

BT Q1 2012 Results Presentation

Attendance List: Ian Livingston (IL)
 Tony Chanmugam (TC)
 Jeff Kelly (JK)
 Gavin Patterson (GP)
 Liv Garfield (LG)
 Damien Maltarp (DM)

DM Thanks and welcome, everyone. This is Damien Maltarp in BT Investor Relations. On the call today, we have Ian Livingston, Chief Executive and Tony Chanmugam, Group Finance Director.

Tony will start with an overview of the financials and Ian will then go through the lines of business. We will then open up the floor for questions.

In the room with us today, we also have senior management from 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 our annual report can be found on our website.

I'll now hand over to Tony. Please go ahead.

TC Thanks, Damien.

Good morning, everyone, and thank you for joining our results call. I'll start by running you through the financial results for the first quarter.

Starting with revenue on slide 4. Headline revenue has declined by 5%, with underlying revenue, excluding low margin transit revenue, down 3%. Remember, this is the revenue line that we provided our outlook on.

EBITDA grew by 3%. Together with a small increase in depreciation and a lower interest charge, profit before tax grew by 20% to £533m. As a result of EPS of 5.2p was 18% higher than the prior year.

Free cash flow before specific items of £308m was 33% lower than last year. And I'll explain shortly what the main drivers of this were.

After cash-specific items of £61m, free cash flow came in at £247m. This contributed to a further reduction in our net debt to around £8.6 billion.

Turning to slide 5, which focuses on our revenue on EBITDA. Transit revenues declined by £109m to £300m, and we continue to expect these to decline by around £400m in total for the full year.

Of the decline, £79m was due to the impact of mobile termination rate reductions.

The 3% decline in underlying revenue, excluding transit in the quarter, had been driven by the continued decline in calls and lines revenue in both Retail and Global Services. In particular, the quarter was impacted by an additional bank holiday. This not only meant one less working day, but also resulted in less business activity around that time. Most of the impact from this was within Retail.

For the year as a whole, we remain on track for our outlook of underlying revenue, excluding transit, to be within the range of down 2% to flat.

EBITDA grew by 3%, reflecting the results of our cost transformation programmes across the Group. And I'll say more on this shortly.

In the quarter, we saw a weaker performance from BT Wholesale, but this was offset by continued good performances at BT Retail and Openreach. Ian will go through this in more detail.

For the full year, we expect these trends to continue. Our outlook of EBITDA growth for the full year remains unchanged.

Turn to slide 6. This sets out the detail of free cash flow in the quarter.

Cash out flow from capex in the quarter was £618m, broadly in line with the prior year. We expect this to increase in subsequent quarters to meet our outlook of around £2.6 billion for the full year.

Interest was £81m lower, reflecting the lower level of debt. This was partly offset by a slight increase in tax payments.

Working capital and Other were £237m lower than last year, which has included a receipt of around £200m relating to a major customer contract.

Together, these contributed to free cash flow before specific items being £151m lower for the quarter.

We've made progress in smoothing our cash flow profile. Remember, only two years ago, Q1 free cash flow was negative, with Q4 providing 50% of the cash flow for the year.

As I've said before, there remains some underlying volatility in the timing of our cash flows, due to the nature of our business, and our free cash flow still tends to be weighted towards the second half of the year.

Our outlook remains unchanged, which is for free cash flow before specific items to be above the 2011 level. This year and next.

Finally, we incurred cash specific items of £61m relating to the Global Services restructuring and the property rationalisation programme. We continue to expect the full year cash cost for specific items to be around £150m.

Turning to slide 7... We reduced operating costs by £269m or 7% in the quarter. There has been continued reduction in the level of POLO [payments to other licensed operators] costs, driven in the main by transit decline. Excluding transit, our operating costs reduced by 5%.

Net labour costs reduced by £58m or 5%. Leaver costs increased by £18m to £28m, due to increased take-up of the labour schemes in both Openreach and BT Operate. This will help us deliver sustainable reductions in our labour costs in the future.

Other costs reduced by £75m as we continue to drive efficiency across the Group. We expect to continue to deliver further reductions in our cost base, driven by productivity improvements, process reengineering and a continued focus in driving value from our suppliers.

Turning now to slide 8... Depreciation increased by 1%, due to the impact of shorter lived assets in Openreach. For the full year, we expect depreciation to be broadly level compared to the last financial year.

The lower interest charge reflects the reduction in net debt and the repayment of higher coupon debt in the second half of last year. This reduced the average rate of interest to around 8% compared to over 10% last year.

S&P's upgrade of our credit rating should reduce our interest costs by around £6m per year, although the benefit of this will be seen more next year due to the timing of rate resets and coupon payments.

The effective tax rate in the quarter stood at 24.1%. This is consistent with our expectation that the rate will trend towards the statutory rate. The UK Finance Bill will change the corporation tax rate from 26% to 25% from April 2012. We therefore expect to recognise a tax credit of around £80m on the re-measurement of deferred tax balances in the second quarter, which will be included within specific items.

The IAS 19 pension deficit is still at £1.8 billion after tax. This is reduced by £3.9 billion compared to a year ago, mainly due to the move from RPI to CPI and the payments we have made into the scheme.

Thank you. And I'll now hand over to Ian.

IL

Thank you, Tony. And good morning to you and thank you for coming on the call; particularly, I realise it's a very busy day for telco results.

If I can ask you to turn to slide 10... This slide goes through the line by line summary of performance, and I will go through the individual line of business performances, but just I thought I'd give you my view overall.

I think, first of all, the performance of the business is very much in line with where we thought and very much in line with the goals we set out.

At an individual line of business level, I think Global Services results were very much in line and reasonable. Wholesale was clearly a few percentage points weaker than we thought, and we're going to talk about why that was. However, more than balancing it off, I think, the stronger performances from Openreach and Retail, meaning, as a Group, we did somewhat better than expectations in the quarter.

