms of the Q1 cashflow number. Tony will talk through some of the reasons for that but of course a lot of it is an acceleration of money from later on in the year but it does represent a good number and very much underpins, as all 1these numbers do, our full year expectations. As a result, net debt down by 1.6 billion to now less than 9 billion.

Now just turning to individual lines of business results. First of all I just want to apologise for the number of small changes we've made regarding intra-company trading. None of them affect the Group numbers but they do affect individual numbers and the reason we're doing this, is that they are better for business, they make things simpler because they reduce eliminations, but I appreciate it does require some fiddling around with your model. Apologies for that but we've given you now the numbers for the rest of the year for the comparators to make it easier. I think these numbers show what we said. The revenue declines; we've shown adjusted revenue which is basically adjusting for changes I've talked about.

The very strong EBITDA performance in Global Services. Retail down 2% but, as I'll point out later that's actually due to the VAT, the one-off item we had last year that we did mention this time last year, we drew your attention to and it's just anniversarying that. Wholesale flat performance, Openreach up strongly. In terms of operating cashflow, by line of business, we say this all the time, it will tend to bounce around quarter by quarter, it will do that at a line of business level but I think it is well worth saying that Global Services performance obviously is a big improvement in what is traditionally a weak quarter but we'll talk about some of the reasons for that.

So now turning to Global Services. Revenue is down 3%, there's very little FX effect this year but the main reason for the revenue decline is declining in calls and lines, particularly some of the pricing things and just the broader economic conditions. No big surprise I think with these numbers. Net operating costs are down 7% and that means that EBITDA has more than doubled. It is a strong cash performance as I mentioned earlier, and we had almost about £200 million as a real acceleration of a major contract receipt so it's accelerated from being spread throughout this year and that accounts for a chunk of the cash out performance, but doesn't distract from the fact ofa strong overall performance.

The order intake was 1.6 billion. That's a couple of hundred million higher than this time last year and it brings the rolling twelve months up to 6.8 billion. Some notable contracts: the re-signing extension of our deal with Unilever. Unilever were one of our first really core, multi-national customers and it's nice to see that they've come back and extended their deal for a significant number of years. Also on Nationwide, they've been growing as a big finance customer and we signed other major contracts with them. I think you particularly see some of sector specialisation in Global Services coming through, I mentioned Unilever earlier and that now means with customers we have, Nestle, we have P&G, we have Unilever, we have Mars all within that sector and it shows some real sectorial strength.

On the subject of sectors, I think one or two of you might ask about the UK public sector. Apparently it's been the topic of conversation elsewhere. The public sector accounts for, approaching, not quite 10% of Group revenue. We have seen some stopping of small projects but frankly that's been pretty immaterial. The Government, however, are absolutely looking at the contracts, looking to see how they can save money and that's with all customers who are looking to save money and improve services. We're going to try and help them do that and we will actively engage the Government in doing that, and that represents a challenge on one side, because there will be some challenges, but there is also opportunities, but we're going to assist the Government in helping them and I repeat the comment we made on the front page of our press release, 'we are reconfirming our estimates for the year, they are underpinned by our numbers and we think we can manage and help the Government in a way that is acceptable for us.'

Now moving over to Retail. The revenue excluding the prior year one-off benefit (the 38 million I referred to) down 5%. Consumer down 6%, business down 4%. That's an improvement in the business trends from where we were seeing before, particularly I think growing ICT, but the SME sector was very weak last year so we would be expecting to see an improvement in trend. Net operating costs down 8%; now that's the sixth year; and a lot of you always ask the question about how long can you keep on reducing your costs? Well we're in year six now for Retail of significant cost reductions. That means if you exclude the one-off benefit and bear in mind that one-off benefit meant last year, Retail's profits were up around mid 20%, I think it was 28%,that actually the underlying EBITDA performance was up 7%.

We do think in Q2 that will be a lower position because we will put a lot of investment in marketing and subscriber acquisition. That's absolutely in line with what we said we'd do in Q4 and I think this is just a general point about a number of the things we talk about, they will be, there's nothing we're going to say today that is not absolutely in line with what we said in Q4. This is very much the execution of the plan we put forward. ARPU, I'm pleased continues to rise in Retail and a lot of that is because of the increase in Broadband. A 40% share of Broadband net adds and that's the sixth quarter we've run it, 40% or better, so a good performance. We added almost a hundred thousand new customers. It's probably worth saying that we actually, across BT network as whole, added two hundred and forty thousand customers onto our Broadband network which is, I think about ten times Cable and Wireless Worldwide (CWW) did completely, so it does show that customers, when they've got a choice are absolutely choosing the BT Network, whether it's with BT Retail or any of BT Retail's competitors, they are voting with their feet.

We also announced, to be broadcast from 1st August, our Sky Sport Offer for £6.99 per month you can get Sky Sports One and we'll obviously talk about that in future quarters after it's launched and how we're doing with it. The initial customer response, I think they recognise that they've now got some choice which they've been lacking in that sector.

Over to Wholesale. Wholesale's adjusted revenue, down 6%. Now transit and MTRs account for most of that, down 2% excluding that. Net operating costs are down 8%, of course that's also affected by the transit in a positive way but that means overall, EBITDA is flat, a sort of stable performance we talked about for the Wholesale business and that's a big change from a couple of years ago. It's worth saying Wholesale did some big contract wins, over £1 billion in the quarter of contract wins including taking over the Orange Broadband infrastructure in the UK and that's very much what we said we would do. We are passionate about Wholesale and really believe it's important, we believe we can make money from it and actually also helps the competitiveness and the dynamism in the UK market, which we are also comfortable with because we are comfortable with competition.

