

BT Q3 2012 Results Presentation

Attendance List: Ian Livingston (IL)
Tony Chanmugam (TC)
Liv Garfield (LG)
Gavin Patterson (GP)
Jeff Kelly (JK)
Nigel Stagg (NS)
Catherine Nash (CN)

CN Thank you and welcome everyone. I'm Catherine Nash, IR Director here at BT. 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 for the third quarter and then Ian will go through the lines of business. We'll then hand over to you for questions. In the room with us today we also have the chief executives from all our 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 20-F for examples of the factors that can cause actual results to differ from any forward-looking statements we may make. Both the slide and the annual report can be found on our website.

And I'll now hand over to Tony.

TC Thanks Catherine.

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

We've had a reasonable quarter in a challenging economic environment, with results broadly in line with or slightly ahead of expectations. Revenue in the quarter was down 5%. This includes the impact of transit revenue, which fell £109m in the quarter. For the year to date transit revenue was £345m lower.

In terms of our more relevant measure, underlying revenue excluding transit was down 3%. As anticipated, this was a weaker performance than in the second quarter, mainly due to around £60m of contract milestones in Global Services which were achieved in Q2 rather than this quarter. It also reflects tougher comparatives from some of our lines of business, as I mentioned last quarter. For the year to date underlying revenue excluding transit, was down 1.8%, which is consistent with our outlook for the full year.

We delivered another quarter of growth in EBITDA, which was up 3%, reflecting our cost transformation programs. I'll say more on these shortly. Together with a small decline in depreciation and a lower interest charge, profit before tax grew by 18%. As a result EPS of 6.1p was 13% higher than last year. Free cash flow before specific items was £65m higher and this contributed to a further reduction in our net debt to £7.7bn. This is a reduction of over £900m compared with a year ago. In fact over the last three years our net debt has come down by over £3bn.

Turning to free cash flow in more detail, cash Capex was £31m lower than last year, partly due to the timing of payments. Capex in the fourth quarter is typically higher so we expect Capex to outturn in line with our outlook of around £2.6bn for the full year. Interest was £67m lower, reflecting our lower debt levels. This was offset by a higher tax due to our higher profits and as we return to a more normalised tax position.

Working capital and other were £4m lower than last year. There were a number of moving parts within this so I'll just highlight some of the larger ones. Working capital in Openreach was down after we were paid later than contracted by some operators. This was largely offset by a better working capital position elsewhere in the Group. Our regular pension contributions were also lower this quarter. If you remember, we said these would reduce this year after we made some overpayments last year.

Overall free cash flow before specific items was £65m higher than last year with lower Capex and lower regular pension contributions being the main drivers. Finally, we incurred a cash cost on specific items of £48m, which relates to the Global Services restructuring and the property rationalisation programs. The full-year cash cost for these should still be around £180m. For the quarter free cash flow after specifics came in at £586m, a £71m improvement on the prior year.

Turning to costs, we reduced operating cost by £314m in the quarter and by around £700m or 6% for the nine months. Gross labour costs reduced by £124m or 3% for the nine months. This was partly offset by higher leaver costs, which increased by £32m, as more people participate in the leaver schemes within Openreach and BT Operate. The amount of labour cost that is capitalised has come down, which meant that overall net labour cost reduced by £51m or 1%. Other costs have reduced by £655m or 9% in the nine months, driven by lower transit revenues and as a result of our cost transformation activities.

We've continued to focus on improving the efficiency of our processes, driving procurement savings and managing our suppliers. For example, we've identified annualised savings of more than £60m from our reviews of our consumer sales teams, the development processes for new products and the delivery processes for some of our more complex products. We've made good progress in the first

nine months of the year and see scope for further reductions in the next quarter, enabling the right exit trajectory into the next financial year.

Given the progress we've made to date, I want to provide an update on our outlook for the year. There is no change to our revenue outlook, but on EBITDA we now expect to hit our 2013 target of above £6bn one year early. We now also expect our free cash flow before specific items to come in at around £2.4bn for the year.

With that I now hand over to Ian.

IL

Thank you Tony and good morning to you all. As Tony said, a reasonable quarter and he took you through the overall numbers. What I would like to do is take you through the individual lines of business, starting off with Global Services.

Global Services revenue excluding transit was down 1%. As you will recall last quarter we highlighted a £60m milestone that was achieved in Q2 rather than Q3. And that's worth about 3% overall and that explains really the movement between Q2 and Q3. Year to date our revenue is flat in Global Services excluding transit. Now that hides a number of variations. We've seen double-digit growth in revenue in Asia-Pacific region. We've seen 20% plus growth in Latin America and the Middle East. So very strong growth in emerging markets, of course being offset by weaker performances in parts of Europe, which shouldn't be a huge shock given the overall economic situation.

Net operating costs were down 5%. I think it's more reasonable to look at the excluding transit number, which was down 2%. And that combination meant that EBITDA was up 2% and year to date it's up 8% overall. Our Capex was up at 9%. That number would tend to move around between quarters and reflected capital expenditure on some contracts that we were delivering. Overall we expect to achieve the circa £200m of free cash flow that we set out previously.