In terms of actual cash flows, Tony mentioned on a quarterly basis for the Group, they do tend to be very volatile, even more so at a line of business level. So, I won't really focus much on going through individual line of business cash flow numbers. But to reiterate what Tony said, we are comfortable with overall cash flow forecast for the year.

So, turning to slide 11 on Global Services. Underlying revenue, excluding transit, was down 2% against revenue down 5% overall. Net operating costs continued to fall, down 6%. Excluding transit, that was down 3%.

What we've tried to do now in each slide is show not only the financial performance, but individual growth indicators – effectively the milestones we talked about in our strategic plan to grow the business. And so you'll see as we go through each of the lines of business how we're doing.

So, firstly, in Global Services, with those growth indicators. The twelve-month growing order book, up 8%, 2% in the quarter. Now, we have seen a mix in the change of the order book. In the quarter, we've seen more new orders rather than resigns, but that's a specific intention to, I think, focus on particularly new orders – they will feed through to revenue more quickly. So, you will see a change in the mix of the order book over the course of the year.

Within the individual regions, we've seen a good increase in the pipeline in AsiaPac – about an 80% increase in the pipeline. Of course, these have to be converted into orders. But that's encouraging.

In Latin America, we recently announced our largest ever contract with the Brazilian post office. So, not only are we a provider of services to the Post Office, Royal Mail in the UK, but also in Latin America.

And I should mention, because we don't tend to focus on it that much in this, in the UK, Global Services was unquestionably their best performance. We've seen big contract wins, for instance, with Lancashire County Council. We've also seen the revenue trends

improve and profits in the UK at Global Services have improved. So, whilst it may not be a great environment in the UK, we do feel we are starting to win, and we're winning back a number of customers. So, a pleasing performance in the UK, so it's worth mentioning.

Now, turning over to Retail. First of all, the financials for Retail. Revenue trends are pretty similar to what they were last quarter, with Consumer down, continued lower calls and lines revenue. Some improvement in some of the metrics there. Business was flat despite fewer working days. I think a general feature, and Tony mentioned it, is April was unquestionably a difficult month and May and June were better. You know, over the course of the quarter, that's pretty immaterial, but we definitely did see the effect of what were some long holidays in April.

In terms of net operating costs, down 6%. We're now seven years into our cost improvement programme, and there you still see some pretty reasonable numbers coming through. And that meant despite very significant investment in the business in terms of marketing and actually subscriber acquisition costs because, as you'll see shortly, we did acquire a lot of customers in the quarter, EBITDA was up 1% in Retail.

Now moving actually within Retail to the growth indicators, Consumer ARPU continues to grow – up 5%. The main driver of that Consumer ARPU growth is very much broadband and broadband growth. And we saw a 56% share of net broadband adds – that's DSL. We don't normally report the numbers including cable because we actually don't normally know the cable numbers by the time we report. In this case, we do. So, to give you the number, actually, the share was 59%, including cable, and that is actually the highest ever retail share. So, that's encouraging in terms of overall performance.

And there are a number of factors behind that, but one I'd just like to draw out is the attraction of bundles. In summary, nine out of every ten new broadband customers are now taking a bundle from us, and it wasn't so long ago that BT Retail was not able to sell bundles. And I think it does go to show that if one is able to compete on a level playing field, what can be achieved by our team.

Another factor that's certainly helping our broadband performance is the performance of BT Infinity. We have over 200,000 now Infinity customers. The rate of net additions in Q1 is 50% higher than it was in Q4. And around about a third of BT Infinity base are new to BT Retail. So, we're obviously gaining customers.

I think one of the interesting sides of that is actually what's happening in Market 3, the Ofcom Market 3, which is the most competitive market. These markets – Market 3 – would tend to include a lot of local loop unbundlers and usually cable as well. And actually, we're seeing a significant better – about 50% better – growth in our broadband base in Market 3 areas with fibre compared to Market 3 without. So, it does seem to have a differential effect on Retail's performance where we've got fibre. So, that's the encouraging for the overall fibre story.

BT Vision? Well, BT Vision continues to grow solidly. It's up 24% year on year. Over 600,000 customers. We gained TV customers in the quarter. I know some other people are talking about this as a seasonally weak quarter, and I guess it is in some ways. But we did add over 20,000 BT Vision customers in the quarter.

Moving away from Consumer, BT Business – the sort of stable revenue position is very similar to the last quarter. Continued growth in IT services and mobility. Up 7% overall. A bit less than it was last quarter, but I think we're starting to see also an improved performance in the traditional business in BT Business. So, when one talks about growth, it's about two bits. It's about very much sustaining that which one has, as well as going into the new; and it's doing both of that.

Now, turning to Wholesale... Wholesale – underlying revenue, excluding transit, was down 1%. So, reasonably stable, and we did see the effect of things like broadband lines migrating to LLU and that affected revenue. But I think the issue very much is the EBITDA, which was down a few percentage points more than consensus, and I think, to be fair, our expectations.

Now, why was that? Well, first of all, there was an impact from some regulator decisions covering - there were a number of small ones - but they pretty much all went to the same direction. And that very much we were aware of, but it has affected the year on year profit.

Also, the rate of broadband migration to LLU was quicker than we had expected, and you see some benefit of that in Openreach, but particularly on a year on year basis, it has a significant effect on the Wholesale business.

And also, the managed network services contracts. The migration costs are a bit higher and taking a bit longer. Now, I want to be clear – you know, these are still profitable contracts, but we are in cases running two networks or expensive underlying services. So, there are dual running costs there, which are costing us a bit.

And we do expect the issues we've mentioned to have an impact on Wholesale for most of this year. But, as we've said earlier, that will be offset by, I think, stronger than expected performances in other parts of the business.

Now turning away from Wholesale, over to Openreach. Openreach revenue was up 5% and actually, I think for the first time ever, both internal and external revenue in Openreach grew. And that's the highest overall rise since the formation of Openreach. I think this is a sign investment is starting to deliver. You know, bear in mind, this time last year was a lower quarter, so that does the flatter the numbers. But I think it is a very solid growth number.

