BT Q2 2010/11 Results Presentation

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

Title of Meeting: **BT's Results Presentation for the Second Quarter Ended 30th September 2010**

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

IL

Good morning and welcome to BT this morning. Hopefully you've had the chance to look at some of the demonstrations beforehand and if not, perhaps afterwards.

As usual, we have the Forward Looking Statements that you need to just have a quick look at. And now onto the numbers.

Q2 was another reasonable Quarter. We saw revenue decline 3%. Now if you exclude the effect of mobile termination rates and also a one off item in Wholesale, the underlying position is about 2% and that's probably reasonable guidance in that sense. So down 2%, slight improvement on the previous Quarter.

In terms of EBITDA, EBITDA up 3%; that was really accounted for by Global Services' strong increase, excluding Global Services, EBITDA was about flat and that reflects, as we'll go through, very much the expected expenditure in Retail. So there's nothing surprising; in fact these numbers are slightly better I think than you had expected and slightly better than we had expected.

In terms of Earnings Per Share, up 16%, slightly down on a headline basis, which is due to a credit for tax that happened this time last year but the underlying performance is 16%.

In terms of free cash flow, similar issue on the tax; £170m down but, if you remember, Q2 last year we had a very big tax credit, over £200m. So that's the reason for that and, for the half as a whole, we've seen the cash flow, even despite that credit, up significantly.

Net debt has fallen to £8.7bn, fallen by £1.2bn and the interim dividend up 4% from 2.3p to 2.4p. Critically we have increased our

EBITDA and cash flow outlook. I think particularly we always said cash flow was a key thing we would look at and try to aim for and we said if you recall, that we would aim for £2bn of free cash flow in 2012/13 but we've brought that forward and said we'll do it this year and do more than £2bn thereafter.

Now turning to individual Divisions. Global Services. Global Services' revenue was down 2%. That's reflecting half and half between lower volumes in our European Wholesale business and a decline in calls and lines in the UK. Now that's been going on for a very long time, it's something we would like to do better in but that's really the core cause of that decline.

Net Operating costs continue to fall, down 4% and that means we put together EBITDA up 45% and you can see the chart on the right hand side, we are continuing to see steady, ongoing improvement in EBITDA performance. We said also to expect a substantial improvement in GS's cash flow this year and absolutely we've seen that. It's been a cash outflow for the first two Quarters of about £30m but that's a big improvement year on year, albeit, remember, Q1 did benefit from a quite substantial receipt from a customer; we mentioned that in Q1.

One of the things that is interesting is the chart, on the right hand side, showing what's happened to sales order value in the Quarter. Global Services had a good Quarter for sales, £2.1bn in the Quarter – and this is the twelve months' rolling average these numbers – but £2.1bn in the Quarter, which is 50% up on the same period last year; we did £1.4bn. A range of wins, some big like DFTS but also you see some of the names up there, could add to that list of names, people like Proctor & Gamble who signed an extended and bigger contract with us and Proctor & Gamble is a big name from before. It's also interesting to note the Ministry of Defence actually in the UK and in Spain on the list. Companies also like Balfour Beatty, the Rail Network as well, so a big range of companies but particular strength in financial services, as one would expect, as a key sector for us.

An area that gets a lot of mentioning is of course the public sector. I just want to be clear about it. We have signed over the course of this calendar year contract renewals, extensions with public sector on a number of key contracts in the Health Service, in DFTS, a defence contract, DWP and together they account for over 40% of our government business. So actually, it's not just have we held on to them, we've extended these contracts. So we're actually, yes, we're giving the government savings but as with many other customers, we extend, we expand and we, therefore, hope to do pretty well ourselves. We have signed a Memorandum of Understanding with the government and they have benefitted from some savings; absolutely in line with what we had expected and six months ago we absolutely expected that whatever government came in that there would be challenges in the government sector but nothing particularly new there. And we're continuing discussions with government and in those discussions we're trying to show them new ways in which we can save them money and of course expand our business. I suspect some of our competitors might be trying to do the same but now we've signed the Memorandum, I think that's an entry ticket to those discussions but the discussions will be ongoing.

Asia Pac. If you recall, in May we said we're going to expand in the Asia Pacific region. We're going through just now a recruitment phase to increase our workforce there, key skills, but also to bring a number of our products around contact centre management for instance, unified communications, bringing them out into the Asia Pacific region. We're seeing some initially good signs; it is very early days but we've seen the pipeline for orders increase by about 50% in the last four or five months, so that's a very early step but we're trying to give you an update to the extent that we've got one.

Another thing I should mention is a project called Smart Reach, which we announced a few weeks ago. This is a consortium between BT, Arqiva and Detica and this is to provide an alternative for Meters. Smart Meters are going to be a big thing in the UK; twenty odd million households having Smart Meters, the idea is that it will substantially reduce energy consumption. This consortium with Arqiva, providing the radio capacity and BT doing a lot of the project management and installation is something that we think could be very interesting over the long term, albeit it is the long term, but I just wanted to draw your attention to it.

Now turning to Retail. Retail's revenue down 4%. I think Consumer's running pretty much as it has done and I'll go through what's happened in various areas of Consumer, but probably worth drawing your attention now and in more detail later. Business being flat, which is a big improvement and we'll talk about that.

Net Operating Costs continue down, 3%; would have been down more were it not for the planned expenditure we made, we told you it would be coming and that meant that EBITDA was down 8%. Now we are going to carry on that level of expenditure but net, net we would expect the Retail business in the second half to be better than that -8% and in fact in the Quarter itself, actually the underlying performance was about down 5%. It was a big significant one-off item that we mentioned last year.

Now turning to the different parts of Retail. First of all, Consumer. Consumer ARPU continues up; it's been going up for a very long time and I remember one of the very first questions being asked about when, five years ago, I joined Retail was *can you ever get Consumer*

ARPU up again? I think we've been doing it pretty much since then and the key reason for that is Broadband. Broadband net adds strong this Quarter, 114,000, up over 60% year on year, I think it's a very good number. 45% market share of the standard definition we use, which is of DSL and LLU; actually we've included another market stat here. We don't normally get cable's numbers before we announce but we did on this occasion. So we also tell you it represents 40% of all Broadband, whether it's cable or whether it's over DSL.