And from an operational point of view, I think a solid order intake, £1.6bn. It's very similar to last year and better than the previous quarter. In terms if you look at year to date, all of the year-to-date decline in order intake is due to renewals, with new contracts and growth contracts actually being very solid. We have actually seen a reduction in the length of contracts delivering that, and that has some upside because it means in fact for any £1m of contract win that more does flow into the revenue in a shorter space of time. I think again, as with revenue, I'd like to highlight the progress we've made in Asia-Pacific and Latin America regions, where we said we're investing. And the combined order intake in these two regions is up over 50% year to date.

Now turning to Retail, in Retail consumer revenue was down 6%. Now that hides a number of improving metrics that I'll talk about in

the next slide, but one of the reasons for that decline was actually due to the warmer weather. I always get nervous as an ex-retailer talking about weather, but one of the effects of not having such cold weather is you do get less calls. And about a third of the decline of 6% is actually due to a change in weather compared to a very snowy period in fact in the last couple of years.

Moving away from the weather to our business, BT Business, revenue was down 6%. All of that bar a couple of million was actually due to lower IT hardware sales. That accounted for pretty much all of it.

And I think there's three reasons why we saw lower IT hardware sales; that's hardware as opposed to services. One, of course, is economic. I think small businesses, it's one of the places first of all that they hold off on making capital purchases. But it's also an active decision by us to move away from very low-margin trade sales and that impacted our business and will do so as we anniversary this for a few quarters. However, that doesn't change our strategy of seeking to sell to end-user customers a combination of IT services, hardware, telecoms of various variety and communications. And that remains our strategy.

Overall for Retail, continues to deliver on operating costs, which have been very important. And the chart in the right shows we're six, seven years now into program of reducing net operating cost. And that is coming out very much from the efficiency programs, lowering the cost of failure in our business, and we will continue to drive that forward.

Now turning over to the operational numbers I referred to in Consumer. First of all, Consumer line loss, active line loss -- that's people who have a line and make calls -- was at the lowest level for five years at 93,000 reduction. The chart on the right shows that. It's a continuation of a trend. Obviously that's something we would like to continue.

Broadband net adds, I think it's the fifth consecutive quarter now of over 50% market share, 56%. That's about 146,000 net adds. And Infinity, we're very pleased, over 400,000 Infinity customers now and we've seen the week-on-week rate in terms of net adds up 16% compared to quarter two. So that's good and we continue to drive that forward as the base grows. And BT Vision, another roughly 40,000 net adds on top of the 40,000 the quarter before, so again doing well.

And all of these additions together drive our ARPU. Our ARPU is up 5% year on year to £337. So continuing improvement in the metrics in our Consumer business and I think particularly on broadband encouraging progress.

Now turning to Wholesale, Wholesale was very much as expected and as we've set out to you. Underlying revenue ex transit was down

3%. That's really reflecting the migration to local loop unbundling. Now of course you see higher local loop unbundling revenues in Openreach, but also this ongoing transition towards IP-based products and particularly Ethernet. And that does affect the margins and does have an impact on the profitability.

So whilst the net operating costs were down 9%, if you exclude transit they were flat. And that really is more efficiency in Wholesale offset by that change in product mix and also some network migration costs on some of our big contracts. Now the network migration costs should be finished the next couple of quarters, but we will see the continuing effect of the product change for a bit more than that. So that is very much the same picture for Wholesale.

Operational metrics were pretty reasonable. Order intake good at £340m in the quarter. Our MEAS, the mobile Ethernet sites, continue to increase. And one of the nascent businesses, IP Exchange, we've mentioned before, minutes up 50%. So it's a transition time for Wholesale, but that's something we can absolutely manage within the overall results of the Group.

On the flipside, in Openreach, Openreach's performance again was strong, revenue up 5%. The growth in the LLU I mentioned earlier coming through, but also Ethernet. Again it's the flipside a little bit of what's happening in Wholesale. And delighted to say for the second quarter running mention fibre growth because it is starting to make a material impact into Openreach's growth profile. Net operating costs up 3%. There were efficiency improvements, but there is a lot more activity going on in Openreach, particularly regarding provision activity and also relating to broadband.

Operational statistics, fifth successive quarter of line growth. And I keep being asked, why are copper lines growing? There's a couple of reasons. First of all fixed-line broadband is being seen as what people need, particularly if they've got high-intensity usage. And with video you've seen higher and higher intensity usage. But the other thing, and I think it's something about -- let me separate the UK from a number of countries across Europe -- is population growth. We are seeing more household formation and the population in the UK is expected to grow by around 5m people by 2020, and that should help the overall line position.

On fibre, another quarter with quite a number of announcements I think on fibre. We've now passed over 7m premises with fibre and the speed of the rollout actually is accelerating. Fibre-to-the-cabinet (FTTC) speeds, we expect this spring to double them to 80Mbps per second.

And we also announced our new product, FTTP on demand. That's basically in FTTC areas. Near the cabinet we can actually deliver fibre for those customers who want and need it directly to their premises, and we think this might have some attraction for some business customers.