Net operating costs were up 4%, and that reflects there was a lot of engineering activity to do, particularly on provision. Also, I think some higher leaver costs. So, that balances it out a little bit.

In terms of the growth indicators, very pleasing to see another quarter of copper lines growth. The chart on the right hand side we show actually shows the twelve-month position for copper. We're now at the stage where over the course of the year as a whole, copper has grown three quarters running now, and now that offsets the decline we had nine to twelve months ago. And if you look at that chart at the extreme left hand side, Q1 2009/10, we actually saw almost a 500,000 decline in copper. So, that's a big turnaround. And it does really show, I think, about the way that people are valuing broadband and valuing fixed line broadband.

I think they'll value even more with fibre. And we went through 5 million premises now passed with fibre. And in terms of overall take-up, I think some encouraging signs. It's still early days, but 500 cabinets; and the cabinets represent, of course, a fairly small area, but now we're seeing over 500 cabinets with over 10% fibre take-up. So, it does show it does have absolutely an attraction. That attraction will build over time and very much both from a cost and delivery point of view of customers, going pretty much according to our plans.

So, in summary, in our view, this was a pretty uneventful quarter overall, which given, I think, some of the tribulations in the sector, is no bad thing. We said for the year to expect 0% to 2% revenue decline, and so therefore, you can take from that we expect revenue trends to improve through the balance of this year from the -3% underlying in this quarter.

In terms of line of business trends, as I mentioned earlier, I think, expect some of the same trends. A somewhat stronger performance in the rest of the group offsetting a bit weaker in Wholesale. But overall, and this is the important thing, the Q1 results very much add to our confidence in delivering our outlook. And that outlook is to get to 0% to -2% on underlying revenue [excluding transit], to improve EBITDA, to improve cash flow. But, as we always say, and no presentation from BT nowadays would be without it, there is always more to do – and for the rest of the year, we'll absolutely be doing that.

Thank you very much. We'd be delighted to take questions.

Question and Answer Session

Andrew Lee
Goldman Sachs

I've got two questions. One on Global Services and one on Retail.

In Global Services, Colt and Cable & Wireless both had weak results in the UK corporate market, and the latter blamed more aggressive BT pricing than expected, why do you think you seem to be currently winning in this apparently difficult market? And are we missing that you've reduced your cost base significantly which is enabling you to price more competitively? Any colour on that would be helpful.

And then on Retail, just earlier, TalkTalk was highlighting on their call that customer churn is starting to significantly reduce. Are you seeing any impact on your customer intake? Thank you.

IL Right. I'll pass to Jeff about UK corporate in a second, but I'll just give you my overall view on that.

We're doing better. You know, I mentioned, however, our profitability is increasing in the UK. So, it's always strange the way people sort of want to blame other people for things. We think most of life in business is about self-help or self-harm. And, in our case, we weren't as good as we could and should have been, I think, in the UK a few years ago and we lost some business and we're starting to win it back. So, I think we're doing better. I think our propositions are stronger and we're doing a better job. But not as well as we intend to do going forward. But Jeff, do you want to talk about the UK?

JK Yes, I think probably, to mention number one, is we are more focused on certain aspects of the portfolio – UK products being one of those because it's our core business. Cost improvements there have helped us, I think, in the competitive situations where we price more aggressively. We've also changed the sales plan this year. We have implemented new sales plans to emphasise TOV (Total Order Value) less and revenue growth year over year and new acquisition of business in the UK more. So, you might see a mix in our TOV there, but to all intents and purposes, we're going after revenue growth in gaining back share that we've lost.

I think also some of the infrastructure improvements that we're making in the UK, we're also bringing that through our product portfolio and that's helping as well.

IL And the aim, as with all our business, is to have profitable growth. So, it's good to see UK profits increase.

I'll ask Gavin if he wants to say anything about the UK broadband market. You know, bear in mind guys, it's four weeks since we reported the results. So, we're not going to comment on what's happened in the last four weeks in the marketplace. You'll just have to wait and see the joys of next quarter as to how we've performed.

But Gavin, do you want to talk about the market just generically?

GP Yes, sure.

I think the TalkTalk comment was that towards the end of the quarter they'd seen an improvement in churn. We haven't seen any impact on our ability to acquire customers, be it from TalkTalk or anybody else in the market. Acquisition remains strong through May and June on both brands, both BT and Plusnet.

Robert Grindle
Deutsche Bank

The trade press has suggested you are upgrading your network to cope with broadcast IPTV. Is that right and would you be able to get rid of the digital terrestrial multiplex at some point?

And then, secondly, please, what is the latest on the duct and pole trials and the prospects for any agreed reference offer anytime soon? Many thanks.

GP

Multicast is absolutely on our roadmap, as we said. I don't think that's instead of DTT. I think that's as well as. You know, I think the main broadcast channels probably will be best run with broadcast, but there'll certainly be other linear channels which will be provided over wires effectively. And it gives us real optionality, and in fact the optionality to combine different types of offers.

What we've seen generally among customers is things that they don't have to watch live, more and more, they're not – they're watching it on demand when they want to. But clearly things like sport and sort of events like X Factor, they will want to watch live. So, I think the UK is in a very interesting position and it seems when I talk to a lot of technology companies around the world, they see the UK in this way – which is that combination of DTT and fibre coming together, and it's one of the reasons they're very interested in YouView.

On duct and pole, I'll ask Liv to comment in a second on it. I mean, we are working hard on the duct and pole trials. I think the question is can we come to an agreed reference on it? We will base our pricing off our cost base, and we've already said our pricing is better than the European average. I can't speak necessarily for whether that fits into other people's business plans, but what certainly our reference offer cannot do is solve other people's business plans that are uneconomic. But Liv, let's see how it's going.