Now turning to Openreach. Openreach revenue down 4%. There were some one-off things this time last year and again I think we highlighted them this time last year. If you adjust for that, basically it's about flat. Net operating costs, an improvement down 8%, *e* excluding the effects of internal changes as all the way through we're trying to just give you the sort of underlying position and operating cashflow pretty flat. Probably the big news with Openreach really is the progress on Fibre. Now Tony will talk a bit more about the cost but they're very much running in line with the numbers we gave you. We have now passed over 1.5million households in July and to give you an idea of the scale, we are now averaging passing a hundred thousand premises per week and that makes it one of the fastest fibre roll outs anywhere in the world.

This also of course, probably the largest one that does not have Central Government funding, so we're pleased with the progress. Of course there is a time delay between rolling them out and then making it available for service, but the infrastructure is there and we're enabling the exchanges at a fast pace, so that's catching up.

Now turning to our favourite subject, pensions. What we try to do every quarter is give you an update on where we are on the various valuations. On the Trustees Funding Valuation, which is of course the one used for the £9 billion as at December 2008 calculation; that's improved to £6.6 billion, the Trustee's sort of latest estimate. So that's a big improvement and that's not a surprise of course because assets have gone up very considerably. The median estimate if you recall represents: if you took the expected returns from the various classes of assets and implied them rather than the Trustees very conservative approach to it, it's what you got.

That was £3 billion in December 2008, now improved to £1.5 billion. IAS19 which is the accounting valuation, tends to be far more volatile, but actually in this case is flat from March – June. We have seen a reduction in the discount rate but assets have fallen back a bit. It will have recovered actually a bit since the end of June because of course the market has. Discussions with the Pensions Regulator are ongoing, very much as we said in Q4, this is going to be a long process, nothing has changed there. Some of you also I suspect, were asking about the Crown guarantee. I just want to explain what's happened on the Court case for the Crown guarantee.

The Trustees wanted to just get real clarity over who and how the Crown guarantee covered, so it's something they wanted to do on behalf of their members. I think that's a very sensible thing for the Trustees to seek to do. They went to Court to just get clear legal advice on it and we'll get, in due course, just confirmation exactly from the Courts point of view, what the guarantee covers. We don't think it's necessarily a huge issue from a valuation point of view because actually the Trustees never used the assumption of the Crown guarantee in any of their work. The Crown guarantee only applies if BT becomes insolvent and the Trustees don't believe that's going to happen, and certainly we don't. So this is a sort of back-up, somewhat hypothetical things, but it's right that the Trustee is doing the right work for the members.

The other thing which some of you have picked up on is the announcement by the Pensions Secretary regarding the change in indexation, moving from RPI to CPI. We have said in our press release that they may reduce the liabilities of the pension scheme but we are reviewing that with our Trustees and our advisors and nothing really much more to say. We just wanted to highlight that it may have an impact, obviously that would be a reduction in liabilities.

Finally, just some other matters on regulation. OFCOM treatment of pensions. They announced basically, no change. That's still a sort of discussion document, but we will be making strong representations as to why that is incorrect and we will be pushing back on that. We always said it was something that was only going to mean some tens of millions of pounds a year.

It was not the biggest issue that we had. Things like MTRs are actually much more important but we think OFCOM have come to the wrong answer and we'll be making that very clear and looking at whatever action we need to take on that issue. But, it's tens of millions I think, not more than that.

On the pay agreement, we have agreed a three-year deal with the CWU. It's got to go to consultative ballot, we're actually in a consultative ballot as we speak but it's gone with a recommendation to accept from the CWU. It's a three-year deal, 3% per annum. We think that's a fair results, on one hand it gives our people certainty in this uncertain time that they know what they can look forward to in terms of increases. It can be managed within the guidance that we set out to you and it also gives us certainty in our planning Overall I think it's a fair result and it's important that in the changes that BT have to make, that our people and the company overall can get on and address these.

So overall, I'm sorry to be marginally boring on this. We started the year; it's been an acceptable start. There's nothing we said to you that we were going to do that we're not doing now, we're going on the right track. But of course this is only the first quarter, there is of course more to do and that's a good thing, there is more we are going to do. With that I'll pass you to Tony.

TC

Thanks Ian and good morning everybody. I will now run through the results for Q1. Before I do that I want to draw your attention to a few points. From this quarter, as previously indicated, EBITDA is reported post-leavers as we consider leaver costs part of our ongoing cost base. For 2009/10 line of business comparative results have also been restated for customer account moves from BT Retail to BT Wholesale. This Group of service provider customers have a better bit and will be better served from within BT Wholesale. This reduces Retail revenue by £42 million in the quarter and increases Wholesale by £35 million, with the balance in other. The move was effective from 1st April and has not impact on Group results. We've also further simplified the Group's internal trading model.

This reduces Wholesale and Openreach internal revenue c£62 million each quarter with the corresponding reduction in inter-company eliminations. There is no impact from these changes on total Group revenue. Due to its volatile nature we've include the net pension interest expense in specific items, rather than adjusting our earnings for this item as we've done in the past. Consequently you'll see specific items increased by £20 million per quarter to reflect this. Further details on these changes are shown in the press release and we've provided you with a revised consensus this morning to help you understand the impact.

In terms of the key financials, both reported and underlying revenue for the quarter were down 4% at £5 billion as foreign exchange movements have no significant impact on the Group's revenue in the quarter. The underlying revenue decline of 4% compares with a 2% decline in Q4 and a 5% decline in Q3 last year. The main contributors to this are the continued decline in calls and lines in both BT Retail and Global Services and the impact of the Mobile Termination Rate reductions. The impact of this is felt across the Group, primarily in BT Wholesale and accounts for 1% of the year on year decline. As I mentioned in our Q4 results announcement, we anticipated that Q1 would show a slightly higher rate of decline before improving again in the second half of this year.