Actually, if you look at the chart on the right hand side, you can see, I think it's quite interesting, the BT Retail market share based on that wider definition, about 40% market share and I think you see in contrast how Virgin's market share has been going down as a share of the total market. So Virgin added 30,000 odd, BT Retail alone added 114,000 and of course the total BT network added over 250,000. So about seven times the amount of net adds on the BT network as the cable network.

Also, Retail have been doing a lot of upgrading and we've been upgrading our customer base. 1.6 million customers now on the up to 20MB or indeed the fibre product. That's an increase of about seven times over the course of the last year. So big, big increase and that's going to continue.

One of the other things we think why we've done pretty well in Broadband in what's a very competitive market – there's no question about it – is also WiFi. We made the decision very early on to invest in WiFi and it's become more and more important because, frankly, it's the best way to get a decent amount of bandwidth when you're out and about. We've now got over two million WiFi hotspots; the customer minutes on WiFi have more than doubled over the last year and it's running in excess of two billion minutes a year. We thought actually we probably haven't told customers enough about it; for those customers who know about it, they really like it, so what we're going to do is we're going to actually start advertising our WiFi capabilities and the BT FON network. So let me just show you this advert:

Advert Plays

And lots and lots of people are downloading the new App. That advert will run at the weekend I think, Gavin, is it? So there's still time to change it if anyone doesn't like it!!

BT Vision. We've gone through a half million BT Vision customers; added in the Quarter, twenty odd thousand and we launched Sky Sports, 50,000 customers, so about 10% of our base are now on Sky Sports after a few months. Of course – and we said this in May, said it last Quarter – this is a long term game; there's a lot more to come on BT Vision, you're going to see a lot of things such as the BBC iPlayer coming on, faster HD downloads and a whole range of new services. But rather than me talking about it, we thought we'd show you a quick video and, by the way, you can see all of it outside, so if you haven't seen it, you should really have a look at the demonstration.

Video plays

As you see, there's a lot going on with it and lot to come. We are going to be in this for the long term, make no mistake, and a critical part of it is going to be fibre and what fibre can do. BT Infinity, therefore, is very important, fibre is actually very important for us and I think some really encouraging things are happening in fibre. First of all – and we'll talk about it in the Openreach section – rollout is going at a pace. But actually, we're seeing real traction with customers and the chart on the right shows – we don't normally and I'm not going to normally show weekly numbers, but we do show the full weekly moving average of sales. In fact of net adds, you can see it absolutely ramping up quite exponentially. Last week alone we sold 4,800 Infinity orders. So that, even then, is another new number.

As we roll it out we're seeing a lot of traction; a number of the customers are new to BT, most of them are taking the higher end of the two products, that's still a great priced product. Also what we're trying to do is encourage communities to get involved and be interested in Infinity. So we've been doing Race to Infinity and if any of you are living in an area that is not yet Infinity enabled, not yet fibre enabled, go on the site, you see the site here and vote for your area because it can bring you up the list, or even if you aren't due to get it at all, you might be able to if you show enough enthusiasm. Just now, I doubt any of you live in Caxton in Cambridgeshire but in fact Caxton in Cambridgeshire, almost 40% of people have been on the site voting and it's currently in the lead and would be an area that, if it wasn't due for it, it would absolutely get it and if it is due for it, it will be moved up the stack. So still plenty of time to vote, although I know Paul Howard has got his already, so you're okay Paul, aren't you?!

Infinity is really exciting in what's going on and the rollout continues apace and I'll say more when we come to the Openreach section about it.

BT Business. The SME sector had the most difficult time over the recession, there's no question about it. We saw Consumer still having money to spend and we saw big corporates were still expanding around us but the SME were being hit by a variety of factors and we saw it in our numbers. We saw the SME business down eight to ten per cent through most of last year. We've seen a big improvement in that. You can see the chart – basically revenue was stable last year and there are a couple of reasons for that. We're seeing line losses reduced quite significantly - down by about 40%. We're also seeing the strength of some of our propositions, for instance, the One Plan Plus, which is £15 a month all you can eat calls package to wherever to international, mobiles etc, etc. But also real strength in the areas we want to expand into: in IT, Mobility and SME. This is what we said we would do and we are seeing well into double digit growth in both IT Services, I think in excess of 20% and in Mobility.

So, again a lot more that we can do in the BT Business sector but what I'm trying to do with each of these things is relate it back to what we said we were trying to do in May and the progress we're making.

Turning to Wholesale. Wholesale revenue was down 5%, however, I mentioned earlier there was a one-off charge to revenue from a regulatory decision. Whilst it didn't affect overall Group profit, it does affect Wholesale's numbers and excluding that, Wholesale's revenue would be down about 2%. Actually, probably the best way to look at Wholesale is the chart on the right. What we tried to do is show basically, if you exclude all these one-off items, both good and bad, what's the underlying position? It's pretty clear that Wholesale's EBITDA is pretty stable and its revenue is pretty stable and that's what we said would be the position in Wholesale. The reason it's able to do that is operating costs continue to come down, it's doing well with its big managed network service contract, so for instance, some of the early ones, K-Com, a lot of you will have attended K-Com results – they've been very pleased with it, we are pleased with the results and actually that contract continues to expand because it's working well. So, Wholesale is making good progress, it's a very different business from the one that was posting double digit declines only a few years ago.

Openreach. Openreach's revenue was flat. Strong growth in LLU external, 22% growth and I think critically a big reduction in line losses, that's what this chart shows. We were losing about 150,000 copper lines, whether that's MPF or WLR, about 150,000 a Quarter. So close to half a million plus a year, 600,000 a year. That's changed quite a lot over the last Quarters and last Quarter we actually lost about 30,000 and I think that's quite a big change. Now whether that change has come about because of wins from cable, whether it's come about because there are less mobile households, there's a natural drift down in copper lost lines actually anyway because as people move to Broadband they often remove one line because they don't need it for dial up any longer. But I think that's an encouraging thing and will be quite underpinning of Openreach's revenue going forward.

As a result of that, together with operating costs being down, EBITDA is up, up 5%. Cash flow isn't up and the reason cash flow isn't up is because of the fibre investment programme. Again, no surprises hopefully to anyone there.