LG

Yes. So, what we said we'd do is that we would look for people to trial with us. We've got three parties signed up to trial, and we only actually received the terms from all three of them recently, but we've got those terms and we're waiting for them to begin the actual dig, so, they're surveying.

As we've said all along, the state of ducts in the UK is not exactly perfect. And some of the early surveys showed blocked ducts. So, people are now surveying new routes - that's happening at the moment.

We would hope that they would begin to do the actual physical dig activity maybe even as early as over the next couple of weeks. And as soon as we've got early results, we will issue revised prices, as we've always said.

So, I'd say, certainly not before September, but I would imagine early September is when we'd hope to have the results from the trials; and we would then issue some revised prices.

Paul Sidney
Credit Suisse

Just two quick questions, please.

S&P recently raised you to BBB. I was just wondering, how should we think about how that impacts your thoughts on distribution going forward, and how much do we think about particular timing on any

communication you make on distribution following that announcement?

And secondly, a very hypothetical question, but if the triennial review on the pension scheme at the end of the year decides that your scheme is in surplus, could you just confirm that the top-up payments would stop immediately from that point? Thank you.

IL The danger with hypothetical questions is you might get real answers. Look, I think it's too early to speculate as to what might happen on the triennial. You know, we've got to see what happens there.

You know, in principle, would one pay additional contributions into a surplus scheme under the actuarial valuation? I would find it difficult to understand why one would. But I think, as you said, you know, we're talking hypothetical questions at the moment.

So, that deals with that. In terms of the BBB upgrade, I don't if Tony wants to add anything. Look, we were expecting to receive it at some point. We never should have gone down in the first place. And our aim remains to be BBB, BBB+ - you know, it's positive that S&P recognise, I think, the financial strength of the company. But it doesn't really change what we said in May - you know, people can look forward to a progressive dividend. We obviously have to be clear on the pension, but we have a very well covered dividend on one side, and we recognise that, and we're very confident of our future. And we'll also be prudent, prudent guardians etc. But shareholders, certainly in the meantime, whilst we get clarity on some of these points, can look forward to a progressive dividend.

Wilton Fry
Merrill Lynch

Three interrelated questions, if I may.

If you could give us some colour on the amount of overlap between your fibre rollout and the cable footprint.

Secondly, do you expect yourselves, BT Retail and Wholesale, and your wholesalers, to ultimately take share from cable given what it does effectively to your speed and price relative to Virgin?

And thirdly, can you give us an update on any conversation you're having with Sky around wholesaling fibre? Thanks.

IL Right, on the last one, I don't think it is fair or reasonable for us to give an update on another company's discussions with us. And I believe Sky are announcing tomorrow. So, best ask Jeremy, I'm sure he'll be far more willing to give you an update on his company than I should.

On share, I don't want to predict the future, but we can look at the last quarter and that's exactly what did happen. We did take share from cable. You know, for every broadband customer cable lost, we gained twenty on our network. So, that was a pretty clear net gain.

And effectively, we've seen that happening over quite a long time. You know, who knows what's going to happen in the future. We recognise cable is going to be a difficult competitor, but, as I said, we are gaining share from cable – and quite well last quarter.

In terms of fibre and cable overlap, Liv, anything you want to say about that?

LG

I mean, we went to three different areas, if you remember, in our early pilot deployment. We decided to try some rural as well as just urban. We also went to some of the big urban city areas, and then we also said we'd try market towns. And I think so what you can expect in our early phases is where we're typically in the urban areas, there's a very strong crossover in terms of dense populations. Clearly, when we're trialling out places like market towns and more rural locations, then it's just us. So, it's a bit of a mixture in the early days.

As time goes on, as we build up towards the 66%, then we've taken learnings from that, and we announced about a year and a half in advance. And if you were to fast forward through the announced phases, there is a higher crossover going forward with some of the cable areas. But it's by no means a perfect match because we believe that we can take different customers on a different journey, and that's the path that we're on.

Nick Lyall
UBS

It was just a couple of questions on the consumer situation please.

Because of Sky's comments and also a weak consumer...have you seen any notion at all in your churn or any of the numbers that pricing may now be difficult to increase for the Retail business?

And secondly, on the consumer, any effect at all on the fibre plans or take-up? It doesn't look like it, but, you know, given the extra price of the product, have you seen any effect at all? Thanks.

IL

Look, customers are looking for value; and they see value in the BT product, it would appear. As they should do, because what we've done is we've put a lot of value into our product. You know, one of the things I want to be really clear about because I know some people seem to have misunderstood this – is that Plusnet represents well under a fifth of our net adds. So, you know, whilst Plusnet is a very good, very price-led, cheapest standalone product, actually we're seeing the vast majority of the increase in our base coming from BT Total Broadband; and the numbers speak for themselves on fibre.

And, we are pricing fibre very aggressively, quite intentionally, because we want to get people on fibre. We make a better ARPU from fibre because people are choosing the higher level. So, what you're seeing is sort of pricing fibre is very comparable with our top range of DSL, but actually, because of the mix, we're seeing an increase in ARPU.

And, of course, people are choosing bundles; and you can see... what's our summer sale offer just now, Gavin?

GP £16 for broadband and all-you-can-eat calls.

IL So, a bargain. And I know things are tough in the City, so £16 for broadband and calls – that's one to go for. And in all seriousness, these sort of promotions, where we're bundling things together, seem to be having an impact for people. And they also like, I think, to see the price certainty that comes with a lot of these things, because it includes things like 0870 and 0845 calls, unlike a number of other players and I think that's also playing to our strengths.

**Steve Malcolm
Evolution**

I'll just go for one question if that's okay. On the cost base.

I take on Tony's points about process reengineering and on other stuff that's driving cost control, but I guess the biggest driver is still the number of people you employ and what you pay them. And the sort of standout cost number to me was the direct costs, which have been running sort of flat year on year and they were down 6% this quarter – which is still a very good performance. Can you just give a bit of colour into how you achieve that? Because as far as I can see, there's no compulsory redundancy scheme you've got, you had a 3% wage settlement, you've got rising NI contributions. I guess, offsetting that, you've got some pension cost reductions. So, it feels a little counterintuitive, but it would be helpful just to understand the dynamics behind that cost reduction. Thanks.