This reflects the fact that in Q4 last year we recognised some £100 million of revenue due to the early delivery of a contract milestone. In addition we don't expect to see the benefit of our investments flowing through until later this year. Adjusted EBITDA, that is before the specific items and, remember we are now talking post-leavers increased by 6% over last year. The growth reflects the ongoing focus on our cross-transformation programme across the Group. We indicated at Q4 that we expected to deliver at £900 million of cost savings in the full year, and in Q1 we've achieved £291 million.

Global Services performance improved from £62 million last year to £130 million this year. The Q1 performance is flattered somewhat by a number of non-recurring items and on a more like for like basis, the GS performance was around £120 million. Excluding Global Services, EBITDA post-leavers for the rest of the Group was flat, however after adjusting for FX, the one-off benefit in BT Retail last year that Ian referred to, the increase in the pension service charge that we indicated in Q4 and a one-off charge in respect of the back dated element of the proposed pay settlement, EBITDA post-leavers would be 5% higher year on year.

I know many of you still think about our numbers on a pre-leavers basis so this would equate to an underlying growth of 2% which is broadly in line with last year. Q1 has seen a solid start to the year but it won't be until Q2 that we see the full impact of the cost of our investments come through. We therefore expect to see a lower year on year growth in Q2 before strengthening again in the second half of the year.

Moving on to free cash flow. There was an inflow of £415 million in the quarter, £537 million better than last year. Let me draw-out some key movements. Cash outflow from Capex in the quarter was £610 million and we fully expect this to increase in subsequent quarters to meet our previous outlook of £2.6 billion for the full year. The increase will reflect the phasing of our key programme, such as fibre roll out. Working capital and Other is £9 million outflow in the quarter, £647 million better than the prior year. This is predominantly driven by the early receipt on the major contract in Global Services of c. £200 million. As I mentioned last year we're focused on reducing some of the volatility previously seen in our quarterly cash flows. The Q1 results reflect some progress towards this but the quarterly cash flows will still have some variability in them, reflecting the nature of our business.

The one-off contract receipt I just mentioned has helped off-set the fact that in Q1 last year we received a one-off tax refund of £210 million. In the current year our cash tax payments will be minimal in the first half of the year, with the full amount being paid during Q3 and Q4. Free cash outflow in Global Services in the quarter is £38 million, a significant improvement against a year ago, driven in part by the early receipt on a major contract but it also reflects improved profit and contract related cash flows. Net debt of £8.9 billion shows a £1.6 billion improvement compared to last year.

In terms of costs, total Opex reductions of £291 million in the quarter are equivalent to a 7% reduction and in line with the reductions made last year. We have made solid progress towards delivering £900 million in the full year. I would like to reiterate this is not about finding opportunities; rather it's about our capability to implement them. Let me turn to fibre. The roll out of fibre continues to run to plan, which as Ian said, 1.5 million premises passed earlier this month and we're now passing an average 100 thousand premises per week. Given the progress we've made it's worth reiterating some key points on the cost base. We passed 1.5million premises with Fibre to the Cabinet. This gives us a clear understanding of the underlying cost base and the current unit costs are in line with our expectations.

On our current plan, Fibre to the Cabinet represents broadly 75% of our total fibre rollout profile and the unit cost information we're seeing, to reiterate, is in line with our plan. Very much based on the assumptions inherent in those plans as well. On Fibre to the Premises, we're in a trial phase, but some elements of the Fibre to the Premises spend are based on common activities with those undertaken in Fibre to the Cabinet roll out, e.g. capital equipment in the exchanges, some elements of blowing fibre and base planning. As we have previously said, like for like comparisons are difficult to make but our own analysis indicates that our unit costs are broadly in line with those seen by other European operators. So to reiterate, we remain confident that our roll out plans can be accommodated within our outlook of £2.6 billion of capital expenditure over the next three years.

In terms of the outlook, at this early stage in the year we've made no changes to our outlook. We have a solid quarter one result underpinning what we said at our year end results presentation on 13th May. I now hand over for questions.

Question & Answer Session

Damien Maltarp
Credit Suisse

Just a couple of questions. Can you be a bit more specific perhaps about the discussions you're having with the Government and how any changes that do happen, how that would perhaps play out. Would you be willing to accept a price cut today in return for maybe a longer contract, for example? Secondly, on the subject on net neutrality, Ofcom's position appears to be that there is an argument that content providers should bear some of the cost of the network. Do you think there is model whereby you could charge the likes of BBC, or Google, for using the network? Thanks.

IL

I'll say a few words about Government and then pass to Jeff and then I'll talk about net neutrality. On the Government, look, as we say, we are trying to, customers do come to us and say look how can we make things better. We'll come up with suggestions to them as to how we can reduce costs for them as a whole and we understand the challenges that the UK economy has and we'll certainly be trying to assist in that. We think there's a number of ways, as we do for Local Authorities, we take over services and can provide better services at lower cost, so we'll be helping them. As you would expect, probably best that I don't share with you exactly the nature of our discussions. I know Damien, you'll keep it to yourself but there are other people on the call that might not. But maybe Jeff, do you want to provide…

JK

I would say the nature of some of our larger contracts, all you have to do is go back into some of our earlier releases. We've benefitted from extensions in those contracts to date so I'm pleased to say that those are usually driven off delivering value and driving positive quality and results and value for money. So I feel pretty good about our position with major contracts. Obviously the Government's going to look through some major programmes, reviews to evaluate value for money there, but at this point we're very early in the discussions with the Government so it would be premature to give you anything other than that.

IL

I reiterate what I said before about, we've seen a million small contracts, a million here and a million there that have been stopped but we really haven't seen a material effect as we stand to date. So maybe we're in a different position from other people. On net neutrality. Look, on net neutrality our position on net neutrality is we think if you have a really competitive market as you do in the UK and I think Ofcom share a lot of that view, that net neutrality becomes generally less an issue because ISPs cannot impose themselves on customers because the customers have a choice, they go elsewhere. Now that's a different question from the one you're asking about – is there some services that may be, that get charged more for?