On the subject of the fibre investment programme, about three million households we've passed just now and there are about 25 CPEs either trialling or already offering Infinity and it's very important for us to have as many people selling this network as possible because volume is important for this. So we've got people ranging from Andrews and Arnold to Zen Internet, already trialling or offering this service and we expect to see that increase over time and see some of the big boys come in. In the meantime, those ISPs who jumped the gun, of which Retail is one of them, who went early with that and decided to go for it, I think they'll benefit . So we're seeing some good results there.

Also, another important thing is the partnership of private and public investment. You've seen certain of these, a few years ago for instance, there were a couple of big, private public investments that BT weren't involved in and nothing much has happened, certainly not from a customer point of view. A handful of customers literally – if that. Actually it's quite different if you look at somewhere like Northern Ireland. A year ago we announced in Northern Ireland that we would be rolling out fibre as part of our partnership with DETI to Northern Ireland. We've now got 60% of that rollout completed and really good take up. In fact, the places in Northern Ireland, together with some of the early exchanges we've done, we're already seeing take up in excess of 5% of the base, which after not very many months is very encouraging.

We also announced a couple of months ago, went down to Cornwall to announce £130m investment; £50m from the EU, £80m from BT. That will deliver fibre to somewhere between 80% to 90% of Cornwall. Now Cornwall would not normally have been in the two thirds of the UK we'd have done and of that eighty or ninety per cent, the majority will actually be fibre to the premise. That shows what's coming.

And on the subject of fibre to the premise, we're already offering to our customers in the pilot sites, over 100MB per second, actually i would stress over 100MB per second, and 30MB upstream which is coming more … the upstream speed is becoming more and more important. We will be rolling that out in the spring and we've already announced a large number of exchanges, about fifty exchanges, that will be a combination of fibre to the premise and fibre to the cabinet. So we see fibre to the premise having, as we expected, a bigger rollout as the rollout went on.

Now pensions. There has been, as usual, quite a lot happening on pensions but to give you some numbers first of all. The IAS 19 deficit has now fallen to £3.8bn and the key reason for that is the change from RPI to CPI. That's an automatic change for a large part of our pension scheme because basically the wording refers to the government index that they announced that just automatically happens. But this has a £2.9bn gross effect on our pension scheme and whatever you think the deficit is, has reduced the deficit by that amount, the long term liabilities of the Scheme.

Interestingly enough, and we show you this number quite regularly, what we call the median estimate. That is if you take the returns expected from the asset classes we hold, this is the returns, there's a quarterly Watson Wyatt Global Asset Returns Index. If you take those returns and apply them to the assets we hold and do the deficit calculation based on that, now that is not a huge return, 2.7 real, then you get a deficit of £0.2bn, ie pretty much break even.

Now of course the pension remains a big thing but that is sort of the expected value of the pension scheme. Now how much you put in for prudency, how much you put in for high beta, and you can all decide that better than I, but I think it's important to understand that is what the median estimate is.

We also had the Crown Guarantee Ruling; that ruling said that substantially all of the pensioners would …. all the people in the pension scheme would be covered by a Crown Guarantee. That doesn't really affect BT directly because it only kicks in if BT is unable to pay the pension schemes and that's not - as someone helpfully pointed out – part of our long term plan. It certainly is something that gives added reassurance for pensioners.

I've said this before and may well say it again – discussions are ongoing with the Regulator. There is a whole load of new information of course they've got now because of the things that have happened and they've got to digest that, so discussions remain ongoing.

Really this takes us to a slide that hopefully you'll know and not hate: what we set out as our strategy. Very simply, what we were trying to do is to build this base at the bottom around customer service improvements leading to substantial cost reduction, allowing us to invest in the future. That is what we have been doing and you see it in the financials. You see it in the cost savings, you see it also in the customer satisfaction. To use that base and to use the resources that we free up to invest in a number of areas and we set them out to you in May. What I've tried to do today is to show you, we are delivering on the financials and we are making progress in these other areas. Of course - and a phrase we've said before – we have made a lot of progress but there is a lot more to do, maybe even better to say AND there is a lot more to do. So that's where we are six months after our strategy presentation. Over to you Tony.

TC

Thanks Ian and good morning everybody. I'm going to start by taking you through our reported numbers and outlook and then spend a bit of time on costs, debt and interest.

So starting at the top of the Income Statement, revenue for the Quarter was down 3%, an improvement on the 4% decline in Q1. This is in line with our previous outlook for the full year. The revenue decline has resulted from lower calls and lines in both Retail and Global Services, the impact of reduced transit revenues in Wholesale and Global Services and a £19m one-off charge in Wholesale due to an Ofcom determination on termination rates. This is the charge that Ian mentioned earlier. We're Appealing this.

Despite the regulatory charge impacting Wholesale revenue and EBITDA, it has not impacted Group EBITDA as it's been offset by the release of provisions for such charges in the Other segment, so it is basically in and out.

For the first half of the year revenues declined by 4% and for the second half we expect to see a slight improvement in the rate of reduction. Adjusted EBITDA, that is before specific items but after leaver costs, increased by 3% over last year. Leaver costs were £14m this Quarter compared with £21m last year. The growth reflects the ongoing focus on our cost transformation programme across the Group.

Global Services' EBITDA improved from £95m last year to £138m this year, showing continued year on year improvements. Excluding Global Services, EBITDA for the rest of the Group was broadly flat, the same as last Quarter.

Operating profit increased by 9% due to our EBITDA performance and lower depreciation, predominantly driven by the lower levels of capital expenditure last year.

Net finance expense of £224m was flat year on year. While our net debt has reduced significantly, the interest earned on our cash and investment balances of £2.7bn is considerably lower than the average interest cost on our debt. As our debt matures this position will improve and the average interest rate on net debt will fall.

As a result of tax efficiencies across the Group, the effective tax rate on the profit before specific items has fallen from 24.5% to 22% for the half year. This reflects our current expectations for the full year. Adjusted EPS, that is before specific items, is 5.1p, that's 16% better than last year. Net specific items in the Quarter of £2m relate to the ongoing Global Services' restructuring programme, our property rationalisation programme, net interest expense on pensions, offset by a specific deferred tax credit of £76m relating to the reduction in the UK corporation tax rate from 28% to 27% next year.

In terms of free cash flow, the reported free cash flow was an inflow of £535m in the Quarter. This is £170m down on last year but after adjusting for cash specific items, which includes the impact of the prior year tax credit and associated interest of £226m, cash flow has improved by £32m.