IL Thanks for that. There is an element of which the indirect and direct sort of numbers bounce around a little bit depending on whether we've got temporary people in to go and help with work stack and things like that. And I think some of the underlying performance last year in direct was somewhat hidden by increased pension costs, for instance, that aren't the case this year.

And to a large degree, we like to look at total labour costs when we look at things. We did pay people more, I should add. You know, so it's not wage reduction; quite the opposite. But it is about greater efficiency. But Tony, do you want to talk in a bit more detail?

TC Yes, just a couple of things, I think.

If you look at our gross direct labour costs, they'll go down between 1 and 2% each quarter sequentially. It will, as Ian said, bounce around, because, in some instances, we're in-sourcing work from our indirect labour; in some instances, we're renegotiating rates on indirect labour and passing that through in terms of direct labour on transfers.

But I think the key point though is, and Ian said this directly, if you improve the customer experience by improving the way we're providing customer service, taking out the cost of failure and reengineering the processes, there are plenty of opportunities. The key point here is Retail's being do this for six years. And, you know,

Gavin and I have a number of discussions – there are still further opportunities within Retail.

And while we're not into target setting now (he's nodding his head here), the reality is these cost reductions will continue. But don't get fixated by direct labour costs. Don't even get fixated by labour costs, because there will be swing items between the different headings.

Steve Malcolm

Yes, but I mean, is it just absolute number of people in the business going down? Is it a mix thing? I mean, you've obviously got the headwind of the salary increase. It feels like the leaver costs last year were down very sharply and the rate of reduction should be kind of slowing, yet you're actually delivering very good numbers still. I mean, any more on that?

TC

Yes. Look, there will continue to be further reductions on our total cost base. The key piece you're making about direct labour costs is we're not fixated about the number of people in the business. The key piece here really is the value of what those people are providing – value for money. So, you know, we're focusing on ensuring that the people that we've got within the business deliver value for money without focusing specifically in terms of the number of people.

In terms of your question, 'Is this going to continue?' we will continue to reduce our total cost base. Don't get fixated by direct labour.

Steve Malcolm

What you're saying – it's kind of mix? You know, the absolute numbers may not reduce much, but there's, you know, people that are not producing that are maybe high cost are coming out. Is that fair?

TC

Yes. Absolutely.

**James Ratzer
Newstreet**

I'd add two questions, please.

The first one was just regarding your overall revenue target. You suggest in Q1 that you were running a bit below that target and you've mentioned that the bank holiday had a bit of an effect on that. I was wondering what other areas you could talk about that give you confidence that the rate of growth is going to accelerate through the year. What kind of specific items we could be looking at to drive that?

And the second question I had was just regarding your Infinity net adds. Clearly, you've had a very strong performance in the quarter. Are most of these adds coming on at your new discounted package of £18 per month? I'm just trying to get a feel of whether Infinity's actually being accretive to your existing ARPU at the moment. Thank you.

IL

Infinity is accretive to our existing ARPU. We're seeing quite a bit higher ARPU on Infinity. A number of pounds higher per customer. I won't give you the number just yet, but suffice to say we are very comfortable with that. So, Infinity is fine.

In terms of revenue, yes, we're expecting improvements. I think Global Services... I think as we said, translating some of the stuff into revenue and the way some of the contract recognitions happen. You know, Q1 is very consistent with what we expected. So, from our point of view, Q1 numbers are no great surprise in terms of revenue. And actually, they're no great surprise in terms of that we're pretty much bang on consensus.

So, this is very much steady as she goes, pretty much expected. And we would expect to see through the course of the year an improvement. And, of course, you would want to see that as well – and I can't guarantee that it's absolutely smooth quarter by quarter by quarter, but you would absolutely expect to see that because the following year, we're moving to 0 to 2%. So, you need to have your exit run rate going in the right direction.

So, no, it's very much steady as you go.

And the one thing you've got to look at with all these numbers when you talk about year on year numbers, you've got last year and you've got this year. And, within a quarter, you can get some volatility in trying to get these things down to the nearest ½% - it's a degree of accuracy that I think all of us probably would struggle with. But the direction of travel is absolutely right and we're very comfortable with the guidance we've set out.

JR And the biggest drive of that improvement would come from Global Services, you're suggesting?

IL Well, certainly, it would be one of the drivers of that improvement.

Carl Murdock-Smith
JP Morgan Cazenove

Just a quick question on YouView.

Last year around this time, there were lots of Sky Sports adverts from yourselves advertising your BT Vision package, and the message was very much that you were going to be here year in, year out for the long haul. It's two weeks until the Premiership starts. The advertising has definitely been more muted this year. I was wondering is it a conscious decision to hold off until maybe a Sky Movies resolution and until you have YouView? So, any colour around that would be great. Thank you.

IL I don't think we're holding off overall with Vision. I think that's an important thing. We did have to establish ourselves as being someone who offered sport, and that was important. I think, as we talked about last year, we didn't think that necessarily the execution was probably outstanding in there, but we did have to establish ourselves, which we did. But critically, what was important was the overall vision, and in fact actually, overall broadband. And, you know, I can put a really big tick in the box for broadband. I mean, as I said, this quarter, including cable, best ever. In terms of Vision, it's been a very solid 24% growth, and that compares very nicely with other TV companies. So, I think you're

going to see continued, steady growth. New propositions coming in, which are advertising for instance our new Essentials package. There are going to be further enhancements to the service. As you say, when YouView comes in, I think that will present new opportunities; and there'll be a huge amount of marketing spend effectively from the YouView partners as well.