For most people, the 80Mbps or in fact I think in the future over 100Mbps service we'll offer through FTTC will be fine for a long time. But there may be some, particularly small businesses, who want faster services. And we're testing our 330Mbps service actually in Cornwall. That will help small businesses and so we'll offer that on an on-demand basis and, to a degree, it gives the best of both worlds in terms of FTTC and fibre-to-the-premises (FTTP).

Now over to pensions. On pensions the IAS 19 net deficit was £4.1bn. Now that's gone up from £2.5bn from the last quarter. Now that is despite actually the assets rising. So the assets three months ago were £35.1bn, gone up to £35.8bn, so you've had a £700m rise in assets.

So what's happened on the other side? There are two things that have happened. First of all, on inflation. At each year we have to take the inflation rate in September and at the end of December in order to work out the pension increases. And there were some spikes in inflation, and that impacted it.

But also, and this is a thing about IAS 19, we are seeing historically very, very low interest rates and very low corporate bond rates. And a lot of that is being caused by quantitative easing and the impact of quantitative easing. Actually if you look, there are some estimates that say that quantitative easing has an effect of about 100 basis points or around that actually on bond yields. That in its own right accounts for all the IAS 19 deficit. So the real driver is actually the discount rate rather than what's happening on the asset side of the equation.

We have commenced the work on the triennial valuation, you'll be expecting. I really can't add anything more about it at this stage. It's very early on the work. So I know lots of you will have lots of questions, but I won't be able to give you dates of when we expect to finish it or progress to date. So I'll say that in advance.

So in summary, as Tony said, it's a reasonable quarter. And I think it's encouraging that we've been able to not just show growth in profits and cash flow, but also bring forward our EBITDA estimates a year forward and also raise the expectations on cash delivery. And the reason for this is despite the economic environment, self help remains the best help. And I think we're showing that in our business and our ability to deliver on cash and profit continues.

We are also continuing to invest in our business. I think you see some of the decent signs in Asia and Latin America, for instance. And also I'm very encouraged by the fibre rollout, both in terms of the rollout itself and also in customer reaction, and also the way we're able to be introducing new technology that will further improve the service and the value of the fibre.

So we have made progress in the quarter. We're looking forward to making more progress. And, as always, and I will no doubt say it

again, there remains more to do in our business, but another reasonable quarter.

With that, thank you very much and we'd be delighted to take questions.

Question and Answer Session

Nick Delfas
Morgan Stanley

Three questions. Could you mention who the operators are who've paid late? It would be interesting to know the ones who paid later than contracted.

Secondly, specific items is ticking up a little bit to £180m. Maybe you could talk about why that is.

And finally, on YouView, could you confirm when you expect a pilot and launch to occur? Thanks very much.

IL

Okay. What was the middle question, Nick?

Nick Delfas

The specific item number is going up to I think a little bit to £180m. I think consensus was around £160m so I was just interested to know why that is.

IL

Yes, I think we guided about £180m last time, Nick.

In terms of who paid late, they know who they are and they know that I think we will not take well to continued late payment. Tony, do you wish to say anything more than that?

TC

No.

IL

I think at this point, they know who they are, would be the best way to say. And no, we are not Bank of BT.

TC

One thing I'd just add to that is that, look, because it was the Christmas period it did make it more complicated, especially when the last day of the month took place.

IL

Yes, okay, and hopefully that they won't find it as complicated at the end of the next quarter. In terms of YouView, middle of the year is the answer, remains the answer on YouView. Gavin, anything to add to that?

GP

No.

IL

Middle of the year. Thanks Nick.

Andrew Lee
Goldman Sachs

Couple of questions. Firstly on the macro impact you're seeing across the Group. Are you seeing the macro pressure that you highlighted in small businesses spreading into the larger UK corporates that you serve in Global Services, and are there any other signs of macro strain in any other parts of your business?

And then just secondly on fibre pricing. Sky came out with a more rational fibre price than expected a couple of days ago whereas for Virgin the only price it didn't take up yesterday was its 60Mbps price. How do you see the UK fibre market pricing playing out in the medium term and how do you think about your price position in fibre versus your price position in broadband? Thank you.

IL

On fibre, we said we are going to be aggressive in this marketplace. You can get fibre from BT for from £20 a month. I think it's a very good offer, seems to be attractive for the customers and certainly by international comparisons it's a very good price. And I think Sky has sought to match that price. In terms of Virgin, yes, it was interesting that their supposed free upgrade has suddenly turned out to be not free within a few weeks.

And so we think we're competitive. And of course we have the BT Infinity offer at around £20. Plusnet is at £16 a month. So we're hitting both ends of the market. At the present moment we think it's a very, very good value offer on the fibre and I think that's why customers seem to be taking it up. And they seem to really like the service. And as Ofcom's speed test confirmed, getting really very good speeds and that's before we do the upgrade.

In terms of the macro business environment, I think there's -- clearly the market, the environment is worse than it might be. That being said, I think corporates generally are in not too bad a shape. Their balance sheets are pretty liquid, but they are taking longer to make decisions. I don't think particularly it's a UK feature. I think it's a global and particularly Western feature. And we've -- it's a comment we made in the previous quarter that getting contracts concluded was just taking longer. They tend to be a bit smaller. People are uncertain. That shouldn't come as a shock.