I think not, I'll just say if, for instance, somebody wants a guaranteed quality of service, like for instance our Vision service, effectively there's a cost for that Vision service because it guarantees really good quality, of their HD or standard definition service rather than the vagaries of what can happen throughout the global internet, so that's something we've worked with providers to see whether they wanted to provide a premium product, and that's not unusual for providers. But I think in the UK, unlike some other countries, , probably the whole net neutrality issue is not as significant.

Paul Howard
JP Morgan Cazenove

Just one follow-up on that Government question. Has anything changed in your expectations in the quarter or following the Budget or following the meetings with the UK Cabinet Minister? Secondly just on pensions, you obviously highlight that CPI, a move to CPI may reduce the liability. I guess we can all use the sensitivities that quantify that, but can you try and talk us through the process. What has to happen for CPI to be used in the measurement of your liabilities and how could that process develop, how quickly could we get through that process?

IL

Right, on the Government thing, I think the answer is nothing has really changed from our expectations. We thought this was going to be, I don't think it's any secret over the last six months, that Government of whatever shade came in would have, would need to be looking at all of this and it's interesting, and I would reflect on the fact that we've actually had a number of re-signs over the last few months in areas such as DWP, NHS, so I think the Government is looking very carefully at these contracts and re-signing with us. I said at Q4 when asked this very question, I said there will be challenges and there will be opportunities, nothing in that has changed. I know, perhaps, there were other people who said there wouldn't be, but we've been absolutely clear about this for months and months and months and nothing has changed.

There will be challenges, there will be opportunities. We have a business that is widely diversified, we think there's things we can do to help the Government save money and we're absolutely presenting that to them. Many customers have these challenges, I guess they just tend to be a less up…you know the nature of them tend to be less public because they're not Government so nothing much has changed.

On the pension CPI, I think the answer Paul is, we're discussing this with the lawyers just now, with the Trustee, to understand the nature of it. We want to highlight, we think it could have an effect. I don't particularly want to say anything more at this stage. We'll update the market when we have a completely fully understood position or at least, close to a fully understood position. But I think, as we said, we indicated that it may have an effect on it and that's what the initial work with the lawyers has indicated that there's that possibility. Nothing more I want to add at the moment but we will at some point in the future, I think, give you an update on it.

Paul Howard **Will it change your discussions with the Pensions Regulator, does that sort of get put on hold until you get some clarity on CPI?**

IL I think you'll have to ask the Regulator that question. Bear in mind, though, the Regulator's valuation is done as at December 2008, that's their initial position. Now I would imagine a Regulator would probably have to look at what happened with asset movements and experience etc, since then but the Regulator is based on December 2008, you'll have to ask them as to whether things that happened post-December 2008 have an impact. As I said they're still doing their work and we're still in discussions with them so it's too early to say what the starting point is never mind what necessarily the finishing point would be.

Robert Grindle
Deutsche Bank **Sorry, it's on the Government again. Is there a timeline on the discussions which are taking place, is there a formal process, when can we expect this all to bed down? You've kindly highlighted how much it is as a percentage of Group revenues, around 10%. Is there an inkling as to how big a percentage of profits it is. Thanks very much.**

IL With some of our experience of Government contracts, less than that. But no, there's not much of an inkling as to how much it is of profits. Obviously the vast majority of Government work, not all of it, but the vast majority sits in Global Services rather than Retail so that should give you some indication of some of these things. Jeff, anything you want to say on timeline?

JK Well we had our first formal session with the Government yesterday. I'd say there is a sense of urgency to move through it because there is a desire for in-year savings, but no specific timeline was discussed in that session other than us putting our ideas on the table, some of which are, they're all opportunities for the Government to save money. Actually some of them are opportunities for BT and what we can do to help them save money.

Lawrence Sugarman
ING **A couple of questions on BT Retail. Firstly, you made some comment about how customers are responding to the greater choice now that you have Sky Sports available.**

Can you be a little bit more specific about the early customer response in that area? Secondly, with respect to the legacy business in Retail, there seems to be some slight acceleration of decline and I'm aware that call volume in Q4 was helped a little bit by the weather but could you perhaps comment a little bit more on that.

IL

I'll ask Gavin to comment. Just to be clear, I know Gavin will say the same thing, it really is very early days with Sky, but there seems to be a good reaction. This is not a three week thing, it's not a three month thing, it's very much more a three year thing plus. We're going to be in this market place for some time, we're not going to be like Setanta, we've got the resources, we're devoting the resources to it, so this is a very long-term thing from our point of view. So we liked the initial customer reaction, again, we made that very clear when we did the Sky announcement, this is going to be a long-term thing because this is about building a customer base over a long period and being a credible player in TV. There's a lot of things we're doing in TV and so this is, you don't change the marketplace in a couple of weeks so, no, nothing else to add to that, but Gavin do you want to add to that and maybe talk about what's happening on the traditional business as it were.

GP

...Ian's comments on Sky Sports, we're in this for the long-run and we'll judge it over the long-run, but we'll give you more detail as the business develops. In terms of what's happening on calls and lines, just one point to bear in mind, the £38 million, that is a one-off, turns up in the Calls and Lines numbers so that will slightly skew the trend on a like-for-like basis. In terms of what the physicals are looking like around line losses and active customers, there isn't any fundamental difference quarter on quarter versus quarter four so we haven't seen it particularly worsen, but we haven't seen any signs of improvement yet, so it's, the main activity that we've got to address now begins to kick-in from this quarter and beyond. So we're looking to see that trend improve.

Simon Weeden
Citigroup

I wondered if I could just ask on the detail of the Trustee valuation that you give us which you've updated to March. When they provide that to you do they make an adjustment to the discount rate to align it with the current market conditions or is it principally an adjustment based on the assets and any ...

IL

The answer to that question is, yes they do.