Capital expenditure in the Quarter increased to £602m as expected and will slightly increase in subsequent quarters this financial year. This reflects the phasing of our key programmes such as fibre rollout. We expect to outturn at £2.6bn for the full year; this is in line with our previous guidance.

Working capital and other is a £101m outflow in the Quarter. £38m better than prior year, driven by lower regular pension payments. As I have mentioned previously, we're focused on reducing some of the volatility in our quarterly cash flows. The Quarter Two results continue to reflect progress towards this but the quarterly cash flows will have some variability in them. This reflects the nature of our business.

For the first half of the year, our cash tax payments have been minimal; we will return to a more normal payment profile during Q3 and Q4. Net debt of £8.7bn shows a £1.2bn improvement compared with last year. In terms of the outlook for 2010/11, given the performance in the first half year and our view of the remainder of the year, we now expect full year EBITDA to be £5.8bn. In addition, we also expect to achieve our 2012/13 outlook for free cash flow of £2bn this year. This is before around £200m of cash specific items.

For 2011/12 to 2012/13, free cash flow before cash specific items will be above £2bn. Otherwise our outlook for the period remains unchanged.

We continue to make solid progress and cost savings. Q2 operating cost reductions were £194m, that's a 5% reduction year on year. This is slightly lower than Q1, reflecting the profile of the investments that we have made, pay inflation and higher pension costs. On a half year basis, operating cost reductions were £487m, a 6% reduction. We are on track to meet our full year target of £900m.

I'd like to give you a few examples of the type of things we're doing on cost savings. At the full year results, I promised to update you on the progress we're going to make on reducing the cost of application support and maintenance. What we've done is we've consolidated our suppliers, aligned them to specific work streams and what we've delivered is 32% savings on a cost base of £59m.

On the Telco side we have addressed about £157m of contracts with an annual value and delivered savings of 11% on an annualised basis. In terms of our fleet business, we've rationalised the number of workshops we've had and delivered nine million savings. There are plenty more opportunities in this area and I'll give you an update as we progress on that.

We continue to reduce our labour costs which have reduced by 6% in the half year. However, the split between BT staff costs and third party staff costs reflects the focus that we've made in terms of saving jobs within BT. The savings on BT staff have been 1%, the savings on third party staff costs have been 25%. I'd like to reiterate, there is material opportunity to continue to reduce our labour costs and we will take them.

We've seen reductions in our operating costs such as property and energy and this is reduced by 11%. Just to reiterate, this is not about finding opportunities; it's our ability to action and implement them.

When I first stood up in front of you I said I'd try to improve the clarify of some of our costs reporting and this Quarter you'll notice we're providing a more detailed split of our cost base in the press release and KPIs.

Some of you have concerns on the feasibility of delivering our fibre rollout within the £2.5bn capital envelope. The reality is the current rollout is well in line with the cost projections we've given you. By the end of 2010/11 we'll have spent under a quarter of our total fibre spend and we'll have delivered just under a third of the total network footprint.

In terms of future spend, we've contractually committed equipment prices and have a high degree of confidence in the unit costs associated with rolling out fibre to the cabinet, given the deployment that's already taken place. In terms of fibre to the premises, again, we have contractually committed equipment prices as well as a good understanding of the unit costs of the processes common to fibre to the cabinet and fibre to the premises. For example, sub surface infrastructure costs - basically that's digging the trenches for laying the fibre - as well as having reasonable levels of contingency to cover any overspend at this stage of the rollout. Consequently I'm confident that we'll rollout the network in line with our cost projections.

I'd like to confirm our current position on liquidity. We've got currently £2.7bn of cash and investments to cover £2.5bn of debt that is maturing in December 2010 and February 2011. In addition, we currently have facilities in place of £2.2bn, with £1.5bn remaining in place until December 2012. Consequently there is no immediate requirement to raise further debt. However, we will continue to evaluate if there are opportunities in the debt market given the lower projected debt levels.

I would therefore expect the absolute level of interest payments to decrease in 2011/12. However, this will be broadly offset by an increase in the cash tax payments as we return to a more normalised cash tax profile as a result of the effective tax rate trending towards the statutory rate.

Thanks for listening and let me hand you over now to Ian.

IL

Before we go to Q & A I just wanted to ask someone to come and help me with the Q &A. Now there are two reasons I want this person to help me with the Q & A - assuming he does come out. The first reason is BT will be running tomorrow what we call 'The Chat For Children Day.' Chat For Children we donate 1p for every call you make and we're hoping to raise many hundreds of thousands of pounds for charity. So for all of you, ah, come on Pudsey. So Pudsey wants you to make lots of calls tomorrow please – tell your family to do the same and all your friends and colleagues and we'll make hundreds of thousands of pounds for children.

The other reason Pudsey is here is that, apart from to answer the questions – and I know it'll be an improvement – is that I often ask you guys for one question only each and you never listen. So we thought on this occasion we would turn that to good. So what's going to happen is you can ask more than one question but the price is £10 for Children in Need for every extra question you ask. So when the person comes round with the microphone, they will also come round with a bucket! Feel free to put more – we do take IOUs, we probably don't take cheques from most of you!! But giving what I hear about the financial sector bonuses, I'm sure you can do well. So please contribute well, it's for a good cause and help Children in Need and help Pudsey. Pudsey, thank you very much.

Question and Answer Session

Paul Howard
JP Morgan

I guess one clarification. On BT Infinity, I'm not connected yet, I think it's another six months; if you can hurry that up I'll put some more in the bucket!

Just on dividend policy, clearly the business has come a long way since you rebased the dividend in 08/09. I think cash flow is close to tripling and the pension situation is much improved. When do you rethink the dividend policy? What's your current thinking on that?

IL

We said we'd increase it. Six months ago we said we'd increase the dividend and that's what we've done. I think this Quarter's dividend reflects a couple of things. We know it's a little bit below some peoples' consensus but two things: one is we want to be cautious, we want to get our rating up, we want to be consistent, we want to deliver it. There is also an element of the law of small numbers, a 0.1p increase is 4% a 0.2p increase is 8%. If you recall last time round, we had a 6% increase in dividends, so it was just a bit of a law of small numbers. But we will be cautious, consistent, etc, I think we've shown the issues, certainly not our expectations for the business given what we said about free cash flow but that's above where we want to be and I think in the meantime, however, reduce the debt, get the credit rating more solid – I don't like being BBB minus and we would hope to move that up. And that's really what the dividend is about. But of course the company does have more capacity, the debt is coming down and eventually that will reflect through in shareholder returns.