That being said, we're seeing on a global basis the places that you expect to be stronger are strong in terms of Asia and Latin America. But Jeff, anything you want to add to that in the corporate sector?

JK

I think you said in times of doubt and I think sometimes discretionary spend is the first to go. We are seeing some of that in the corporates. But I think it's also important to note that even the domestic markets in Europe, many of these corporations, the decisions made there and their investments actually in Asia and LatAm because they're expanding into those areas. So you can't look at it on a geography basis because a lot of them are investing just like we are in these emerging markets.

Robert Grindle
Deutsche Bank

Just on the announcement on the FTTP technology, what broadly is the innovation that you referred to this morning? That'd be nice to know.

And secondly on the lower regular pension contributions, you've clearly flagged that before. Are you still expecting those payments to go up next year by about £100m or has the situation improved a bit? Thanks very much.

IL

On the pensions the exact payment is still to be settled, but I think that's broadly about right.

And innovation, there's no-one better to speak about innovation - so, Liv, is it a new type of shovel or is it something else?

LG

No, there's no shovel involved. So basically the innovation, Robert, is the fact that previously we used to have areas that were either FTTP or FTTC. The innovation is the fact that now we can splice off the FTTP fibre and take it straight to the house in an FTTC-enabled area. So what it means if you're a small business, for example, is you're not thinking what type of area I'm in. Every single customer should they desire to do it will be able in an FTTC area to order for themselves FTTP speeds.

IL

And it's the ability to mix it in an individual area rather than saying we go one way or the other that I think's the big difference. Thanks very much. Next question?

Paul Sidney
Credit Suisse

Yes, I just had a couple of questions please on the UK broadband market. If you look at your 56% of DSL, LLU and fibre in the quarter, it suggests that the UK market's slowed. I was just wondering is there any reason for this in particular. When I say slowed I mean the absolute number year on year. Any sort of seasonal impacts going on there or any changes in the competitive dynamics?

And just as an add-on to that, where do you think broadband penetration can go in the UK ultimately, say, on a four/five-year view? Thank you.

IL

Difficult. Broadband penetration continues to increase. It seems to be at the core. One worries that with the difficult economic times that broadband penetration, actually growth might stop. That's not happened. Ultimately I would say if you take the longer term it seems like it's going to be such a core service that you are going to see long term growth. It's difficult to call whether you might see some sort of S curve before it takes off again; very, very difficult to call that.

But I think what's actually --- the solidity of the broadband market has been actually if anything the most interesting thing, that we've seen roughly 250,000 odd customer net adds, sorry, 250,000 a quarter, about 1m per year pretty much quarter after quarter. So I don't think particularly we see that as slowing down this quarter. It seemed to be pretty much okay. And, as I said earlier, with more households one might actually -- one expects that to be one of the drivers of growth of broadband.

But, yes, there might be a quarter or a few quarters where it slows down. We've not seen it yet. But I think I said a year ago and two years ago that and that one day I suspect that will happen. But we're still at penetration at, whilst it's over 70%, we've still got some way to go I think on penetration in the UK.

**Maurice Patrick
Barclays Capital**

Couple of quick questions. First of all on the additional copper additions that you're seeing, a sense of how many of those go straight to broadband or perhaps go to analogue first and then go to broadband afterwards.

And then on the Retail side of your Opex, minus 7% in the quarter, was that materially impacted by the lower hardware sales, i.e. you've talked about the revenue, but was there a major cost element in that 7% number? Thanks.

IL

I'll ask Tony to talk about the EBITDA. They were low margin sales, but I'll ask Tony to add anything.

In terms of copper additions, they were at an Openreach level so it's difficult to tell. You see LLU going up. To be honest, we don't really look at it that way. You do see the broadband growing faster than you see the copper growing, but the good news is the copper's still growing. But, Liv, I don't know if there's anything you want to add to that?

LG

We have seen a little bit of second lines coming back. So I guess during the heart of the recession we saw people cancel second lines and we have seen a little bit of that coming back during the course of this year, but not enough to move the dial. So we just don't check it out in the same manner.

IL

Yes, I think it's mobile-only households coming back a wee bit. But actually net-net-net the household creation is tending to flow through into lines. And actually it's not going probably quite as fast as household creation so we're creating more headroom I would think in the future in that respect.

But, Tony, do you want to talk about cost, EBITDA etc?

TC

On the Retail side, the reduction in the low margin hardware sales would have had an impact on the cost base. It affected the cost base by a couple of points. But if you look and see we took 7% of the costs out this quarter compared with 6% so if you look at the overall trend across the year it's still mid-single digits.

**Steve Malcolm
Arete Research**

I'll go for two questions. First of all a financial one. You've got about £3bn of debt maturing in the next year and a half, but it's fairly low coupon. Are you more minded simply to retire that from cash or will you look to refinance a reasonable chunk of it?

And then moving on to rural broadband BDUK, can you give us a sense of what we should look to see in the BDUK tenders over the next 12 months? There are a number of lines coming up for tender.

And also related to that maybe give us an idea of your working assumption as to when LTE might be a more credible broadband threat in markets one and two in particular where a lot of the BDUK lines will be coming up for tender. Thanks.