Simon Weeden

Second one then is, the pace of fibre roll out, given its reaching higher and higher levels. Is there a prospective chance that you might be able to beat the four million target for the end of this year and could you in the answer also touch on whether you're doing the 25% fibre to the

home as you're going along at the moment or whether or not in fact it's mostly fibre to the kerb so far?

IL — Well it's mostly, I'll pass over to Steve if he hasn't left the room screaming at that suggestion, that he should be going faster. Mostly it is, we've done a couple of areas with fibre to the premise, we want to test that, make sure that's embedded, and when we start moving with fibre to a premise it will represent a decent proportion of the overall build but just at this moment, no I don't think we're going for a higher number than the four million at this point. What we have shown is we really can industrialise this process and of course, actually we'll look to build on that level. Steve, anything you want to add to that?

SR — Just to be clear, to hit the four million number by the end of the year it will require us to do a further ramp up in terms of numbers of homes passed. We're confident that we can do that and all our plans are in place and I would appreciate it if nobody else could suggest to Ian that we should be going for a higher number. Four million is quite high enough for us at the moment but it is going very well. In terms of the proportion of FTTP, as Ian says we've got a place in Milton Keynes, Bradwell Abbey, and Highams Park in North London where we're actually out doing decent numbers in terms of piloting fibre to the premise.

We've got a couple of more pilots just about to start where we're using a mixed economy because our plan is that in each exchange area we will deploy a mixture of fibre to the premise and fibre to the cabinet, there won't just be a vanilla solution and that stage of pilots is really critical for us. It means we've got to share some of the technology and we want to make sure that we get that absolutely right before we press the button to industrialise our fibre to the premise roll out, which we expect to really kick in early in the next financial year where we'll see really significant levels of fibre to the premise, but it's all contingent on us making sure that we can hit the right cost points and hit the right quality in terms of the customer experience. Right now we're focusing in terms of volume on fibre to the cab.

IL — Thanks then, but I will invite you to the next budget discussion I have with Steve because given your targeting intentions, appreciated.

Simon Weeden — Happy to come along and help.

Nick Lyall
UBS — **Could I ask you a couple of questions also on fibre. The comments, I think on slide eighteen, you mention that fibre to the home is still at trial stage, but it was in line, the unit cost was in line with other European operators and so far I think they'd suggested that fibre to the home unit costs were significantly higher than fibre to the cabinet. Is that at odds**

with your previous comments from Steve in May where you talked about unit costs being almost the same for fibre to the home versus fibre to the cabinet?

The second one is just a follow-up to Simon's question. Could you give us a few stats on subs take-up so far of the total fibre roll out and any ARPU thoughts you might have.

IL

Alright, I'll pass to Tony about some of the cost things, but just for the avoidance of doubt. What we said is fibre to the home will cost more than fibre to the cabinet, but when you looked at European comparators, particularly at fibre to the premise, actually when you looked on a like for like basis for instance, not having things like connection fees in one capital number but in a revenue number for someone else, it looked very much in line. Actually when you look at some people, like Portugal Telecom, actually our costs are a bit higher. Now, some topography reasons for that but we're looking to try and understand how we can take the cost down. The point we're making on fibre to home, it's early days as opposed to fibre to the cabinet where we absolutely know what we're doing so far. We continue to look at opportunities to reduce the overall cost.

I think what we said in the past about fibre to the home is the whole life costs were broadly similar but the capital costs obviously are much higher on fibre to the home than they would be. In terms of stats so far, no, we will give you some more, but what we're seeing is, because of course there's a lag between us actually selling the product from passing the home, as we ramp-up on the passing of homes then more and more exchanges are available to sell and so we're seeing a big increase week by week by week. You're seeing over the course of a month a sort of doubling, trebling of sales in terms of the weekly run rate so it's very early days yet but we're pleased with customer reaction. It's a bit like the other stuff we said, too early to call it, but pleased with the reaction and customers really like the fact that for twenty pounds they can get fibre, so it makes it an easy decision and half the price of course of some of the competitor products, so we think it's, but it's very early days in everything and these are long-term investments, short-term reaction ok though.

Andrew Lee
Goldman Sachs

A question on Retail first and then maybe, sorry to bang on, but a question on the Government spending cuts second. On Retail, your share of broadband net adds looks very resilient this quarter given the increased marketing spend we've seen from Virgin Media, raising it by 30% year on year, and Sky's explicit targeting of your customer base. I wondered if you've seen competition intensifying into Q2 and whether you think that may press your share into the next quarter. Secondly, just on this austerity impact again, I wonder if you could give us a bit more colour on your relative comfort, namely explicitly versus the severe impact that Cable & Wireless Worldwide, which as a similar

business, is expecting. Is there something different about your exposure or your business that we might be missing or is the difference simply you were perhaps more cautious in expectations when setting your guidance. Thank you.

IL I think we were cautious, I think we expected challenges, in fact, we said we expected challenges, so maybe that's more incorporated within our overall business plan. It is early in any process but as we've said it's 10% of our revenue and we did expect some effect of it. I don't want to say I know all the answers just now, it's just nothing is different from when we spoke four weeks ago. Maybe it is for other people, it certainly isn't for us so maybe it's just where we set it.

In terms of Retail net adds, I'll pass to Gavin just to comment, but Q1 was incredibly intensive, you're absolutely right and I think it's a good number. I've been saying for ever that that 40% number will bounce around, I've been saying it quarter after quarter and no doubt one quarter I'll be right. I've been amazed actually about how stable it's been but me and Gavin talk about some of the market place but certainly being a recipient of advertising, if you carry broadband ads you'll be doing quite nicely out of all the companies. I think there will be a few disappointed people about their quarterly net adds given the amount of money they've spent on advertising and the aggression of their offer. Customers, I think it's holding up very well for BT in those circumstances. Gavin, do you want to add?