Maurice Patrick
Barclays

Two questions please. The first one is the free one!!

IL

Included in the package, I think we call it here!

MP

On the BT FON is there a level of critical mass that you see with that and what you see critical mass being.

The second question is, is there a practical limit by how fast you can currently add customers to the BT Infinity product? You talked about the 4,800, is that demand that's limiting how fast that's going?

IL

I'll answer on Infinity and maybe ask Gavin to talk about FON. On Infinity, it's pace of rollout. Certainly there may reach a point at which we just can't physically have enough engineers going into people's homes but at the moment we think we can meet that increased demand and we'll try and stack up for it. I hope, over time, our ability to meet huge demand is a good thing but just now what we're seeing is the numbers going up as we do the rollout. And if you look at the percentage, given that it's three million now and if we're doing 4,000 odd orders a week, if you do the maths for that, that gets you to a pretty decent percentage pretty quickly and as the rollout carries on from three to four to five to six million, you would of course expect these numbers to increase quite a bit. Its' pretty recently that we started the advertising for infinity but net, net, net, we're pleased with how it's going just now. I think there was a sense, maybe from others that people weren't that interested in the high speed product. I think if you have it priced right, maybe you'd get a different answer. Gavin, I don't know if you want to add anything to that or talk about FON?

GP — On WiFi, there's BT FON, there's the Openzone estate and there's the Wi-Fi City, so it's a combination of all three. What we see is that customers who use this have significantly less churn, so we know it drives down share. This is a unique thing that we can offer in the market place but you're right, not enough customers know about it but that's changing. So over the last six months the number of customers using it on an active basis has increased threefold and what you'll see as we increase the marketing of it now, with the TV ad that we showed earlier, we expect that to go significantly higher over the next few months.

John Karidis
MF Global — **The first question is the new guidance that you've given for the next few years, does that still assume that Openreach sales will be flat over the period?**

Secondly, as far as BT Retail is concerned, can you help me understand again why it is that BT Retail needs all these different brand names, Infinity, Vision, Openzone? Why couldn't it just be …. Are you essentially divvying up your marketing budget among too many sub brands?

IL — I'll ask our brand guru probably to talk about retail brands. They represent different products and you understand as well, you have to call the products something.

In terms of our guidance; our guidance is our guidance. We've not changed anything else and we're not giving .. I don't recall we particularly gave Openreach revenue guidance, in fact I think we said Openreach fundamentally would be pretty stable and I don't think there's anything I really want to add to that. I think we're just saying it is encouraging to see the copper line loss number coming down quite a lot because if that had carried on by 5 to 600,000 a year, that was troublesome.

GP — We operate two brands: Plusnet and the BT brand and that strategy has worked very well for us because we've got Plusnet focused on being very value conscious customer based and BT focused more at the higher end of things.

In terms of the product names, to Ian's point, we have to call them something; you can use very descriptive names or you can use names with a little bit more emotion in them. It's really just a marketing challenge in that respect but they all feed the BT brand.

IL

For Infinity as an example, you might be able to get fibre from twenty-five different service providers; you can only get Infinity from BT Retail and I think that's the point we did try and want to create very much a separate thing because we think our product will be better, it will have a lot of features in it and we wanted .. if we had just called it fibre frankly it wouldn't have been (a) it wouldn't have been patentable either.

Simon Weeden
Citi

The median basis on which you're doing the pension scheme, can you just remind me which of the various changes that you've highlighted since the triennial review are in and which are out? So is CPI in, is the employee terms change in? I presume the Crown guarantee is not, clearly, by definition.

The second question is on fibre deployment. Can you just update us on where you think you'll be in terms of the mix of fibre to the premise and fibre to the curb. I think at one point we had a 25% number in mind, for fibre to the premise, is that still the case?

IL

We quoted a three billion median number when we said the nine billion trustees' valuation and that three billion included an assumption about £1.5bn improvement from the changes we had agreed with our employees because more people would buy out and that would reduce the overall cost. That's not changed. Effectively, basically what we reflected is asset movements, which has moved things up on one hand and return assumptions, which have actually come down and the change to CPI and I think that's pretty much all the movement from when we originally said the three billion … and of course we paid some money in as well, £500m.

In terms of fibre, I may ask Steve to comment about the fibre to the premise rollout but overall we're still working on a 25/75 split. Obviously the split as you move on is going to be a lot higher fibre to the premise because we've done very little fibre to the premise now, so it'll be a higher percentage as we move on. But, Steve, do you want to say anything about that?

SR

Our priority is to make sure we get as large a footprint as quickly as possible and you can see by the pretty impressive numbers actually of homes past we're doing that. It's very important for our customers, it helps to build the marketing case. In terms of the split, it really depends on the way that our pilots pan out; we're still at a very early stage with fibre to the premise. One thing is for sure, where we're deploying it has got to be consistent with our overall business case and the early experience is extremely encouraging. However, it does depend on the mix between overhead fibre, fibre through the ducts, level of blockages and that's something where we are still learning. Broadly speaking though, the percentages that Ian quoted are exactly where we're heading for.

Steve Malcolm
Evolution

I'll go for two questions but only, if you don't answer them properly, you have to put money in as well Ian!

The first one is on the dividend again. Can you just maybe frame the short term dividend thinking against the maybe longer term impact of a ratings upgrade and how you position that with the benefits to the shareholders of getting a ratings upgrade and how that might fit into interest costs and what you might do if you got a ratings upgrade.

Secondly, it's just on the Broadband market share, as you said. Obviously those numbers were a little skewed by the fact that Virgin covers half the country and you cover all of the country. Could you give us an idea of how you think you're doing in Broadband market share in cable's franchise as opposed to nationally?

IL

I might ask Gavin to talk about the cable franchise area but even if you halved our numbers you would do pretty well in terms of clearly a lot more going on the BT network and going with BT Retail.

SM

Or is it skewed towards ……

IL

I'll ask Gavin to talk about it.