One of the things that's always been tough with Vision is, to a degree, we're on our own in terms of explaining to customers what it is and what it does. When they got it, they really liked it. But with YouView, you'll have BBC, ITV, Channel 4, Channel 5 all in the mix, and that's going to be very encouraging – very much in the way it has been for Freeview. But Gavin, do you want to add anything?

GP No.

IL Okay. That's pretty much where we are. So, continued, steady progress and we are looking forward to YouView coming around.

**Andrew Beale
Arete**

You saw a decline in unbundled loops this quarter. Can you talk about the drivers of that trend change, including obviously how you see Infinity impacting your competitors? Thanks.

IL Yes, well, that trend change – it's made up of two factors going in different directions. The big factor that caused the trend change is that Orange have moved on to wholesale to run their broadband service. And I think they're seeing significant improvements in service as a result of that. So, that's the change that's going on at the moment.

Against that, actually, we've seen continued, quite strong movement to LLU by other providers. So, ex-Orange, you would see something different. And, of course, the other factor I should mention in terms of overall numbers is the success of BT Retail. So, actually, what you've seen is the key non-LLU business doing particularly well. So, I think those are the key changes, overall, in the mix.

Andrew Beale And how much was the Orange effect on LLU numbers this quarter roughly?

IL I'm not sure we're desperate to give individual numbers, but actually, it was a big movement. You know the Orange size of base, and most of the base has now migrated. So, it is a quite significant measure, some hundreds of thousands in the quarter. A few hundred thousand in the quarter.

**Guy Peddy
Macquarie**

Just a quick follow-up question to earlier.

How many of your 200,000 Infinity customers are getting high-speed broadband for the first time?

And secondly, a bit of a cheeky one, on the Global Services, you talked about new business sign-ups sort of accelerating the revenue

trend. Can you talk about the margin profile of new business relative to retention business? Thank you.

IL In terms of Global Services, all business we've got goes through clear return processes, and I think it's always been one of the strengths of our processes. The new business we're taking on, we're very clear about. So, you know, I think there's not particularly any commentary I can give on that.

In terms of Infinity, how many are new to high-speed broadband? Well, I think most of them will new to high-speed broadband on the basis that unless they were one of the very few customers that are actually on Virgin's high-speed network, they'll be new to it. But I don't think too many of those on Virgin's networks – I've got to guess that almost all of them – are going to be new to high-speed broadband. And they really like it and they're seeing very high speeds. One of the things we're noticing is that they're particularly liking upstream speeds. The fact that they're getting upstream speeds – you know, 10Mbps – is actually a bigger multiple than a lot of the downstream speeds. And the world we're in today is becoming a lot more symmetrical.

But if your question was 'Are they new to us overall?' we said about a third of the customers now coming on to Infinity are new to BT Retail.

Simon Weeden
Citigroup

You mentioned earlier, going back on the fibre questions really, that you see 50% better growth in areas with fibre but not within Market 3. I think that was my understanding of what you said. Could you just clarify what you mean by 'growth' there? I presume you mean gross adds, but I'm not sure if I've got that right.

IL Net adds. So, if you said, that we grew, let's just say on average, by 5% of our customer base in Market 3 in a particular quarter, it will be 7.5% in the areas with fibre. So, that's what I meant.

Simon Weeden Okay. Got you.

IL Yes, so I apologise if I said that clumsily, but you've got exactly what I meant.

Simon Weeden I'm with you now. That's great. Thank you.

And the related questions. I just wonder if you could describe in broad terms, without obviously giving away any commercial secrets, quite what your marketing process is. I imagine there's a point at which a neighbourhood is fibered up and that fibre is released to the marketing division by the network. What's the marketing process there? And would you say that your Retail marketing folk have learned how to sell fibre against cable over the last sort of few months of practice? And how would you describe that?

IL If you actually look at our net adds on the base of fibre that existed, last quarter, I commented actually pro-rata, we were selling six times

as many fibre connections as cable were. So, I don't think it's the case of learning; I think we've been doing a good job from day one.

And in terms of our marketing, I think a couple of layers I'll just say. First of all, creating an overall brand for Infinity is important, and we've putting investment for a while into the brand building. So, we find customers asking us for "Infinity" now. It's become the generic name for a lot of fibre... And that's important. That was a very conscious decision. You can get fibre from anyone – you can only get Infinity from BT. And I think that's encouraging.

And then, we overlay that with a mixture of direct mail, local marketing. And also, things like people pre-registering and showing their interest and just general advertising. But I think, it's very much a multi-layered approach. And word of mouth has also effect, because I tell you, when one person has it, they are talking to others. You know, we're still in early days. So, be clear – it's still a fairly small proportion of our base, but what's encouraging is the rate of growth has increased and it certainly seems to make an overall impact on our overall market share and our Retail business.

Chris Alliott
RBS

A couple of quick questions from me.

Firstly, in Wholesale, I wonder if there's any chance you could give us an indication of how big those migration costs currently are of the sort of total cost base? I guess, in the course of a £700m of cost base, I wonder what those migration costs might be in terms of percentages, just thinking about how that flows through for the rest of the year.

And then, secondly, in terms of, your confidence on the top line, I'm just thinking about how that sits against the concerns of a weaker consumer and a weaker economic environment. Do you feel pretty insulated against that weaker environment to give you the confidence on the revenues? Thanks.

IL

Thanks. On Wholesale migration costs, one of the things you've got to bear in mind... I mean, we're talking about differentials of a few percent here against expectations. So, the answer is they're some single digit millions higher than we expected per quarter and it will carry on for a few quarters. And it's small single digits at that. You know, we were talking about year on year movements and whether you're talking about... I think consensus was something like -7% on profits, and we came in at -9%. It's fairly small parts of that, and of course, it is only one part of it.

So, the answer is low single digits, but it will carry on for quite a few quarters.

In terms of top line, I think it very dangerous for any CEO to say the economy has no effect on our business, and, you know, some of the countries we operate in, it obviously creates more headwinds. But what is important for BT overall and remains – you know, absence of meltdown is what we do ourselves. And if you took areas of our

business, particularly where we've got low market share – you know, enhancing our market share and creating new products and services is more important than just the market growth.