IL

I think that was three. I don't think that was an LTE related to BDUK Steve. On the debt I'll ask Tony to say, but I think exactly what we do on the debt depends on what we do on the pension. We are sitting on over £1bn of cash just now. We're generating cash and actually we've got quite a long profile in terms of for when our debt comes. So I think our position looks pretty stable subject to doing anything on the pension in terms of necessity to raise a bond. But Tony?

TC

There's not much to add, Ian, to that. We don't need to refinance.

IL

Yes. So and then on BDUK, there's a number of local authority bids that actually are not quite in BDUK. So you've got Wales and you've got Lancashire, they're sort of related but not in the overall framework, and they're progressing very well.

And I'll ask Liv to give a couple of comments on it, but just generally we will bid I think in most, if not all, the places. We won't win them all. I think that's unlikely that we'll win them all. There'll be competition. I think the ability of some other people to actually deliver the service I think is unproven at the moment. But given we have an industrialised machine now and that's really what we've got and it's how we're able to do pass 80,000 premises a week at the moment.

And we've got some really good experience in Cornwall and Northern Ireland and we've now rolled out to about 80% of Northern Ireland, which makes it one of the most fibre-connected regions anywhere in Europe. Cornwall is driving at a great pace and I think the relationship with Cornwall is very good and is doing a lot for the local economy there. We've now got a real track record so I think we know what to do on it. But there'll be some competition.

LG

I think, Steve, in answer to your question, we expect about 30 bids over the course of the next while. We think most of those bids will, in terms of process, will run over the course of the next 12 months. Clearly they will have different dates. So some of those will complete earlier than others and I think we'll just have to see how that works in terms of each local authority and what their major driver is. Some will focus on businesses first; some will focus on coverage first. So that's the kind of order of magnitude of bids that you can expect to see come out of BDUK.

Steve Malcolm

Liv, is there any colour on how many lines that 30 bids translate to?

LG

We couldn't tell at the moment because it totally depends on what each council chooses. Some are choosing to go for 95% coverage, some want to go for 90%, some 80%. We honestly couldn't tell you until the bids come out.

IL

We'll go for a very high proportion - exactly which areas they decide to cover and not cover remains a little unclear.

TC

Based on the bids that we've got active at the moment the coverage tends to be 90% to 95%.

LG

That's true.

IL

I think we're saying we would expect post BDUK and the other initiatives that the UK will end up getting more than 90% of the UK covered in fibre. That's really very consistent with that number.

And in terms of LTE, I think you'll have to ask some of the mobile companies about LTE. We are certainly working with them and happy to -- we've been trialing with Everything Everywhere down in Cornwall. In terms of how it relates to BDUK, I think what we would look to do in areas is you do as much fibre as makes sense. And then you look at other technology, such as TV white space, as to what it can do and then see what other technologies, including LTE, do they make sense to add. But we'll also look at the opportunity that maybe some of the rural coverage subsidies that are going to come up might offer and in terms of the fact that we're a neutral and very capable wholesaler to the sector.

So that's how we'll look at it and we'll just have to see. We don't know exactly when the bid process is going to be, exactly who's going to bid, but we'll be delighted to help anyone in rolling out this network. And Nigel, in running our Wholesale business, is nodding vigorously. He'll be delighted to help anyone.

James Ratzer
New Street Research

Two questions please. The first one is just looking ahead to your revenue guidance for next year that trends should inflect ex transit to up to 2%. Are you still happy with that trend of inflection going into next year given what you're seeing at the moment both in the business and from the economy?

And secondly, on the cost side clearly doing an excellent job on cost reduction. Should we see the EBITDA upgrade for this year as bringing forward some of the cost reduction you might have had in for next year or do you think that mid single digit cost decline can continue into the next financial year as well? Thank you.

IL

Yes James. I'm not keen at this point to start giving forecasts for next year. I think that's probably a job for Q4 as to give guidance to where we are. What I would say is we are seeing the underlying trends in revenue are improving. The environment is more difficult, there's no question about that, but the trends are improving. And also, and it goes to the cost reduction point, we've got a lot of self-help in our business. We're pleased to bring forward our EBITDA number and I think that shows our confidence going forward. But we'll probably give you more and better I think in Q4 in the context of the environment and the performance we've had in '11/12 as a whole. Tony, anything you want to add?

TC

Yes. Bringing forward cost savings for this year just gives us a greater opportunity next year to bring forward savings that are going

to take place in two years' time. So in absolute terms there should be no absolute reduction in terms of what we're doing on cost reductions next year.

Saeed Baradar
Societe Generale

Thank you very much. It was just one question. I want to know how you guys think about this issue. Given the very strong cash flows you have and once your pension triennial valuation is concluded and you've reached an accommodation with the trustees, I'm wondering are you likely to have a re-listed re-basing of your dividends, say by doubling it. This is a sector which everyone else is cutting, but obviously you've got huge room here in my view to up it. Or are you more of a proponent of more conservative step changes?

Also can you give me a timeframe in terms of news flows? When can I expect to hear more about these developments here?

IL

We said we wouldn't really look into dividend this side of sorting out the pension. I can't tell you. As I say, I wouldn't be able to give you an update on when exactly to expect the pension. So regrettably the answer to the second question is no except until after the pension.

