



## BT GROUP PLC

### Q1 2015/16 RESULTS CONFERENCE CALL TRANSCRIPT

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Company speakers:	Damien Maltarp	Group Investor Relations Director
	Gavin Patterson	Chief Executive
	Tony Chanmugam	Group Finance Director
	John Petter	CEO BT Consumer
	Joe Garner	CEO Openreach

#### **Damien Maltarp**

Slide 2: Thanks and welcome everyone, my name is Damien Maltarp and I'm the IR director for BT. On the call today we have Gavin Patterson, chief executive, and Tony Chanmugam, group finance director. In the room with us today we also have the CEOs of our lines of business. Before we start I'd like to draw your attention to the usual caution on forward looking statements. Please see the slide that accompanies today's call and our latest annual report and form 20-F for examples of the factors that could 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. I'll now hand over to Gavin.

#### **Gavin Patterson**

Slide 3: Thanks Damien, good morning everyone and thanks for joining the call for our Q1 results. In a moment Tony will take you through the financials but if you turn to slide four I wanted to start by picking out some of the key highlights for the quarter.

Slide 4: This is an exciting time for BT, our fibre performance was extremely encouraging, our roll out continues apace, and our network now passes more than 23 million premises, that's around 80% of all UK homes and businesses. Openreach take up grew strongly in the quarter and we've now achieved the 20% take up that was our base-case assumption when we began our investment. We're looking forward to starting G.Fast trials soon with several broadband providers involved in the trials as we look to drive fibre speeds even faster.

Our mobile plans are also progressing well. Consumer mobile sales are ahead of our expectations and our proposed acquisition of EE is on track to complete by the end of the financial year. And as well as this, we're adding great content to BT TV, in particular from our new partnership with AMC. And we're also looking forward to launching our new BT Sport Europe channel in the coming days.

In financial terms it's been a solid start to the year, and on that note I'll hand over to Tony.

#### **Tony Chanmugam**

Slide 5: Thanks Gavin, and good morning everyone. As Gavin said, this has been a solid start to the year which has given us confidence in the full year outlook we've given the market. We've delivered a better performance on revenue and have continued to deliver on cost transformation while investing in the business to build a strong platform for growth.

Slide 6: First of all slide six gives us an overview of the quarter 1 financials. Revenue was down 2%. This reflects a £48m negative impact from foreign exchange movements and a reduction in transit revenues. Our main

revenue measure which excludes FX and transit was flat. This is an improvement on last quarter's 1.3% decline. Consumer delivered another good revenue performance, driven by broadband and TV. Wholesale also had a good quarter, helped by ladder pricing. With safe performances from BT Business and Openreach but Global Services was again impacted by a tough UK environment which offset the growth in our European and Asian businesses.

EBITDA was up 1%, driven by the benefit of our cost transformation programmes which I'll touch on shortly. Excluding the fact that leaver costs are now above the line, this would represent an increase in EBITDA of 2%. Below EBITDA we continue to see the benefits of our focus on more efficient capital expenditure and debt reduction. These have led to lower depreciation and interest charges which drove a 3% increase in our earnings per share. This growth rate is a bit lower than in recent quarters, reflecting an increased share count following our £1bn equity placing in February this year.

Normalised free cash flow was broadly in line with last year. Our net debt was down £1.3bn, reflecting both the cash generation in the business and the equity placing. Net debt is up £700m from March, reflecting the £625m deficit payment we made into the pension scheme in April. We spent a further £189m on our share buyback programme. We've front loaded it again this year as we have some employee share schemes vesting in August. So overall our quarter 1 performance puts us on track to meet our full year outlook.

Slide 7: Turning to operating costs on slide seven which have seen a steady reduction. This chart shows the underlying operating costs excluding transit were down 1%. At quarter 4 we called out a number of accounting adjustments and one offs that we will face this year. Firstly, as highlighted earlier, leaver costs are now above the line. These were £16m in quarter 1. Secondly we no longer benefit from the sale of redundant copper which we net against our costs. We flagged as well that our pension operating charge which is a non cash item would increase. This had a £7m impact this quarter. And we're also incurring launch costs for our Champions League coverage.

Excluding these headwinds, underlying costs excluding transit were down 3%. This is mainly driven by a reduction in our gross labour costs which are down 4% before leavers. And this is despite continuing to insource roles. We brought in more than 500 jobs this quarter. This means we've insourced almost 13,000 jobs over the last six years. This improves the efficiency and effectiveness of our services which in turn results in better customer service.

Slide 8: We still see more than £1bn of gross cost saving opportunities and on slide eight I'd like to talk you through some of these examples. Firstly we reviewed all field engineering across the group. We now have programmes underway in all our field units which will improve cost efficiency, quality and lead times. For example we're cross skilling the Openreach engineers who work in exchanges, so we can respond more quickly to outages that impact customer service. We've also kicked off a review of the way we work with our third party engineers including whether we should insource some of their work and get better economies of scale by consolidating work streams.

We've also reviewed how we design and deliver new network projects for Global Services customers. We've found opportunity to do this at a lower cost to BT, more quickly and with fewer calls. Overall we see the potential to deliver around £20m of annualised savings.