GP You're right, it was a very aggressive quarter by some of our competitors, so there were some very strong offers out there. Marketing spend went up, as you say with Sky and Virgin in particular and in some cases I'm not sure it's delivered the results looking at the net adds of some of our competitors in the quarter. I think one of the reasons our model appears to be resilient is that we're using both the BT brand and the Plusnet brand to offer a choice to our customers which allows us to maintain the pricing and overall value of BT behind a complete positioning while using Plusnet to address the needs of the very price sensitive customers at the bottom end. We're finding that this is allowing us to, I think, reach more customers overall without compromising on overall price across the whole of the base.

But I don't see it letting up in quarter two. Clearly Sky have responded to our launch of Sky Sports 1&2 on Vision and absolutely swamped the market, so I think it just re-iterates the point that Ian was making earlier, which is, we're in this for the long-term and we'll continue to offer compelling offers for customers but it's going to take a long time, or we going to have to see this grow over a number of quarters, so I don't see it letting up.

IL The great news is we're creating the resources and we plan to use the resources actually to drive this over the long-term. As we said at Q4, and this is absolutely in line with Q4 comments, that we're going to spend more money in this area but because we were doing better in other areas that it wasn't an either/or in terms of you could have profits or you could have other investing, we're doing both of these things.

Steve Malcolm
Evolution Securities

I'll go for two, the first one I'm going to labour the point once again on Government but maybe ask in a slightly different way, I guess a different angle possibly. I guess where you may differ from some of your competitors is that within your Government spend there may be quite a lot, so the Government's spending money that you are losing money in providing the service for, and I'm thinking specifically on the NHS. Could you give us any sort of idea on the opportunity for you of renegotiating or restructuring contract where you're losing money which will save the Government money but will possible save you money as well in the mid-term.

Secondly, just coming back to the Broadband market, take all those points but the other interesting feature is that the overall rate of growth in the market has kind of accelerated again which seems a bit odd, it did in the first quarter, the first calendar. I think net adds year on year were up 18% for the market, in this quarter they were up 40% off quite a low base. Have you got any thoughts as to why that's happening, is it just the extra spend, is it possibly a bit of disappointment with mobile Broadband and experience. Is it things like iplayer, why do you think the overall market seems to kind of accelerated in growth again.

IL

I think the sheer weight of advertising spend is having an impact and there's some really aggressive…, it's not just the spend but also the offers. Plusnet is now running at £6.50 a month for…that's a great price and it makes it incredibly affordable for people. The thing about our industry speeds are going up and prices are going down which is not a bad combination for attracting customers. Otherwise, some of it's a bit of a puzzle but a lot of it has got to do with the fact that customers see Broadband as central to their lives, in the way that I think you wouldn't have anticipated a few years ago. There's more and more applications, whether it's Facebook, whether it's telephone calling, whatever, more and more ecommerce.

Twice as many companies, for instance, are on-line selling their products in the UK, so on average in the EU, which we tend to decry the UK, but 32% of companies sell their products on-line compared with an average of 16% of the EU. We are one of the most switched on societies around. But in some ways it's a wee bit of a surprise. I think you're right the mobile Broadband is disappointing; on the other hand we did keep on saying in the first place we didn't think it was having much of a substitution effect. Whilst I know a number of you did think that Telecom Austria was obviously the model for the whole of the world, what we said roughly would happen to mobile Broadband is happening, It's additional more than substitutional, but at some point you've got to think that the Broadband market can't carry on growing. We're close to 70% of the UK having it now, but I just don't know when that will be.

In your way of asking the Government question, no I don't think that's the thing. We've already negotiated a large number of new contracts with the Government recently. We probably have less, shall we say, discretionary spend with the Government in terms of sort of add on things but, no I think it's just we planned that this would; clearly there would be some discussions. Nothing has changed in those discussions, we don't know the outcome of it, we don't know how it will turn out but the statement we made about our overall results, absolutely holds, which are the results we presented today underpin the forecast we gave.

What you get with us is that, so we know there's some challenges on some sides but you'd also see there's some upsides in terms of the quarterly results, there are some trends that are better than you would have expected, and that's the balance but nothing has changed and I guess in three or four months time when we get the next set of results we'll update you on where we are in it, but nothing has changed in our mind.

Steve Malcolm **Just very quickly follow-up on the Plusnet point that you and Gavin sort of alluded to. The previous quarters you've given us an idea of the adds that have come from Plusnet and I guess you're suggesting that those offers are having a particular attraction. Give us an idea of what proportion of the adds came from Plusnet this quarter.**

IL Well both are adding, Gavin I don't know if you want to add any more detail.

GP Don't want to go into more specifics, Steve on this, apart from saying both brands are growing and there's very little cannibalisation from BT into Plusnet, they largely address different customer segments, so they're not cannibalising each other and the overall BT customer base across both brands is growing very tidily, so I think it's working to strategy.

Maurice Patrick
Barclays Capital **A quick question on Global Services. At the fourth quarter you talked about the eventual return to growth following the cost-cutting and restructuring. Looking at the trends in the quarter, I know Q1 is seasonally weak and quite volatile for the order book but it did improve for the first time in some quarters. Also the ICT Managed Services revenues also seem to be improving for the first time in some quarters. Is it too early to see a sustained reversal of these trends and also on the weaker Broadband and lines in Global Services, is most of this discretionary as opposed to long-term contracts, thanks.**

IL So what's the second bit about Broadband?

Maurice Patrick **So the weaker revenue trends in Broadband and lines in Global Services, to that extent that's discretionary and not a longer-term contract?**

IL The trends in Global Services are pretty much what we expected from when we talked about eight or nine weeks ago, so no, we're not suddenly saying this is a big difference from what we had expected. There is an improvement, we are on contract numbers but still, as we say many times, still more to do. But big customers are both renewing contracts and also big new customers and that's encouraging. As we said last year, the problems in Global Services did have an impact and I think now we're coming back but it's going to take time to grow these things but it's in line with what we thought would happen.