I think one man's realistic is another man's not very well covered dividend. Look, we remain a conservative business but, as you quite rightly say, our cash flows are growing. They cover our dividends very, very well. We're generating a lot of cash. Our net debt year on year has fallen by over £1bn. So we have a lot of flexibility and what we've said is we'll talk to our shareholders. What we want to see is ongoing progression in our dividends whilst maintaining a position where we carry on paying down debt, and we think we can achieve all of these things. But we'll talk to our shareholders and see what our key shareholders are looking for and what their mix of things are, but that will have to wait until we know where we are on the pension. Thanks.

John Karidis
Oriel Securities

Firstly I'm trying to understand how successful BT Retail needs to be with fibre before the extra wholesale cost of fibre starts having a negative impact on margins for BT Retail?

And then secondly I'm keen to get a steer please on how much extra Openreach is likely to charge for up to 80Mbps versus up to 40Mbps. Is it a question -- is it the case of a few pounds or a few pennies?

IL

On the second one, the tradition is we do an industry announcement. In fact the requirement is we do an industry announcement. So we'll do that in the not too distant future in terms of giving an update as to what the likely cost of that will be. So I can't preempt that.

In terms of the Retail, I think it really depends on the mix between incremental -- the thing is when you move people to fibre a few things happen. One is you do get an uplift in terms of people going to higher price bands. So that helps in terms of the mix and that's worth a number of pounds. Secondly, you get more customers so that's good news. And thirdly, the evidence is lower churn. People seem to really like the fibre product.

So in terms of what the impact is, Retail will put their foot on the accelerator as much as they can. And of course there's subscriber acquisition cost, but, as you can see, we're managing that in the overall numbers and that's what we'll continue to do. And it would be a problem I'd be absolutely delighted to have and we are seeing good net additions. And Retail's level of additions in broadband has been something that's pushed up over the last few years and we've managed that in overall profitability. Gavin, anything you want to add to that?

GP

I think that's a complete answer.

Stuart Gordon
Berenberg Bank

Just two questions. Just on Infinity I was just wondering if you could give us some guidance on the number of new customers to BT that are coming through from Infinity.

And also if there's any way you could give us some colour on what your market share in broadband of the covered area is of the 7m homes?

And the second point is on the pension, in the absence of the triennial review being completed, which I know we all know can take any amount of time, will you still be making the remedy payment under the previous agreement in the next financial year? Obviously you've got a holiday this year. Thank you.

IL

Yes. The payment from the last time wouldn't be due til December anyway so I would hope we would have everything sorted before December. So if it wasn't, then yes we would, but without giving too much away, I would certainly hope that we'd get it done by this calendar year.

In terms of Infinity stats, we certainly see a much better performance in areas where we've got fibre than where we don't. Significantly better is the comment we made last time, that the net adds in these areas are a lot higher than they are in areas where we don't have fibre. So it's very encouraging. And in terms, Gavin, of the proportion that's new, of course with broadband you often get completely new customers, sometimes they're just setting up new homes and things like that. But do you want to say anything about the higher proportion

of new customers coming with Infinity or people who previously didn't have broadband with BT?

GP

About half are new to BT Broadband and about 20% are new to BT overall. So that gives you some colour on that.

IL

Yes, hopefully that gives you an idea. As I say, you will always have some of them being new whenever they take a service because they'll be just setting up in home. But about a fifth new I think is quite an encouraging number.

**Jerry Dellis
Jefferies**

Yes, good morning. Two questions please. Firstly in terms of the 80Mbps upgrade coming in the spring, I wonder whether you could clarify how quickly that's going to take effect across the whole of the network.

And whilst I appreciate you're limited in what you can say on wholesale pricing, I wonder whether you could comment about pricing at the retail level, whether it might be an idea to try pricing this product at a premium?

And then secondly just in terms of the March 2013 revenue outlook, again I appreciate your comments from a little bit earlier, but I guess guidance remains in place of flat to 2% growth in revenues ex transit. So I guess at the very least you're endorsing the idea of getting to flat and I wondered what you think the building blocks could be from the current run rate of -2% to get towards that next year? Thank you.

IL

Yes, look, revenue guidance, nothing changes. We'll look at the year end. As I said, the environment is clearly more difficult, but we are making improvements in the trend.

I think some of the big changes you'll see is more and more impact of what's going on with fibre helping us. But also some of the metrics show that the stuff that's declining is declining less, and that will also help. Because basically revenue growth is made up of two bits; it's how much you grow and what you don't lose, and it will really be a mixture. And I think maybe when we get to Q4 we'll talk in a bit more detail about where we are and also frankly what the environment is at that point as none of us are entirely sure of the environment and certainly the environment's worse than when we originally went.

In terms of the 80Mbps Infinity product, when we do it, it will basically be available to the whole country. So it's a software upgrade and it's something we're testing just now, and it will basically be available immediately. Liv, do you want to add anything more about its availability or does that say it all really?

LG

Yes. So the only thing to add is that you have to do an upgrade to the DSLAMS. All of that's completed so it is literally a matter of the day that we decide, and we'll obviously give notice to industry, all the technical work's done so it will literally go live across the entire base.