I've spoken to you before about what we're doing with our contact centres. This quarter we're focused on reviewing those in Global Services. We've looked at the end to end processes for providing new services and for resolving faults in order to improve efficiency and reduce the cost of failure. We've automated processes and we've developed standard approaches to analysing productivity and resource allocation in our contact centres. Overall we've identified around £70m of annualised savings opportunities. And we expect the changes to be in place by the end of the year.

So as you can see, we still have plenty of opportunities right across the business and these savings give us the oxygen to invest in the business.

Slide 9: Moving onto slide nine, I want to take a moment to discuss one of these key investments, our fibre roll out. When we first embarked on this multi-billion pound investment in the depths of recession seven years ago, our original base-case was for 20% penetration. This was based on international precedents at the time and was not without some risk. With 23 million premises now passed and 4.6 million users, we've now hit that original take up forecast. The combination of roll out and take up is a real success story for the UK reflecting the market wide demand for faster speeds. As such we've updated our take up assumption to 28% across the network and 30% in BDUK areas.

This is our latest view and one we will continue to monitor. We are pleased with the progress but it will still be many years before we make a return on our investment. The payback remains double digit years as we've said before. The change in take up assumption impacts our reported capex this quarter which I'll explain on slide ten.

Slide 10: Firstly, as you can see on the right hand side we spent around £660m on capex in the quarter, up around 10%. As in previous quarters, we received grant funding for the work we did in the quarter to expand our network to more BDUK homes.

This was worth £103m and implies a figure for capex after funding of £558m, up £42m year on year. However, as you may remember, the BDUK contracts have an arrangement that if the take up is better than we expected and surpasses the 20% in our original business case, we will either give back or reinvest some of the grant funding we received. Or to put it another way, we will share the success of fibre take up by rolling out to more BDUK homes for the same grant funding.

The vast majority of discussions we've had with local authorities so far indicate that the funding will be spent on reinvesting in the network. In terms of how that's accounted for in our accrued capex figures, we have a deferred figure of £100m which relates to a portion of the total grant funding we've received to date. This effectively increases our accrued capex. It's worth saying that this deferral doesn't impact cash flow in this quarter but will be gradually phased over a number of years as we deploy the grant funding income to further expand our network. The result of this is that our net accrued capex this quarter is £658m, up £142m year on year.

Slide 11: Finally I'll remind you quickly of our outlook on slide 11. On underlying revenue excluding transit, our Q1 performance of flat is a significant improvement on the 1.3% decline last quarter. It's a good platform for our guidance of growth for the full year and in the second half of the year we'll benefit from the launch of our Champions League coverage. EBITDA this quarter is up 1% and we still expect modest growth for the year. And we expect normalised free cash flow to be around £2.8bn.

Finally we remain confident we can grow dividend per share by 10 to 15 percent this year. And with that, now I'll hand back to Gavin.

### **Gavin Patterson**

Slide 12: Thanks Tony. I'll now take you through the performance of each of the lines of business, starting with Global Services on slide 13.

Slide 13: Underlying revenue excluding transit was down 4%. While we made some progress on costs, this was not enough to offset the impact of EBITDA which was down 7% excluding FX. In terms of our revenue we delivered a good performance in Asia, and the fourth consecutive quarter of growth from our European business.

But these were offset by a 12% decline in the UK. We're still seeing the impact of some of our local government contracts coming to an end. On top of this, our major health programmes have now all been substantially delivered, so these contracts have been moved into their service and maintenance phase. This has impacted our revenue and margins. And thirdly we also saw a timing impact on project work with some of our banking

customers which by its nature is lumpy. The resulting decline in EBITDA was a little disappointing although part of this reflects the £7m of leaver costs which, as Tony mentioned, we're now showing above the line.

But the decline isn't reflective of what we expect for the year as a whole as the local government headwinds will start to drop out and reflecting the phasing of project work on some of our major contracts.

And going forward in the UK we will be rationalising our organisational structure, consolidating our cost base and most importantly, focusing on our margin generation. In terms of cash, the outflow was broadly in line with last year, reflecting the typical seasonal phasing of working capital. And as you can see from the chart, our rolling 12 month cash flow has been improving over the past couple of quarters.

Operationally Global Services continues to introduce new services to the market, notably in the areas of cyber security. This is a top priority for companies and new products such as BT Assure Cyber are helping us win in the market. For example, the contract we signed with Debenhams in the quarter includes cyber security protection.

More generally in terms of orders it was a good quarter, with the order intake up 14%. As well as Debenhams I was particularly pleased to sign a contract with Zurich Insurance, who are a brand new customer for us.

Slide 14: Turning to slide 14. BT Business continued the steady financial performance we've seen over recent quarters. Overall, revenue was marginally down, voice revenues were lower reflecting a 7% decline in business lines. But encouragingly we saw a good pick up in our portfolio of IP voice services in particular Cloud Phone, where sales are running ahead of expectations. Data and networking revenue grew 3% driven by fibre, with fibre net adds up 37% year on year. And IT services was also up 3%, with a good growth in our focus area of managed services.