GP

I'm sure you can do the maths. It's quite obvious that we've got a lower share in Virgin areas. We see that as an opportunity though, frankly, going forward, because particularly with the rollout of Infinity, I think it gives us far more fire power to compete and obviously on an end to end basis for the Group, any customers that we're winning back from cable are better for the Group as a whole. So we will go after the cable base and give them a genuine choice.

IL

Virgin clearly did add last quarter but it was a fraction of the total market. So we're doing …. I don't think we've got a split exactly what percentage ……

GP

That we're willing to share

IL

Yes, that we're sharing anyway. But we're pleased and, as Gavin said, big opportunity as our market share is a lot lower. In terms of interest, I'll ask Tony to talk about the effect on interest of an upgrade on ratings but just thinking longer term, I think what we feel is it's important, we're not trying to make big, sudden movements. What we have said to people is you will see an increased dividend, we expect that year after year. Clearly we have, on any metric, we have headroom but I'd like to see the debt come down, I'd like to …. It's a bit like we trying to do in Operations: you build the base and that gives you more opportunity in the longer term. People know they can look forward to an increased dividend over time and they know we have the capability to significantly increase dividend but in the meantime the debt's coming down at over a billion over the course of the last twelve months and our interest costs will come down and a ratings upgrade would help.

TC

To quantify it, interest payments would come down ten to twenty million, somewhere in that region but the main advantage for us would be the flexibility it would give us in terms of raising cash if we needed to go into the market, which, as I said earlier, we don't have any real need right now.

IL

I think it's good for us in the longer term to be able to access CP which is what he means.

Mike Williams
Exane

Firstly, Tony mentioned the material opportunity to reduce labour costs while also highlighting the focus on contract labour. I wondered if you could expand on that in the context of the Agency Workers' Directive that comes into play?

Secondly, I just wondered whether, given the Lancashire County Council deal, I think that was signed during the course of the Quarter, whether on the back of your other relationships with the likes of Liverpool and local authorities, it's really an opportunity to capitalise on government spending cuts and we should be thinking about them more from a positive perspective perhaps than just thinking about the attrition in terms of the existing contract base?

IL

We've said with government things it would represent an opportunity and a challenge and I think people have got a little bit too excited on the challenge side. I don't want people to get too excited on the opportunity side but there will be opportunities and actually Tony is very involved in our local government work so maybe, Tony, do you want to do both of these questions?

TC

In terms of the local government, just to correct you, on the Lancashire piece we've been named as preferred supplier on there, so the deal is not closed, it's not finalised. It does give us an opportunity because we have BPO type activities, which the base of the proposition is to help the Council reduce their cost base. So that does give us an option, it does give us an opportunity and we can get further momentum in this market.

You highlighted a number of contracts that we've already got. There will obviously be pressure on those contracts in terms of reducing, helping the Council to reduce the cost base but, again, it's both a threat and an opportunity. So I think you're spot on there that we have an opportunity to be able to grow in this particular area.

When you talk in terms, come back to the labour costs piece, the key opportunity we've got here is to continue to reduce the costs, both in terms of direct labour and in indirect labour but our focus is on safeguarding BT jobs. Now, what we are actually doing then is we're looking at work we've got with third parties and we're saying does that make financial and economic sense? We'll bring work back into the company and we've brought a number of jobs, hundreds of jobs, back over the best part of this financial year because it makes economic sense because we can do the work cheaper and more effectively and more efficiently than some of our outsourcing partners.

The Agency Workers' Directive, I don't see that as a material issue for us. It's not as black and white as has been made out in terms of potential; I see it as a fairly small issue that we can manage our way through.

Nick Delfas
Morgan Stanley

The first question is on how much of your net adds are Plusnet, ie at the discounted price?

Secondly, there's been some talk from Talk Talk that they're paying you quite a lot for migration of Tiscali customers. I think every single one that gets migrated onto their DSLAMs has to be paid for. How much was that of the Openreach beat and is that going to be repeated going forward?

Thirdly, how much do you have to pay FON for the alliance with them?

Fourthly, given how good the pension number is, are you going to request an actuarial review early?

IL

Pension, possibly not. It takes us so long to get the last one agreed, I'm not sure I want to repeat the process in a massive hurry. We are talking here December 2011 is the next review anyway so we're not that far away so I doubt – I won't absolutely rule it out but I doubt we'll go early on that.

On Talk Talk migrations, there have been some more but, Tony, do you want to say .. they're not huge numbers in the scheme of things.

TC No, it's not material.

IL It's a fairly small element. We've always had migrations, we've been having migrations for a long time and of course it costs us more to do the migrations as well and we would certainly say that the revenue we get from migrations remains not adequate but that's a point we've been making to Ofcom for quite a long time.

On Plusnet it's about a fifth of the adds but, Gavin?

GP Yes, between 20% and 25% of net adds. I think the key on Plusnet is that we focus on bringing the line and the calls package as well so you've got to look at the overall economics of the customer and over 60% of customers – and it's an increasing number – are taking a line and a calls package from us. So you've got to look at it in totality.

TC There's been no material movement/increase in the Plusnet percentage of net adds over the last three quarters or so. This growth is not about an increase in the Plusnet percentage.

IL The absolute has obviously increased because Retail has increased overall but not in the percentage and I suspect the answer to the FON one, but tell me if I'm wrong Gavin is, we obviously won't give you details of the contract; you wouldn't expect us to. So you've wasted £10 there!!

Andrew Lee
Goldman Sachs **Just a question on Retail first of all. We've just seen a very aggressive quarter in marketing on premium TV and above the line marketing on premium TV. Just wondered how you're thinking about defending your customer base from them needing to get a TV product from a competitor while at the same time being at risk of your customer base that wasn't going to churn, taking your TV product and therefore reducing their margins. In a nutshell I suppose, how do you think about premium TV's risk to your back book margins?**

Secondly, a question on Global Services. We're seeing the macro recovery come through in your order book but I just wondered how pricing competition was trending over the last couple of quarters.

IL You're right, we're pleased with the orders this Quarter. It remains a very aggressive market place, no question about it, but Jeff, do you want to comment on what outstanding value we're giving to our corporate customers?