IL

Yes. And in terms of retail prices for that, well as Retail don't know the wholesale prices it would be really rather difficult for them to come to the conclusion of what the retail prices would be. So I think Gavin, in common with Jeremy Darroch, in common with Dido Harding, will be waiting to hear from Liv as to what the prices that they expect are. And when they do I'm sure Retail will make up their mind as to what great value offer they make in the marketplace.

**James Britton
Nomura**

I've got two questions please. Firstly, can you talk about your ambitions for the BT wi-fi division and do you think wi-fi becomes an increasingly critical part of the broadband offering for both fixed and mobile?

And secondly, does BT expect the falling corporate bond rates to further reduce the WACC assumptions which Ofcom applies in its final charge controls in the next few weeks? Thanks.

IL

In terms of second one, certainly compared to last time round, mathematically it does affect the WACC. Now what you've got to look at is what you believe the long term numbers are. So it will have an impact. But the question is will it have an impact compared to the last time they looked at this, because you've got to take this more on the spot rate and that's absolutely what we'll be pointing out to them.

In terms of the wi-fi offering, I'll ask Gavin to say a few words about it going forward. I think it's been very interesting, wi-fi. We made a bet a number of years ago on wi-fi, and you can be right and you can be a bit fortunate, and I think we got a bit of both there, we invested in hubs that could effectively create open wi-fi and do it in a very safe and secure way. And they were more expensive frankly than not doing it and it's been a long-term investment, but it's the reason that we're now looking at 3.5m wi-fi hotspots in the UK as well as the investment we made in the Openzone division.

And I think one of the reasons we were able to do that and willing to do that was actually partially because we were able to focus on fixed line and broadband rather than having a bit of push-me/pull-me with a mobile division. And it certainly has helped. It has helped the UK frankly not to have the problems with the mobile network that a number of other countries have had as a result of data. And it's also given a very good offer to our customer base of taking their broadband out and about. And we think there is more possibility to drive wi-fi further. But Gavin, do you want to say anything more?

GP

Sure. Wi-fi continues to be a critical part of our offer to our customers. We know that the customers that use it have lower churn and get a lot more benefit. So we'll continue to innovate. So there'll be significant improvements around the customer experience we'll be bringing in, in the next 12 months. In addition to that we've got a number of big contracts, particularly in the retail space, hospitality, and of course the Olympics that we'll be delivering as well. So there's a lot happening in wi-fi at the moment and we're very much at the forefront of it.

**Guy Peddy
Macquarie**

Just a couple of quick questions. Can we just confirm that there was no payment delays from a BT perspective in the quarter and as a result of that working capital should improve as some of your late payers pay in this quarter?

And secondly, just on OTT services, there's been a lot of noise about it recently in the press and I just wondered how BT Vision was going to pitch itself against some of these new entrants. Thank you.

IL

Okay, Tony do you want to answer working capital, given of course we've already given our cash flow forecast for the end of this year?

TC

We made a commitment that we will not delay supplier payments simply to meet our quarterly cash flow targets and that commitment stays. So we will get a kick-in in terms of the debt position as long as the people who didn't pay in Q3 pay in Q4.

IL

And they know who they are. On OTT, OTT services will add to the richness of services, no question about that. But one of the really important differentiators for Vision is not just the range of content they've got and the fact it is delivered to your TV, and we've spent a lot of time and money actually getting the connection into your TV set, is it's quality assured.

And that means, for instance, if you take iPlayer (which of course is an OTT service effectively), iPlayer on BT Vision, there's no buffering. And the buffering that happens on iPlayer actually usually has nothing to do with the access line, it's to do with the internet. The internet is a best-effort service and what Vision offers is not a best-effort. It offers guaranteed Quality of Service. And so you get great picture quality and that's why iPlayer has just taken off on BT Vision because it's on the TV set and there's no buffering.

So we see what we're offering in Vision is effectively a higher quality service and I think that's the real differentiator we see versus the OTT services. But OTT in general terms will add to the general thing

because it's another reason for getting broadband and we'll provide a range of services ranging from quality assured and we'll look at other options.

GP

The only thing I'd add, Ian, is we see ourselves as a retailer first and foremost. And particularly with YouView we see the opportunities for many of these services to be provided on the YouView platform into people's homes. So I see them as another reason why they'll choose our offer over our competitors'.

IL

And also another, video is another reason that people like fibre and particularly as they get to the higher speed video. So I think it's -- the more the merrier frankly, broadband at the heart of people's homes.

Nick Lyall
UBS

A question on FTTP overlay please. Just could you give us some idea even very roughly of the cost to Openreach? Is it significantly different because you're mixing in region between FTTP and FTTC than maybe a direct FTTP connection might be?

And do you assume it's just going to be ultimately too expensive for the mass market or is your comment about being interesting to SME more to do with the capacity use you're seeing at the moment?

And then second on Vision, you've got YouView coming, we've mentioned it, it's been pretty strong. But could you mention any updates again you've got on pre YouView coming in the middle of the year and is that going to be enough do you think to maintain the price premium that Vision has?

IL

I'll let Gavin talk about Vision in a second about what we've got planned that he wants to say about at this point.