Costs were down a touch and EBITDA was flat for the quarter. This reflects the changing margin mix of the business as the higher margin voice part continues to decline with the impact of this being offset by our cost transformational efforts. As we look at our EBITDA over the rest of the year, we expect to see a benefit from some contract wins in managed solutions. And we also expect further cost transformation as we complete some systems development and the reorganisation of some of our operations.

In terms of the order book, it was slightly down year on year but included some good contracts, including deals with Avis, and Towergate Insurance.

Slide 15: Now to BT Consumer on slide 15. And it was another quarter of good operational and financial progress with top and bottom line growth for the sixth quarter in a row. Revenue was up 3% driven by broadband and TV. ARPU was up 5%, a performance that compares very well with our major competitors. More than half of the growth is coming from broadband despite a competitive market. EBITDA was up 7% helped by a solid cost transformation performance.

Much like when we launched Premier League content two years ago, we expect EBITDA to take a step back in Q2 as we launch BT Sport Europe. And speaking of investment our cash flow in the quarter was slightly down, mainly due to capex supporting our broadband network and customer service.

Operationally, Consumer had another robust quarter. As I said, mobile got off to a strong start. We added more than 100,000 customers in our first three months. Consumer line loss was 59,000, broadly in line with the last quarter, continuing at the much lower level we've seen since the launch of BT Sport. In broadband we added 85,000 customers, that's more than half of the market growth, and we added 217,000 fibre customers, which means that 41% of our broadband base are now on fibre.

So operationally things are looking very positive. And we have a real opportunity in this market, particularly in terms of triple-play. We know that the combination of Infinity, TV and Sport really helps in terms of churn and customer satisfaction, and the investments we're making are helping to make our TV proposition even more attractive.

Slide 16: So taking a closer look at TV on slide 16 and we performed well in the quarter, adding 60,000 customers, our best for nearly two years. And this was boosted by our announcement of BT Sport Europe. We're really pleased to be working with AMC to launch a UK channel in late August, available exclusively to BT customers. AMC have a great pedigree in producing top rated shows, like Breaking Bad, Mad Men and The Walking Dead. And this offers another opportunity for us to bring great content for our customers.

Turning to sport and once again we grew our viewing figures, this time by more than 50% year on year. And on Saturday we'll be launching our new channel BT Sport Europe as the home of the Champions League. We want to make BT TV the best place to watch this coverage. So not only will the channel be free to BT TV customers, we'll also be the only place where you can watch all the Champions League matches in High Definition. And we'll also be the only place where you can watch in Ultra High Definition, that's four times HD quality and a first for a European sports channel. We're including the Ultra HD channel as part of the new £15 a month TV pack, which will also include 47 premium entertainment channels. So we're making real progress in driving our TV business forward.

Slide 17: And we also made some progress in BT Wholesale as you can see in slide 17. Wholesale's performance improved after a difficult year with underlying revenue ex transit up 5%. Managed solutions revenue was up 4%, driven by higher volumes on some of our major contracts, and that's a big improvement over last year. And IP Services again grew strongly, up 32% with Ethernet and IP Exchange revenues both up double-digit following our investment in these areas. In fact this was our best ever quarter for Ethernet orders.

Our revenue was helped by around £15m relating to ladder pricing, which we earned this quarter. But note that the charging regime for non-geographic calls changed on the 1<sup>st</sup> of July so we don't expect any further direct benefit from this. Underlying operating costs were up 3% reflecting higher volumes in our managed solutions contacts, partly offset by 17% decline in SG&A costs. And the good revenue performance meant that EBITDA grew 11% in the quarter with cash flow also growing by more than £100m, driven by movements in working capital.

Order intake was also healthy, up 33% in the quarter, or up 20% on a 12-month rolling basis, as you can see in the chart.

Slide 18: Turning now to Openreach on slide 18, which delivered a stable financial performance despite the ongoing impact of regulation. Revenue was flat in the quarter. Without regulation, however, this would have been up around 3% with fibre the standout performance. Operating costs were down 2% which meant EBITDA grew by 2%. Operationally it was another very strong fibre performance with 389,000 connections in the quarter. Within this external fibre connections were up 50% year on year again demonstrating the strong market wide demand for superfast broadband. And proving very clearly that this is truly a competitive market.

And as Tony said, the demand has given us the confidence to increase our base-case penetration assumptions. Finally, physical lines were down by 6,000 in the quarter. But the underlying lines performance remains strong, having grown by almost 200,000 over the past 12 months. So our operational performance was good, but as I said, we continue to be impacted by regulation.

Looking forward, Ofcom has proposed new charge controls for the business market, which will come into effect next April. As well as continuing to reduce prices over a three-year period, Ofcom plans to make some 'starting price adjustments' to all Ethernet and PPC products covered in the charge controls. Ofcom has also proposed the introduction of a 'dark fibre' Ethernet product. As a number of other service providers have already warned, this will disadvantage the smaller players in the market and undermine the industry's incentives for investment. Plus it will make it harder for business customers to switch provider.