JK The order book is up and that swings quite a lot based on size of deals. So we had a substantial renewal on this Quarter but even if you took that out we were up 6% year over year. I'd say as far as price, there are certain markets or technologies that we see price pressure more than others, so calls and lines, our traditional products where we're converging into our newer products. There's aggressive pricing there but generally it's margins and deals, I'd say year over year have remained flat as far as our yield on those. That assumes that you execute and you run the transformations and the start ups as you planned them.

IL And our trick has to be to take account of the changes and mix and as Jeff said, the traditional tends to go down but areas such as security for instance is now a much bigger area, unified communications, video conferencing, there are a lot of new areas coming in. All of them use the network or the need to borrow the network is a very important part of it.

In terms of back book, I'll ask Gavin to say something on that but we want our customers to take as many products and services from us and I don't think we quite see it; if an existing customer takes BT Vision and takes Sky Sports with it, they've got less chance of churning, they'll enter into a new long term contract often. I think there's a lot of good stuff in there so I want to try and sell as many services to the customer, have an integrated product offering.

GP We see the back book opportunity as exactly that, as an opportunity for the business because certainly relative to Virgin, we've got fewer skews per customer so we see an opportunity to cross sell. TV is largely all upside for us and we believe with the sort of investments we're making and hopefully we'll get a chance to look around at some of the products that we launched in the next year. It's a really exciting portfolio of products coming down the pipe that I think begin to leverage our competitive advantage of bandwidth interactivity and not having this legacy base, which both Sky and Virgin have, of customers paying £20 or £30 a month for largely a set of basic pay TV services that you can get much more cost effectively through Freeview and next year through YouView.

AL On premium TV, do you feel that specifically about premium TV, the benefits of premium TV, churn reduction, longer contracts, offset the negatives of the cost of premium TV?

GP What we see with particularly sports is that there's a group of our customers who want it, there's no question about that. But it isn't going to be the thing that differentiates us over the long term. It's just a very important part of the overall offer, it's a point of parity in truth. But where we differentiate ourselves will be on on-demand content, interactive services and really bringing the best of the internet into a TV world and doing that all over fibre I think is pretty compelling.

Guy Peddy
Macquarie

On Global Services please. With the recovery in the order book and improving revenue trend, how should we think about that as a driver of capex and working capital going forward because in the past obviously when you had growth you obviously had big investments?

Secondly, a desire to improve the credit rating. Is that driven by a desire to probably get access to cheaper debt rates and therefore prepay some of the pension recovery?

IL

Second one, no, not particularly. I just think a company like us should be looking to be a solid investment grade and also to have access to the commercial paper market whilst, as Tony said, we actually don't need .. we're sitting on a lot of cash, so we don't need to borrow anything any time soon. I think over the longer term we've got too much term money relative to short term CP etc. So why change that mix? And it's what I think BT should look to be, is a very solid, investment grade rating.

In terms of GS, you're absolutely right, in time past big orders meant big negative working capital and big capex. There's always some effect on that but one of the big changes – people often talked about are you pricing things more expensively. Well, actually no, we're not today, that's not the problem. We're delivering them better but also we've cut the capital intensity because we recognise that cash, long term cash sustainability is the real driver, not EBITDA margins which if you target EBITDA margins you'll get the wrong answer. So our contracts fundamentally are a lot capital lighter and you can see that in the GS numbers that capex has absolutely come down and it's being spent better. But we are investing where we need to invest and we're putting a lot more into Asia Pac, we're rolling out global Ethernet, we're doing major rationalisations of the network and systems, all that costs them money. But, Jeff, I don't know if there's anything more to add to that?

JK

Well I think you can expect that working capital requirements will go up on deals like this but our number one priority in Global Services is generation of cash and will be in the short term. So we actually evaluate every deal based on the risk profile, capital requirements and so forth so I'd say it's drastically better than it was as far as the consumption of cash in larger transactions that we're doing. You can third party finance a lot of times; we'll negotiate that back to the customer and so it won't be as heavy as what you've seen in the past.

TC

Two points. The first is the profile of the deals we signed previously, we haven't got the same profile. Second point is we've already given a guidance which says next financial, Global Services will reach cash break even to slight growth. That was done on the back of the fact that we know our order book is going to be even better so that's factored into our numbers, factored into our projections.

Richard Crosthwaite
Bernstein

Two questions on fibre, if I may. First of all, I'm hoping to understand the impact of loop lengths on your FTTN build. Could you give on average what the range speeds in of loop lengths maybe for the first third of your build compared to what you expect it to be for the final third.

The second question on the FTTH build. I understand that the bulk of the costs for a GPON FTTH build is in the connection and you've got an implied uptakes assumption there. Now you've done extensive testing and have contract equipment in place, are you able to give an estimate of what you expect in terms of uptake?

IL

I think we've said generally we expect … our business plan is based on broadly give or take about a fifth of the people taking it up. That applies to FTTC, FTTP and if we do better than that we'll spend more money; if we have less than that, but have a much better business case, less than that, it will be the contrary. But the plan and the amounts are entirely consistent with each other.

In terms of loop lengths I think there has been some misunderstanding about the nature of loop lengths but, Steve, do you want to talk about loop lengths?

SR

Nothing would make me happier, Ian!

IL

And remember we're talking from the cabinet to the home, rather than ...I assume you're talking from the cabinet to the home, not from the exchange to the cabinet because that's all fibre and loop lengths are not that, so anywhere that is variable is from a cabinet to the home.

SR

Clearly, if you look at the more rural areas, then loop lengths are longer but it's wrong to assume that there's some sort of uniform rule. It really depends clearly on the position of the exchange and the community that it's serving. That changes over time, new housing developments etc.

In the main the difference between, say, our first third, second third and third third loop lines would be a gradual lengthening but nothing that is particularly dramatic. That is quite likely to be offset, if you look at the speeds that are being offered, we've now got VDSL equipment in the lab that is comfortably doing 100MB per second and this technology isn't going to stand still. So in terms of the ability to support our CPs offerings, I think we're going to have pretty uniform capability across the UK by the time we get to that final third.

IL

I can tell you the loop length for my house is five hundred yards and I get about thirty .. the speed I get at the moment is 37Meg, so five hundred yards is long, just to give you an idea.

Nick Lyall
UBS

On competition in retail first, have you seen any relaxation in retail competition since the end of the Quarter or should we assume marketing budgets stay at these levels and you're still seeing Sky compete the way it did in your fiscal Q2.