In terms of lines, yes we did highlight that lines were the problem. Partially it's because of the way you move into managed network services, you do have this natural drift away from some of the traditional products. That happens but also I think we've got to do bit better in that area, and I don't know Jeff, if you want to add anything to that?

JK What I'd say, almost every quarter since I've been here we've talked about our traditional business, calls and lines. There's been improvement I think in our existing contracts if you looked at our pipeline results, we're up quarter from a year ago and selling to our existing customers, which there's positive signs there. But I do think we can do better in our traditional products business, specifically in the UK we're focused on that and there's always room for improvement in services, whether it's quality customers or our traditional business and I think that's one area where we could actually do a little better, that's what we're focused on.

Jerry Dellis
Jeffries **Just a quick question on Retail revenues. Calling and line revenues seem to be trending a little bit worse even if we adjust for the 38 million one-off in the prior Q1. Given that, in this quarter in particular, we had a couple of price increases in the year on year comps how do you sort of think about that and in particular how do you think about sort of retail revenue trends through the rest of the year. My second question if I may, just regarding the deal that you did with Orange to migrate their Broadband infrastructure across to Wholesale. What's the sort of timing on actually doing that, are we going to start seeing a bit more evidence of that in the second quarter for example, thank you.**

IL I'll ask Sally to comment about the whole timing around the Orange contract without obviously giving away commercial secrets for Orange. But retail revenue trends, hopefully you see what we try and do now is we very much highlight where there's a positive sort of one-off item, and we said at Q4 last year that, at the turn of the year we saw the effects of some weather on our numbers, a positive effect with all the snow etc, and that's absolutely what we saw. Gavin, do you want to comment in more detail.

GP There's nothing fundamentally changed. In terms of the other aspects of what contribute to the numbers. The phasing of pricing changes in the base and in the quarter will have a little bit of an effect. With a view to the rest of the quarter which I think was the other part of the question, the rest of the year which is the other part of the question. Our intent is to slow that decline over the next couple of years. We're investing a lot in reducing the customer decline and doing more to sell, cross-sell products to our customer base and hopefully begin to see that top line beginning to slow.

IL I think you can, just to add to Gavin's comment, I think we said, as people went to fully unbundled local loop, more and more of them were selling lines and we expected, people who already had the Broadband and already had the calls with a supplier, the sale of the line often, I thought it was an easier sale and we expected to move lines and we're still seeing that migration. No question about it and we will have less customers but we will sell them more and that's the trend that we're seeing and that's the trend we probably expect to see but we will be fighting very hard for every customer and with some very, very good offers and some great new services. Sally, do you want to say just where we are with Orange, going forward.

SD We signed the contract in April this year, it is an eighteen month migration period and we have already transferred people from Orange to us and we have already taken over responsibility for the provision of service there. The full migration really will start to occur over the next twelve months and it's in that sort of period that we'd expect to see the impact.

Guy Peddy
MaCquarie **A quick question please. Firstly on the potential move on your pensions from RPI to CPI, would that also lead to a reduction in the returns you assume if you change your inflation assumption? Secondly, on the TV proposition, we've seen very strong HD growth in the first half of this year and clearly that's not a product that you can actually offer currently so how are you going to position yourself to make sure you don't become perceived as like the lower quality, lower priced TV provider. On that issue would your current TV pricing actually be better suited, better focused on your Plusnet customers rather than your BT Broadband customers?**

IL I'll ask Gavin to talk about HD, in fact Gavin do you want to talk about the HD first of all and then I'll talk about the pensions.

GP You're right, HD isn't part of our proposition at the moment on a linear basis but we do have an extensive HD on-demand catalogue which we're building all the time, including both TV series and most importantly, movies. We have over a hundred hours of HD on the box today and this will grow as we go across the next couple of quarters. Looking into next year, very much part of the canvas proposition in terms of what we do over DTT and over our own network as well, so we're multi-tasking, we will be offering HD linear services, going forward. So it's very much part of our intention to make this the best overall experience in terms of linear and non-linear content providing linear and interactive services for our customers. So it is part of our roadmap and you'll see it come to market next Summer.

In terms of whether we offer TV across Plusnet that's something we will undoubtedly look at because Plusnet customers want TV services as well and it'll be something we get to in the next year.

IL On the returns, the returns actually don't vary because the Government has suggested using CPI as a way of inflating pensions. That actually doesn't change the nominal returns, so no, the answer is you won't adjust the returns because you're inflating the level on pensions more because the returns are what the returns will be. So no, the two things sort of aren't connected in that sense. You look at the real returns, you look at the nominal returns and they will, they're not changed in the market place because of that item, so no.

Andrew Beale
Arete **I was just wondering if you could be a little bit more specific on individual unit Capex per home passed and per connection to fibre to the cab now that you've got 1.5 million homes in the experience and perhaps talk a little bit about how you might reduce cost with industrialisation and perhaps for self-install for the connection. Also, just wondering if you could share any thoughts on where fibre to the premises makes economic sense, is it just overheads, new build or other particular scenarios with regional JV's or anything else that are looking interesting.**

IL Sorry, you weren't very distinct on the call. I think what you're saying is can we give you any breakdown of the fibre to the cabinet cost and then, was that right, and what was the other question?

Andrew Beale **Yes, unit fibre to the cabinet cost per home passed and per connection. The benefits of industrialisation and self-install and any thoughts on where fibre to the home makes economic sense, is it just overheads, new build or other opportunities?**

IL Well fibre to the premises, I'm going to ask Steve to say where fibre to the premises as opposed to fibre to the cabinet might make sense, but largely we look at the whole life cost and certainly in things like multi-dwelling units it does make sense and certain types of things where actually we serve from the cabinet, from the exchange anyway directly, it makes sense. But I'll ask Steve to, any particular guidance on that?