We disagree with a number of Ofcom's proposals, particularly the starting price adjustments and the introduction of dark fibre, and we will be responding clearly to the consultation.

Slide 19: Turning to slide 19, and staying on the subject of regulation, I wanted to touch briefly on Ofcom's Digital Communications Review. Ofcom's discussion paper reflects the significant changes in the market since

its last review ten years ago. The UK has seen an explosion in competition and broadband usage. Consumers are getting more for less and the UK has outpaced its European peers in terms of superfast broadband.

Given how much the market has changed, we welcome this review as it offers the scope to deregulate and strip away some of the multiple layers of regulation that have grown up over the years. Much of the UK's progress is down to our £3bn investment in fibre, which wouldn't have happened had BT been split into two a decade ago. We have a compelling vision for an ultrafast future that will benefit people and businesses across the country and is enabled and supported by the current model of functional separation. And this isn't just about BT. Ofcom needs to provide long term regulatory certainty in order to encourage investment by companies across the industry.

But whilst the broadband market is vibrant and healthy, pay-TV remains one area where consumers have not been getting good value arising from a lack of competition in this market. Prices for pay-TV in the UK have been stubbornly high for years. We believe Ofcom needs to address Sky's dominance creating a more level playing field and delivering more choice and better value for consumers.

Ofcom is also looking at the quality of service across the industry. This is an area I've spoken a lot about and it's absolutely core to our strategy and if you turn to slide 20 I'll take you through some of the progress we've been making this quarter particularly focusing on Openreach.

Slide 20: In Q1, once again we trended comfortably above all of Ofcom's minimum service levels, despite these being more stretching than last year. And our continued investment in customer service is starting to deliver improvements. People are now getting installation appointments one day earlier than a year ago. And we're offering appointments within our service level agreement on more than 99% of occasions, a big improvement year on year. We're fixing faults faster and we're installing Ethernet faster with businesses having to wait five days less for installation, on average. So we're gaining some traction but we recognise that we still need to do better and we'll continue to work very hard to drive improvements for the benefit of the industry as a whole.

Slide 21: So just to end by bringing this all together on slide 21. We've got off to a solid start to the year both financially and operationally. Our improved revenue performance combined with a steady reduction in costs has meant we have grown EBITDA at the same time as investing to support sustainable profitable revenue growth in the future. We're introducing new products and driving orders from business customers. We're investing in new sport, TV and mobile propositions, and pushing fibre further. And of course we're continuing to make customer service one of our key priorities.

So, our performance and investment means that we're building a strong platform for the future growth of the business. And with that I'd like to open with questions.

## **Q&A**

### **Q1: Maurice Patrick – Barclays**

As you say Openreach continues to be impacted by regulation. In the BCMR (Business Connectivity Market Review) document you have got the gradual glide path and also one-off adjustments due to cost allocation. Yesterday at the analyst briefing Ofcom indicated that would also apply to the Fixed Access Market Review, highlighting a number of around £200m. What are your sort of thoughts on, is the cost allocation change correct? I think it refers to centralised costs and application to regulated products.

### **Gavin Patterson**

Sure, well I'll just make an opening comment on this then I'll ask Tony to give more specifics. We disagree strongly with the opening price reductions. This isn't, we believe, a fair way of looking at our overheads, it's just a different way of looking at our overheads and we think it is too harsh and it will be something that we challenge through the consultation. So Tony, do you want to give a bit of colour on how Ofcom are looking at it and why it's different from the way it's been handled in the past?

**Tony Chanmugam**

The allocation methodology that we're using now, which we changed to, had substantiation and agreement from two external independent third parties. And it was a better way of making the cost allocations. That's why we feel very strongly that what we've got here is right and that's why we'll take it to the furthest appeal that we possibly can.

**Q2: Nick Lyall – Societe Generale**

A question about Global Services if I could. Could you give us a bit more detail on when you expect UK revenues to improve and also you mentioned some phasing of contracts there on costs and UK savings coming through. Could you give us a bit more detail on when and, if you could, what sort of size they might be when they come through?

**Gavin Patterson**

I'll add some opening comments and then I'll ask Tony to give some more of the moving parts.

The GS number in the quarter was a bit disappointing, but it doesn't reflect what we believe will happen over the year as a whole. So we remain confident that over the medium term this business will continue to grow both top and bottom line, though it's clearly got some headwinds in front of it at the moment. In terms of the quarter itself, there are some big contracts that came to an end in the health service space in particular and some of the new contracts that we've taken on have some of the costs turning up in the quarter and it's a bit more lumpy than some of our other businesses.

But if you look ahead, some of the headwinds that we've talked about in the past begin to come out of the base and our continued focus on cost transformation and margin in particular give us the confidence that we'll be able to deliver growth in this business going forward.

**Tony Chanmugam**

Gavin has made the majority of the points. Couple of things though that you need to be conscious of when you look at the [headline] EBITDA decline: headline [is an] 11% [decline], if you take into account the impact of FX that brings it down to 7%. If you then take the impact of the movement from leavers from below the line specific items to above the line, it's about a £7m swing in Global Services, that takes the underlying decline to three to four percent. It's important that you look at this base point.