Secondly, on the dividend, is it politically insensitive to raise the dividend? Should we assume you have to wait for a result from the pension regulator first before you can think about raising dividends?

IL

I'm not sure I'm renowned as being politically sensitive in the first place! We told you what we want to do and we're trying to run this business and run the financial policies for the long term benefit of the business and its shareholders, which is consistent growth, conservative – and I admit that we're conservative – but I think we've maybe in time past been a little bit too moving up and down and shareholders can look forward to a progressive dividend. That's what we said, that's key and we know we've got the pension in the background but that's a key thing.

In terms of competition reducing it never feels like it but I'm not sure the advertising is the same intensity and one of the things, again, I said this a couple of quarters ago, we know full well there will be a huge influx of advertising and marketing in this space. The difference is we're going to be at this in three years' time. We're not a company that can be pushed out of business in a year because of the investment involved and the numbers we've given and our expectations for BT and its performance reflects the fact that we believe we will continue to invest, not just in TV but in a whole range of products for our Consumer business, BTB, Global Services and Wholesale and Openreach. We're going to do that and the trick to all of this has been and remains that instead of a company that generated £ ¾ billion of cash a few years ago, we're one that's generating now £2 billion and in that that gives you a lot more flexibility and actually that's having paid for that investment. So, the £2¾ billion we've saved in the business over a two year period, that's making a big difference to what BT can do, so we're going to be in this for the long term. There are a lot of new things coming.

Gavin have you seen advertising weight reduce slightly since the Quarter end?

GP Yes, it was certainly in the July/August period it was very, very intensive and it has eased a wee bit since. But, as you say, I wouldn't draw too many conclusion from that; I think this is a battle that goes on for a long time.

IL We are thinking of getting Gavin's publish relations team into football scouting on the basis that anyone who at the beginning of the season put Gareth Bale to be their ambassador that was not a choice that many people would have made and we're delighted how well, since he's become the BT Ambassador, how his form has improved. We're not taking full credit for it; obviously Harry has a role in this but we're delighted for him and it just goes to show, maybe occasionally get off to a slow start and it's just amazing what can be done later.

Morten Singleton
Investec **Line rental forms a significant proportion of the average consumer bill and during the last quarter you sent out a letter highlighting a rise in the line rental cost or alternatively you could take a discount if you paid for a year up front. I just wonder how many other customers took up that kind offer and whether that's had a material impact on the working capital flows this Quarter?**

IL It's not a material impact. It's been popular and it was the cheapest line rental offer around among the big players and that's what we're keen to have. For those who wanted it, this is a really attractive price and you add that into some of the other things we're doing. You could get from BT something very, very strong in terms of price. I don't particularly want to give the individual numbers; Gavin, do you want to add anything to it?

GP You can if you want.

IL Up to you.

GP It has proven quite popular, there is a group of our customers who like the certainty, so we've sold about 100,000 in the Quarter.

IL But that's not going to dramatically change the overall cash profile of the Group.

Chris Alliott
RBS **Just on Global Services and the order intake. I wonder if you could give an indication how that's split, UK versus non-UK this Quarter and whether that's changed particularly on the rolling twelve months basis.**

Then one slightly detailed but expensive, for me, question! On Wholesale, which is just the managed services revenues within Wholesale, the growth slowed down quite a bit. Is that just a function of the lapping of some of those mobile contracts coming on board and some of the initial work falling away or can we basically expect some growth coming through from there as we look forward as well?

IL

I think I'll ask Sally to comment about the Wholesale but we've had some big contract wins, less so in the last Quarter, and certainly it's grown, as you say, a lot and it's tailed off a bit but I think that is a natural cycle. But, Sally do you want to add to that?

SD

In terms of the underlying growth it's actually about 6% but what we find within contracts, we have there bundles of products often and some of those products will be in decline and others will be in growth. So, for example, in those contracts of maybe call revenue and in common with general trends that's declining but it is being replaced and more by other elements in those contracts.

The other thing worth mentioning is that the major contract that we did secure in April this year with Everything Everywhere, which was the win back of the LLU business, that has yet to show fully in our numbers and won't come through in those numbers until the first part of next year. So some of these, we win the business but it does take a little while to actually come through fully into the numbers.

JK

I don't have the numbers split by geo with me; we usually look at renewals and growth on existing customers because that's where we're focused. My sense is we're up a little in the UK in this particular Quarter, just due to the resign of the DFTS, which was north of £600m. So it does swing but I haven't seen any material mix, I'd say, in geos. Although, as Ian said, that will change over time because of the investment in Asia. We've already seen pipeline increases there. So it will tend to mix but when we sign big deals like this it will, quarter by quarter change mix a little bit.

Jerry Dellis
Jefferies

Two questions. **Firstly in terms of retail revenue trends. I wondered over what sort of timeframe we could look for an improvement in the recent -5% run rate?**

Secondly, in terms of when you thought about upgrading your EBITDA guidance, i wondered which Divisions were really driving the upgrade and to what extent that was Openreach, which was obviously fairly strong this Quarter?

IL — I think on EBITDA, I think that's fair comment. The numbers are the Openreach numbers and demand on Openreach is certainly the key driver. But, Tony, on EBITDA?

TC — There's an impact on Openreach cash because extra volume does have an impact in relation to capital expenditure. In terms of specifically the EBITDA, there is the cost obviously associated with the increased volumes and we're having to finance some of that through overtime, which means that the unit costs have moved up in terms of what we're doing. But overall I'd say that the trend that we've got on Openreach is a positive trend.

IL — And that's probably the main reason for that upgrade. In terms of retail revenue trends, we did say that would improve over time and Gavin, without giving any particular ….too much guidance over and above the three year plan we already have.

GP — I'll repeat what we said in May, how about that? Which is over the period of the next three years we'll see that revenue trend improve. It was five last Quarter, it's four this Quarter, it'll be a gradual improvement from here. The key for us is stabilising the customer base and reducing the net losses and that's really the key underlying physical we're focused on.

IL — Okay, great. Finally, I'll finish off by saying thank you very much for all of you being such good sports with Pudsey. I will happily, for all your £10, because I didn't maybe answer every single question, I will take that and I will match all your £10s as well! So thank you very much and I won't do it to you every quarter, thanks!!