In terms of the fibre product, basically this will be a product on demand and it's going to be customers who want it. Understand, for most customers the sort of speeds we'll be offering will be more than enough. And that's I think how we're saying that actually we're not sure how much demand we'll actually have. But there will be some people, multiple, multiple users, and that will tend to be SMEs, who will want it. They're some of the people who would maybe want a private circuit just now but frankly a private circuit is too expensive. But I think we would recognise there's a capital cost involved and that will have to be reflected in the pricing structure of it.

So I think net terms we're not expecting a huge increase in cost, but we think it's a really good solution to the quandary of the fact there may be a small number of people who want FTTP-type speeds, but actually rolling out a whole area could be incredibly expensive, and it just takes longer and it's far more disruptive to people's homes and

gardens and things like that. And I think it's a really good option - those who want can have it and the vast majority will be very happy with 100Mb speeds, they don't need to pay for it. But I think it will be pretty well priced and we'll have the 80Mbps coming shortly and, as I said, the 100Mbps will be something that when we do vectoring at a later stage that we will be delivering.

So no, and I think the interesting thing is just how much the FTTC speeds have improved even over the last couple of years and customers are really getting those speeds.

GP

Yes, just to say we've got several innovations coming through this year. As Ian said, we've got YouView in the summer. Before that, indeed now, we're beginning to pilot Vision 2.0, which is the next generation Vision interface with much better search and recommendation capabilities, a more intuitive interface. That starts piloting now. And then later in the year we'll start piloting streaming channels so multicasting. So we'll be able to extend our offer.

Carl Murdock-Smith
JPMorgan Cazenove

Just two questions please. Touching on your answer to Guy's question on OTT, just about the cross-fertilisation between Infinity and BT Vision, I was wondering if there are any data points that you could give us or your sense of mutual uptake there.

And then secondly, can I just ask on the balance sheet and the investments that are building up, can you give us a sense of what those are invested in and also the liquidity of those assets? Thanks.

IL

I'll get Tony to say something about the balance sheet, where we're investing, but you should take comfort that the yields on these investments is very much sub-1% so that shows they are very high liquidity, very high quality. Tony, do you want to say anything more?

TC

No, it's less than a percent.

IL

No, we're not doing the Greek bonds.

TC

I was going to add we're cognisant of what's happening in Europe. We need to make certain that those assets that we've got invested are reasonably liquid and we've done that. But the returns aren't great.

IL

And there's a cost of carrying there, we recognise that, but that's because we've gone for very secure assets.

In terms of Vision and fibre, there's not huge [cross-fertilisation] except the fact that we see where people have sub 2Mbps speeds, which is sort of the minimum you need for Vision-type services, we're seeing a much higher uptake of Infinity in those low speed areas moving to high speeds. So that's I guess the only data point, but I think more data points to follow. And of course you've seen very solid Vision performance over the last few quarters and over the last two quarters we've out-performed Sky and, well, we'll see Virgin's numbers this quarter, but certainly in the previous quarter we very much out-performed Virgin in terms of TV adds.

Fernando Delgado
AKO Capital

Just on Global Services, the first question is the contribution of Asia Pacific and Latin America to the overall revenues.

And the second one is, you mentioned the decline in volumes is due to renewals. What's driving that decline in revenues? Is it pricing, volume, competitive losses? Thank you very much.

IL

Yes, what we were referring to renewals was actually in orders that the decline was renewals. It wasn't that we were doing less well in renewals. It's just we had less renewals coming up. It's a comment we made last quarter that this year of our top 20 contracts only three were due for renewal and I think next year there's only two due for renewal. And the answer is because the previous year we'd done a lot of renewals of existing contracts so we expected that change and that's what happened on that.

In terms of the regional contribution, I think we're not going to give, haven't given any regional splits. I think what we have said is we expect to double the revenue from Latin America and see substantial increases over the next five years. And then we expect to see a lot of growth in our Asian business and both are going to be worth hundreds of millions of pounds. But I don't know, Jeff, any other colour you want to add? Jeff's saying I've done it right, so thanks.

Adam Rumley
HSBC

Previously I think you've commented on a 75/25 percent split in the fibre rollout between the cabinet and to the home. Given that you're upgrading the cab speeds from 40Mbps to 80Mbps and you're talking about this on-demand FTTP product today, does it make more sense therefore to do the FTTC roll across the whole of the targeted base to start off with to make the rollout quicker than it would be otherwise?

IL

No, it won't be the whole of the base. We're already rolling out FTTP. We actually asked for volunteers for fibre to the basement for apartment blocks. So there's a lot of places where we're already rolling out FTTP. We're going to carry on looking at the mix and looking at relative demand and look at the fact, as you say, that we

can have in some cases the best of both worlds in terms of FTTC, FTTP, and also what happens in the BDUK bids. But we've got FTTP already available to about 50,000 homes. Is that right Liv, 50,000?

LG

Yes, there's over 50,000 home available now in FTTP and I guess a good few, couple of thousand people actually live on it, not just available but actually connected. So it will be part of our mix.

IL

Yes. The final numbers will really depend on what we see in demand and degree of difficulty, and the other options.

But thank you for that and thank you everyone for coming on the call. And because it's a Friday I'll say have a very good weekend. Cheers.