There are two issues then, so that headline number is not as bad as it prima facie appears on EBITDA. The second piece then is why would the run rate improve? We know that we have to focus on Global Services within the UK, it's something we've been doing over the last 12 months or so. In the evolution we've got at the moment, we are looking at what we're doing and we've already started making some changes in relation to the organisational structure and the consolidation of that. We're looking at the rationalisation of cost base. In terms of account penetration and landscaping of accounts and getting more types of services in there is something we're looking at doing and we're doing at the moment.

And I think the last initiative is about increased focus on the bottom 200 accounts within the Global Services portfolio. If you put all those things together, we're confident that we'll get an improvement. It won't be a linear improvement but it will be an improvement.

**Nick Lyall – Societe Generale**

Is there enough for you to think that you'll have growth issues in EBITDA at GS?

**Tony Chanmugam**

We're not going to give lines of business forecast but what I would say is we grew last year at one percent, and what I'd say is that in terms of this year from where we are now in terms of the underlying there will be an improvement in performance but it won't be linear.

**Q3: Steve Malcolm – Arete Research**

It was just on pricing. I was pretty surprised that you decided to move so early on price this year and every year I think you've come to the end of the line rental that it seems to go up a pound or pound fifty every year. Can you give us some insights as to why you moved nine months after your last price rise, and some general perspective on pricing in the market would be helpful, thank you.

**Gavin Patterson**

Well, John, because this relates particularly to the consumer market, do you want to add your perspective?

**John Petter**

Yes absolutely. So the percentage price increases first of all are quite a lot lower than our competitors, that's the first point to make. So the line rental price increase was 5.9%, compare that to Talk Talk's increase in their simply broadband price, that was 42%, so quite a large difference there. What you've seen from competitors in the period is quite a lot of them have actually made multiple price increases. So for example Sky changed the price of their line rental in December and they're changing the price of their TV packages from 1<sup>st</sup> September.

So this is a single price increase, it's not several price increases. It's simple for our customers. This is a key time for us and to talk to all our customers about the Champions League it makes sense to package up the news to give to our customers, to give them the positive at the same time as giving them the prices message and giving the whole thing very simply and transparently. That's the story there.

**Steve Malcolm – Arete Research**

So is it fair to say the halo of the champions league is the reason you went now rather than later in the year, you thought it was a better time to do it?

**John Petter**

That was certainly part of it. But it's simply around getting this organised so it works best for our customers and best for our business. Because perspective for the Champions League is necessary for us to recruit quite a few people for customer service and for sales, it wouldn't make sense to recruit those people for the Champions League peak then let them go then hire new people under the pricing announcement later on. This was packaging everything together make it simple and straightforward for everybody.

**Gavin Patterson**

It's also worth mentioning there will continue to be offers both to new customers and customers coming to the end of their contract so the promotion market remains strong and we're very competitive there aren't we John?

**John Petter**

Absolutely and particular offers target particular segments, for example the group of customers a lot of our stakeholders are very focused on...these are typically elderly customers that just take a phone line rental from us. For those customers there's the new Home Phone Saver package to give them the chance to freeze their tariff till 2018 and they get a substantial saving in terms of their monthly outgoings of about £10.30 a month. These are very keen, competitive offers.

**Steve Malcolm – Arete Research**

That's good. It won't be long till I'm one of those customers so that's helpful. Thank you.

**Q4: Simon Weeden – Citi**

My question is on quality of service target and I wondered if you could elaborate a bit on how these are intended to tighten over time and whether you're compliant with the various Ofcom targets today and whether you would be on any future tightening of same targets in due course if you were operating at today's level and how much effort you have to put in to achieving them? Thank you.



**Joe Garner**

So there are two parts to that. First of all in the context of the previous FAMR (Fixed Access Market Review) where there are 60 targets that step up over each of the three years of the period of the charge control. We're currently in year two. Ofcom have confirmed we've passed year one. The most testing of those is around on time repair, that steps up from 67% to 72% to 77% next year. As you can see from the numbers Gavin shared, we're running at about 77% today. So we're already running close to next year's level so that gives us good confidence in the consumer arena.

In terms of the BCMR (Business Connectivity Market Review) Ofcom are also floating some levels which we're still in discussions around. And we will do our best to ensure that they land at a realistic sort of level as we have done in the consumer arena.

**Q5: Robert Grindle – Deutsche Bank**

Question about the UEFA BT Sport etc, very early days but what's the level of opt outs that you've seen as you've written to customers to opt out of a new package and not pay the five quid and has that led to a sort of reduction in churn during the summer because people are going to stick with you for that?

**Gavin Patterson**

As you say, very early days but John, any qualitative colour?

**John Petter**

Yes. The number opting out is slightly lower than we anticipated currently and there are differences in particular segments so the customers that are least likely to opt out are the customers that take the service on satellite and they're the ones keenest to get it. So I think that's an encouraging sign from the point of view of churn.