So, are there headwinds? Yes, there are. We also did expect headwinds. We're not banking on a massive wonderful economy, but we're exposed also to some high growth areas, both in terms of products and also in terms of global areas that we operate in. We'd love to see a better economy than we are, but in the meantime, we get on and run our own business better. And self-help, as I said, is really important. So, thanks.

**Jean Francois
Credit Agricole**

A very quick question looking at your net debt to EBITDA level, which is standing at a very strong 1.6 times, followed that for three quarters in a row. I'd like to ask your views on where you would expect... Are you comfortable with that level or is it something that you think you should further improve? Thank you.

IL

Yes, I think that when you look at our net debt to EBITDA, and more importantly, as the rating agencies look at it, yes, you've got to remember we've got some operating leases and also pension that has to be added on.

You know, to be honest, we're not particularly targeting a net debt to EBITDA level. It's very much more we want to be BBB, BBB+; and, we know full well with the rating agencies, different environments set that at different levels. We will see our debt reducing overall. I mean, if you look at the cash we're generating and you look at what goes into pension schemes, pays out the dividends, there's a decent difference. So, you know, I think we will have a lower level of debt. But actually, we've got lots of room (we keep on saying to this), given the confidence of the future cash flow, to pay increasing dividends, to continue the sort of strong investment profile we've got, contribute to the pension scheme and pay down debt. So, it's not an either/or in any of these things.

But I think, you know, we're a pretty conservative management, and you'll see a gradual... You know, if you look at the long-term trend, I think it will be a gradual decrease in that ratio...

Jean Francois

Sorry, can I just follow up on that? Does that mean that the main variable that may affect of that level is actually the situation on the pension scheme?

IL

It is one of the inputs. I was just making the point you can't just look at pure debt to EBITDA on its own. You have to look at some other factors.

Tony, do you want to add something?

TC

Yes. Look, the rating agencies, as Ian said, add to the debt number the operating leases, as well as the pension deficits. The range they want to try and operate on – and they calculate it differently – is roundabout between 2 and 2.5 to 1, to try and get a rating between

BBB and BBB+. We'll operate within that range, which means there are still further things that we need to do in terms of improving our ratio. And that will be basically in terms of improving the EBITDA as well as reducing the debt.

IL Yes, as Tony said, one of the best ways to improve the ratio is to improve EBITDA and that's what we also said we do.

Jerry Dellis
Jefferies

Two questions, please.

The first one on Retail revenues. I think consensus has got an improving revenue trend on Retail – something like -3% and filled in for a full year this year; -1% for next year. Given that you've been tracking in the range -4% to -4.5% for the last couple of quarters, I wonder whether you're still anticipating an improvement in that trend, and what quarter do you think we could start to see that kick in?

And then the second question is just on Infinity. I'm wondering about the 70,000 adds you've posted in the last quarter. Do you feel you're fulfilling all the demand that's out there or is there a constraint on your ability to connect consumers in volume? And if there is, I just wondered whether you could explain what that might be and when that constraint might loosen up. Thank you.

IL There's not over time a big constraint on Infinity. So, I don't think that's the major factor. You know, I look forward to there being constraint because that means we're doing a lot more, but certainly if we have a sudden surge in demand, that can be an issue. But, you know, I think, over any three-month, four-month period, you can react to pretty much any demand level. So, at the moment, no, I think we're in pretty good shape in terms of being able to meet.

If there was, you know, much higher demand for fibre generally across the network, then Openreach would have to react. But we're not going to carry lots of spare engineers if we don't need it. But I think with a wee bit of notice, it's amazing what we can do.

In terms of quarterly trends at individual level for LoBs against consensus, I think, as I'm being told my Investor Relations man on my right, it would be inappropriate for the CEO to give further guidance over and above what we have done. We said the trends are going to improve and that remains the thing.

Nick Delfas
Morgan Stanley

I wonder if you could give us an idea of when you think the first BDUK tender will take place and if you have any indications who may be interested in that besides yourselves? And I don't think you've given it on the call, but have you got any update on YouView launch timing? Thanks.

IL YouView launch timing – I think we'll be looking at Spring. So, I'm glad to say that's it's under a year, not the standard answer of 'around a year'. So, we're making progress. I think Lord Sugar as chairman has certainly helped drive that forward.

On BDUK, a little bit of that is, we'll see, but I'm sure Liv can give a little bit more detail. Because there has been some real progress in BDUK in funds being allocated. But do you want to talk about some of the dates? I mean, you may have to ask BDUK who the competitors are. We could probably only speculate, I would guess.

LG

Yes, so I think there are two that are advancing quite well for BDUK and one that's kind of slightly outside the process but is becoming badged as BDUK. And that's Wales. So, then the two that are advancing at speed anyway is the North Yorkshire bid and the Cumbria bid; and both of those are in dialogues, they're beginning to have financial conversations with the various bidders. And as I understand it, there are probably four to five bidders being selected moving to the PQQ stage for each of those.

Wales is probably the one – although it was outside of the BDUK but has now had, as you know, the £50ish million handed over or allocated over the course of the last couple of weeks. So, I think it's becoming badged as probably the fifth of the early pilots. And the decision making there is expected before Christmas. So, it's kind of like a lead-up to Christmas decision-making situation.

IL

Yes, I would say generally with regional bids, one of the things you see is the big difference in our performance, for instance in Northern Ireland and Cornwall in terms of the speed of the actual delivery compared with a number of other areas in the UK where money was put in and other people stepped forward claiming to do things, and frankly, the citizen is not benefitting. They're not getting services, and I think people are seeing that. And that being said, and I'll just say it right now, I don't think we'll win every BDUK bid, I just think that is the way of things. But we think, you know, our ability to deliver is clearly very superior and we've been doing this for a while.