SR In terms of where fibre to the prem makes sense, first of all any sort of significant new site development it absolutely makes sense. A key enabler is making sure we've got a good Voice product to offer in those circumstances as well and we're well on the way to developing that. So new premise is definitely a key area, it's an easy decision. In terms of the sorts of infrastructure, about 60% of the UK is served by overhead and it certainly can make sense there and we will be doing that. We've developed the technology to blow fibre overhead, we're comfortable that we will be in a position to do that and we're also piloting our underground infrastructure. The issue with our duct infrastructure of course is that it's been there for a long time and part of the learning process for us is going to be to make sure that the condition of the infrastructure makes economic sense in terms of blockages.

All three of those look good for us just now, the mix really depends on the specific circumstances and the geography. I think you were also asking about the sort of steps that we're making to industrialise. Typically what we're doing. As we're learning through the fibre to the cab roll out, the number of individual steps that we take is coming down as we understand the process better, the number of visits to each site is coming down as you understand the process better. The way that we're working, with for instance the power companies, is changing quite significantly so that the people who are doing our civil contracting are starting to work much more closely with the power companies, so really it's all the obvious things that you would expect as we're learning them through the process, levels of automation, all the normal stuff around industrialisation is kicking-in and helping to support the unit costs that we were expecting.

Andrew Beale **Sorry, just on the unit costs, can I ask specifically what they are at the moment.**

IL No, no, well you can ask but I think we're not giving any more detail, apart from anything else these things will absolutely change over time and the more you do the cheaper they get. We've got one of the fastest programmes already, certainly in fibre to the cab which means that we do have a level of industrialisation that really helps us. Tony, anything else you want to add on the cost and what we're experiencing.

TC I think, just the one thing to add is that as you roll out to a different profile of exchanges, based on the current unit cost, you'd actually expect the cost to actually increase. What you're then finding is the industrialisation process brings back that unit cost down to broadly in line with where we are now. I think you need to understand the two elements of those dynamics.

IL And of course, the fixed costs on things like systems, is a fixed cost by nature and so that itself, the more customers you spread it over has another impact on the overall average cost, but we'll give you more over time but I think what we'll say to you is, look at our Capex this quarter. Whilst we will spend more over the full year, we said it would be around the 2.6 billion that we intended to.

Ottavio
Societie Generale **A couple of questions. The first one, I would like to go back to Global Services. I appreciate that you cannot comment on ongoing negotiations, but is it possible to shed some colour on the duration and nature of current contract with the UK Government. You gave the sort of average to full contract for Global services last quarter, do you have the same duration, like 46% of contracts with the UK Government have an average length of more than five years. The second one on Global Services, could you shed some colour on which are the departments that you export the most in terms of this year revenues. The second one is on option, the UK Government has now paved the way for an option of 2.6MHz spectrum. Could you shed some colour if you will bid for it and how this would impact your fibre all round, for less expensive in populated area?**

IL We'll look at the auction. I think our enthusiasm for becoming a mobile network operator is, I think has certainly in the past been limited. We'll look at, if there's some amazing opportunity then of course we'd look at it but until we look at it really we don't know, but I wouldn't get overly excited about it from our point of view. I think what's important is to make sure, with the whole option structure that there's wholesaling obligations that go with it because you want to make sure you have an open market. I think Wimax doesn't look like such an exciting opportunity as it did two or three years ago before the mobile operators banded together to stop that happening in the UK, by sort of appealing the process to the point where, as a technology probably it passed it's time. So that's the comment about the spectrum.

On duration, we've actually done a number of contract renewals so there is duration on some of the contracts. Typically there's not that much, going beyond five years, that's the unusual overall but certainly a number of contracts have a duration beyond three, but Jeff I don't know if you want to add anything.

JK Well let's just make sure our definition of Government is correct here. So if you would include Local Authorities and Central Government, some of those contracts will go ten, fifteen years because they're more like BPO and so you're transitioning assets and things over a longer period of time. There's a percentage of our business that does have that contract link. I think when we talked to you last year we gave you an indication, it's three to five year contracts we're doing, I think the average at the time was about 4 or 4.2 years, nothing has materially changed in our business in that regard and you can take a look at the Government, it would be right in that zone, I won't give any specific details on contracts because we just don't do that.

Chris Alliott
RBS **Morning all, yes thanks for the last question. Just quickly on wholesale. On those MNS contracts of a billion, of contracts won. I wonder if you could give an indication perhaps of what percentage represents incremental revenue potential for you. Secondly, whether there's a potential EBITDA drag in the initial phase. So for example in the Orange contract with its initial sort of EBITDA drag as you implement the contract and then a pick-up after that. Thank you.**

IL You are right, a good question in terms of the fact that part of the business is a straightforward win from other providers and in fact that's been the case if you look at K-Com as well for instance. We've been winning from people like Cable & Wireless business and part of it is replacing our own business. Some of that in the short-term can have a bit of a drag, particularly during the transition phase, but Sally do you want to answer anything else.

SD I think many of our contracts actually embed some of our existing products so it's not so much that they're substitutional, it is embedding a long-term contract for some of those good products. Some of these contracts also have entirely new services and overall we've got more growth coming from those new areas and not just the defence of existing revenues. So they're positive growth stories.

Chris Elliott **So some of it is incremental?**

IL Sorry, what was that?

Chris Elliott **Some of it is incremental but you're not going to give me a proportion of the incremental revenue?**

IL No, no we're not. You can understand the sensitivity of that. As I said they allow a long-term maintenance of a large piece of business and then takes on others as well.

No further questions are submitted

IL Look, for all of you after a busy week, I hope you have a, if you're still to go on holiday, have a really good break and we look forward to speaking to you in a few months' time. Cheers.

(END OF CALL)