**Q6: Paul Sidney – Credit Suisse**

The decline in physical lines was the first time we've seen a decline in almost two years. I was just wondering, is that indicative of any change in terms of the structural trends or do you still expect long term growth in physical lines going forward?

**Gavin Patterson**

I'm going to ask Joe to give a bit of colour. But overall the underlying growth in the line space is there. It's grown over 200,000 in the last year. It does move around quarter by quarter at times, and we've seen that in the past. Joe, do you want to add anything, from what you're seeing?

**Joe Garner**

That's really the answer. No change in underlying, always some one off movements in the quarter.

**Gavin Patterson**

The broadband market is competitive. But not dramatically more so than it has been over the last year, there's some very strong offers out there in the market. I don't want to particularly advertise some of our competitors' offers but we've got some strong ones as well. But at the same time I don't see it as a dramatic acceleration in promotional activity.

**Paul Sidney – Credit Suisse**

Great, and line growth still being driven by population growth and mobile-only household reduction.

**Gavin Patterson**

And new developments.

It's one of the benefits from being in an economy which is doing very well and living in a country where the population is growing, in our situation that's going to be a positive long term trend in the business.

**Q7: James Britton – Nomura**

Question on GS please. Why do you think - local government headwinds are unlikely to continue when councils are going to be facing big squeeze on their budgets in the coming years? I seem to recall the headwinds last year were dominated by a handful of councils which embarked on quite bold insourcing projects. Do you think there's a risk that these councils feedback to their peers and encourage more of them to have a go at this sort of project?

**Gavin Patterson**

Well, that's exactly what we talked about last year and we are going to anniversary some of those deals. We haven't got a lot more to go across the business. Don't know if Tony wants to add a point?

**Tony Chanmugam**

I think it's worth reflecting, there were a couple of big contracts, this type of activity it's not all local government work. It's primarily in the area of business process outsourcing. It's an area that we have, we're looking at, we've pulled out of two big contracts. And it's not an area that we would look at future investment in. So as we anniversary out some of these contracts, that's why you've got that negative in there.

**Gavin Patterson**

Anything to add Luis?

**Luis Alvarez**

There are two elements there, one is that there is a different way of procuring this kind of contract also in some of this local government. And also we have an increase of activity as Tony said before, on the basic products so that we have a more better landscape on those places.

**Gavin Patterson**

Very good.

**Q8: Stephane Beyazian – Raymond James**

Quick question on the AMC agreement. Could you give us an idea of the costs related to this one and how much money you're committed to spend in building more non sport exclusive content I guess to better compete with Sky's bundles?

**Gavin Patterson**

We wouldn't go into the specifics of a contract Stephane but John, do you want to talk a bit about how the AMC deal works, how you're going to use it in our Consumer offer?

**John Petter**

Sure. Like you said Gavin, this is a very financially disciplined step in entertainment, - it strengthens our offering, it's part of a strategy that we've seen over previous quarters of increasing the strength of that TV bundle, driving - extra channels to our existing customers. This is a very compelling offer because it gives you some of the big US dramas - such as Breaking Bad, Mad Men, back series of those and the new series – Fear The Walking Dead. So that is going to be very popular we believe.

And then in terms of just how we plan to use it, clearly it's going to benefit BT TV but the package is also going to be available on satellite too for customers taking the BT Sport pack, so that's the customers paying the £5 for the added value pack. This is a further bit of value for them to encourage them to trade up and take it.

**Stephane Beyazian – Raymond James**

Planning any more deals?

**Gavin Patterson**

We'll see how this goes. In general the entertainment market we think works at a wholesale level better than the sport market has done in the past. So we're keen to make sure that our customers get great value and great

breadth of entertainment content. And if we can provide that with deals like AMC then we might look at others in the future. But at the moment we're happy with what we've got. John wants to add something else?

**John Petter**

Yes, I just wanted to say that although the wholesale market for entertainment does work better than sport, that is a very very low benchmark because there are still lots of anti-competitive practice that we see from Sky such as most favoured nation clause in contracts that dictates Sky's cost base but actually affects the cost base of other players and have an exclusionary effect. So there are still issues too from a competition point of view as well.

**Q9: John Karidis – Stifel**

I just wanted to ask about phasing please. First of all in terms of the regulatory price cuts and the impact on Openreach you said £40m in the first quarter. Is it still the case that we're expecting something like £90m for the full year and what will be the phasing of that? And if possible, to extend this to the phasing of leaver costs over this year that would be great in terms of which quarters are likely to be heavier versus others.

**Gavin Patterson**

Tony, do you want to open up on that?

**Tony Chanmugam**

Our overall profile on guidance in terms of what's happening on regulation hasn't changed, it still stays as intact. In terms of the phasing in relation to leaver costs, it very much depends on how our programmes work. We gave an initial guidance of £100m, we put through £16m in the first quarter. There's nothing that's happen that will change that, but as I said, it's worth emphasising on the leavers it is a volatile number. If we can do a bit more on insourcing we may not need to spend as much on leavers and therefore it will be variable.

**John Karidis – Stifel**

Sorry, can I confirm. The impact on Openreach is £90m for the full year, and the first quarter was £40m?