Some of the stuff is not straightforward, and experience and capability will count for quite a lot in delivery. So, we'll bid, we're keen for it, but I think just be practical – if there's a dozen bids, we won't win all of them.

**Stuart Gordon
Berenberg**

A couple of questions.

First of all, you spoke about improvements to your network that could double the Infinity speeds, and there were a few processes that you had to go through. Could you give us an update on how they're going?

And secondly, just kind of a follow-up to an earlier question, clearly chasing revenues in Global Services... Now, you do say the processes are in place to ensure that they meet return hurdles, but the same could be said about Global Services when you were growing revenues aggressively in the past. Could you just give us some guides on what process changes you've made to ensure the same pitfalls don't befall those revenues this time? Thanks.

IL I'll ask Jeff maybe to comment on the 'clearly'... We're not clearly chasing revenue. We're clearly chasing profitable growth, that's for sure. And maybe I'd ask you to look at our profit and cash flow performance of the Group to give you a general feel for maybe a change in BT in how it delivers. But, Jeff, do you want to talk about some of the processes we go through to deliver profitable growth?

JK Sure. The process we use, it's a blend of EBITDA performance and cash flow performance, what areas of the business we're selling into, whether it's geographic, overall risk profiles; and we look at the equality in those parameters. Over the past two years, we've implemented common solution centres. We have three of those around the world, and what you get out of those in the more complex deals – and they all go through that – are more consistent solutions that we can rely on and that have less risk profile to them.

And then an account start-up unit that gets us more consistent, coupled with what we call an 'IRT' team that looks at deals once we implement them – and it's an independent review team. So, all that comes together in what we call our 'overall risk management' approach when we implement deals. And I'd have to say, sitting here, there are probably three that I can remember off the top of my head where we chose not to pursue because those things didn't come together.

IL Okay. Thanks, Jeff.

On the band plan change, first of all, we have to agree this with industry, and we're making good progress on that. But it's still being discussed with industry. Then, we have to test it, roll it out and be able, as we say, in our terms, 'consume' it. All of that, you know, we have a very good degree of confidence, and unless there's a major problem we haven't expected, to have it done by the end of 2012.

So, I think next year, we'll be looking at not just downstream speeds going up to 80Mbps, but I think also very important upstream speeds going 20Mbps, maybe even slightly higher than that. And that will be a multiple for instance of the cable network on upstream speeds. And we are seeing, as I said earlier, customers find that very important.

**Maurice Patrick
Barclays**

We've focused a lot on cost reductions, whereas in Openreach this quarter, your costs went up by 4%. Just curious to understand whether that's all fibre-related, the element to which the cost increases are external rather than internal costs and also where we are on the cost time to install on the Infinity base. Thank you.

IL I mean, I'll give it to Liv to comment on why our costs went up. It's more volume. Particularly engineering volume has been a key thing. Also, some elements of clearing. We have been bringing down our work stack and that's been important. And yes, we are doing a lot of Infinity. But, Liv, do you want to...?

LG The other dynamic was the extra leavers. So, we did fast track some leaver payments during the course of the quarter. And that definitely will help us going forward. But I mean, the volume is a major increase for us. That's a good news situation. So, if you're going to grow copper, you're going to spend more volume and it's a combination of those couple...

Adam Rumley
HSBC

I just wondered if you could comment on the progress you're making with fibre-to-the-home? I guess you're now about a third of the way through the complete rollout for fibre and I just wondered, you know, the kind of timescales you're thinking about at the minute. Thanks.

IL We are making progress, ask Liv. It's tough going, I've got to be clear on that. But we're making progress and more areas are being rolled out. And clearly, as we go on fibre-to-the-home will represent a bigger proportion of the mix than it does currently. But Liv, do you want to talk about the roll-out areas and how many areas we're rolling it out to etc?

LG Yes. So, what we decided to do when we were doing fibre-to-the-home is, we could have just gone one for type of area and we could have probably got some high numbers on the board quite early on, but what we realised is that our view is that if you're going to do 66% of the UK and beyond, ideally if we're in the BDUK bids as well, then clearly you need to have a formula that you can do at scale across the UK and every different type. So, we chose to go for different pilot areas. So, York, Leytonstone, Cornwall, St Austell – they're all very different places. And that gave us a chance to see what FTTP looks like in different parts of the UK.

It looks different, but it looks tricky, I guess, in lots of those, to begin to work out the perfect process. And I think we're still working out that perfect process. We've made tremendous progress over the course of the last six months, I'd say, with working it out. At the same time as making sure that we're clear on the fact our customers want speed fibre now, which is why we've been making sure that we can give FTTC as quickly as possible across the UK.

A couple of recent innovations we've made... I know these might sound not very exciting to the rest of you, but they're very exciting to me. We've got a new spade, and this new spade allows us to dig just literally next door to a pole; and it means that if you're doing a pole version of FTTP, you're actually able to do it much quicker because you don't need to do a separate civils dig – it can be done there and then by the same man. This special spade can cut through tarmac and is a genuine innovation in the marketplace. So, that's one I've highlighted as a highlight of my quarter.

And the second area I think we've worked out is you can also do the same areas, you can do a very good mixture of FTTC and FTTP, and originally, we were like 'you're either one or the other' – we've worked out a much clearer, much more efficient, financially and effective process for us operationally to be able to do quicker fibre in areas by doing a mix on a street by street basis. And we're doing

that in Cornwall right now in conjunction with the deal we've got down there. So, there are a couple of innovations for you.

IL

Well, that just goes to show how quickly someone can move from being a strategy director to her special spade.

And I think I'd also say it's got to be remembered, of course, with FTTC, we're bringing fibre effectively within about 400 yards of the home; and that also, you know, presents some future opportunities. But we will see that greater mix.

So, with that, thank you very much everyone for the questions. Thank you for being on the call at a busy time. And can I just finish by wishing everyone a very good holiday if you've not been on holiday. And if you already have, well, tough. But thanks very much and I'll speak you to a few months' time. Cheers.