**Gavin Patterson**

Joe, do you want to...?

**Joe Garner**

Yeah, at the Openreach level we have absorbed all the significant impact of regulation in the first quarter so there's not huge amounts still to come through.

**Tony Chanmugam**

Our guidance remains unchanged.

**Q10: Andrew Lee – Goldman Sachs**

Another question around the promotional activity just because TalkTalk flagged it. And you've mentioned it quite a lot too during this call. Can you give us a bit more colour around it? How much worse is it really compared to say two years ago? And do you expect it to abate through the year? Do you think the expectations of your champions league launch is the key driver of this or is there something more sustainably pressured happening here?

**Gavin Patterson**

Just to underscore Andrew what I've said today. There's a lot of promotional activity going on out there but if you want to grow your customer base there's still a scope to do that, and I think you can see that in our numbers. 85,000 broadband net adds in the quarter, 217,000 fibre net adds in the quarter, that's 57% share of the market. That's a decent performance overall. The market tends to be a wee bit quieter across the summer in general, as you know the bigger quarters are Q3 and Q4. Or our Q3 and Q4.

But in a nutshell it is competitive, I think there's plenty of promotional activity out there but it's not fundamentally different than it has been in the past. And as you say, I don't think it's dramatically different than it was at this point a couple years ago. John, is that a fair reflection?

**John Petter**

Yes. I think it is. And the comments from TalkTalk seem somehow to suggest that there was an exceptional spike of activity and they nobly stood apart from it. They seem to have forgotten the fact they had 12 months free simply broadband on offer during that quarter in fact. So...the market hasn't really changed but they were competing hard themselves doing free broadband for 12 months. There were some exceptional offers from Sky I would say in the last two weeks of the quarter, so just to mention these. They were offering a free 32 inch Samsung or LG television from 16<sup>th</sup> June to the end of the first week in July.

And then on Money Saving Expert, on top of their free unlimited 12 months broadband plus a £50 or £100 Marks and Spencer voucher, they were also offering for the first 14,000 people to sign up, that they would get their broadband for the year for £6 and get their line rental for half price for a year. So the last two weeks it was a bit unusual, but I've been making points like this on every single one of these calls for ages and it wasn't very different honestly. It's a consistent pattern of behaviour from the market, from TalkTalk and from Sky.

**Gavin Patterson**

I think the key for us is we don't just compete on price, the pricing on BT is very good value but it isn't simply a price play, it's about the value of the bundle, it's about sport, it's increasingly about fibre and about service. So being reliant on being cheap we don't think is the right positioning for our brand going forward.

**Andrew Lee**

Thanks very much, that was really clear.

**Q11: Jerry Dellis - Jefferies**

I wanted a bit more colour on mobile please, firstly in terms of the adoption rate that you're seeing sort of month by month and whether those are generally getting stronger. And also within the various packages that you cover some colour on the relative take up rates between the half, the two and the twenty gigabyte plans would be useful. TalkTalk obviously mentioned that heavy consumption rates in their own SIM only products were squeezing margins and I wondered whether you were seeing anything similar?

**Gavin Patterson**

I'll give a couple of comments and maybe John can chip in. We were really pleased with the start on our consumer mobile offer. 100,000 customers added within three months of launch. And that's without any above the line marketing, that was largely direct marketing to a part of our base. So we've got confidence in the fact, it built our confidence in the fact that there is a market for cross-sell of mobile in to fixed and that as consumers have multiple SIMs not just for their own use, but within the family, there's a natural buying behaviour that we can market towards.

Our offer is I think very well priced, it's not crazy in terms of its pricing but it's very competitive we think. We wouldn't go into the specifics of the mix but it does skew towards the lower of the tiers. But from a profitability perspective we're very comfortable with where we are and we're not concerned in the same way I know Talk Talk were concerned by their offer. But John, anything I've missed there?

**John Petter**

A couple of points I was going to make and this was that first of all there's been a bias in demand towards existing BT customers taking these packages first off. And that's a beneficial factor here we believe, because it consolidates those overall customer relationships. Secondly, it's quite frequent that we're seeing a typical household taking more one SIM, there's a fair amount of that happening as well. Most customers are taking the smaller data bundles, Gavin as you said, but it's part of our offer that customers get to trade up easily between the packages so as to avoid overage charges. And the final bit of perspective to give is that this has been a gradual below the line entry into this marketplace, to ensure our customer experience is absolutely right first of all, and the signs there extremely positive. Customer satisfaction from our mobile customers is absolutely great.

**Q12: James Ratzler – New Street Research**

One question please. Great news you've been able to up the take up of fibre in your assumptions. What does that imply for your thinking about where the GEA pricing moves over time, do you think that can still remain stable from here especially as we go into the next FAMR (Fixed Access Market Review)?

**Gavin Patterson**

From our perspective, we are pleased that we've met the original forecast that we had, which was the case was built on 20% take up and a mixture of CPs, both our own and more broadly across the market were expected to deliver that. And I think it's worth just reflecting on a second that when we made the investment originally in 2008 was when we announced it, but 2009 was when we started selling. It was a pretty ballsy assumption. It compared extremely well with markets around the world and the speed of adoption we'd seen there. And we were launching this in the middle of a recession, and a very tough recession.

So it is worth reflecting I think for a second to say actually that's not a bad accomplishment, we've hit the number we thought and there's still momentum in that business in the market going forward. We're calling that we can see 28% from this point. When that happens will depend largely, or to a large extent, on how the other CPs apart from our own, if they continue to market it in the way they have been in the last year. And it's something that they've clearly seen demand in their own customer bases for fibre, and you can see that in the sense that we're now of the order of 50/50 in terms of market share within the quarter between BT's CPs and other CPs. And that's really what we wanted in the first place.

So having shown a lack of interest in it in the early years they've certainly decided that their customers actually wanted it after all. The last thing I wanted to make as a point was while we've hit the 20% mark it is worth remembering that the payback is still double digit years. So we are several years off getting our money back from the original investment and that is the point we will continue to make to Ofcom in any future regulatory discussions.

We went into this investment with the basis of it being a fair bet. If we were going to put several billion of our shareholders' money at risk it was only right that we had a chance to make a return on that. And in spite of what has been a very successful first few years, it won't earn that money back for a few more years yet and we know they understand that and we expect them to respect it.

**Q13: Adam Fox-Rumley – HSBC**

There were some interesting comments about the below the line marketing of mobile and I wondered if you could make some similar comments around your marketing on TV through the quarter? Your TV ads have just started now pretty much, but was your better quarter for TV growth driven by more aggressive below the line targeting through Q1?

**Gavin Patterson**

John? I don't think in particular?

**John Petter**

No, the short answer to that is no. The TV net ads are pretty much the best...I'm going back pretty much two years. And there were no free colour TVs or half price line rental here at all. So absolutely not, no.

**Adam Fox-Rumley – HSBC**

So you think it's the quality of the content and so on that's resonating better with your prospective customers?

**John Petter**

There was one change and that is that we've begun to more consistently market TV above the lines, if I had to call out one factor it would probably be that one. Because one of the sort of factors that we see is in terms of brand awareness of BT TV relative to Sky and Virgin Media's offering, we start from a much lower base than they do and to one of the things we've decided to do is to just be more consistent with our advertising and have some sort of presence there all the time.

**Gavin Patterson**

What we see is that the customer satisfaction around the TV product is very good, and it compares extremely well with others in the market. So the challenge I think is ensuring that we consistently market it, we build awareness of it, we add content to the platform and make sure it's very good value and that's what we'll continue to do.

**Q14: Guy Peddy - Macquarie**

Just following on actually from that topic of your strong TV ads, are all those customers you're signing up now taking the Champions League product, i.e. are you seeing that as a material driver of the improving trend in TV or is it still too early to say on that one?

**John Petter**

I think it's fair to say there has been quite a strong contribution from the Champions League, and you could see this happening from the time of our announcement on 9<sup>th</sup> June there was an effect straight away. So I think the short answer to that question is broadly yes.

**Gavin Patterson**

We've got time for one more, and that falls to Michael Bishop.

**Q15: Michael Bishop - RBC**

Just quickly on G.fast, I'd like to get an update on the trials and specifically if you had any new thoughts on the cost-benefit analysis of G.fast from the street cabinet versus a distribution point closer to the premise? And how that ties in with your recent comments around future multi-billion pound investments in fibre and superfast broadband?

**Gavin Patterson**

I'll say a couple of comments about G.fast then I'll ask Tony to talk about the financial impact. We are really building momentum I think on G.fast and as I mentioned in a matter of weeks we will be starting significant field trials across a number of CPs, not just BT, but we've been really pleased that the CP community has stepped up and wanted to play a role in this. Because as with superfast broadband, when we make this investment it will be available to the market as a whole and it will benefit the country as a whole. And that's fundamental to what we believe in.

What we're seeing is that the vendors are beginning to step up, the work that we need to happen around standards is falling into place. There are a few things still to get through to really optimise the technology over the mid-term. But we're very encouraged by the progress over the last six months. Tony, financially?

**Tony Chanmugam**

I think it's too early to declare the exact detail of what the costs are. We've always said we will manage this in our capital envelope over medium term timeframe, but it may oscillate year on year if we choose to accelerate the roll-out or not. It's important to note that our cost structures now in terms of our forecast pre the trials, are materially lower than where they were before. (A) because of the points of presence that you talked about, but (B) because the issues that we had in power, we can reverse engineer power, have now been resolved.

The last piece is in terms of the box cost, the box costs are lower. But simply having the increase points of presence, means that we'll be in a position to reduce the dig costs linking into the homes, sorry, linking in to the cabinets, it will make it much more financially viable.

**Gavin Patterson**

Very good. Well that's the end of the call today, just a couple of parish notices. First of all I'd like to thank Alex Pike, who's been in the IR team for a number of years and I'm delighted that he's going to go and work in the Consumer business going forwards for John, so thanks Alex for your huge contribution over the years. And then thank you for joining today and I wish you a very good summer if you have a chance to get away. Thank you very much, bye.