BT Q4 2012 Results Presentation

Attendance list:	Sir Michael Rake	(MR)
	Ian Livingston	(IL)
	Tony Chanmugam	(TC)
	Gavin Patterson	(GP)
	Liv Garfield	(LG)
	Jeff Kelly	(JK)

Voiceover

Good morning, ladies and gentlemen. Welcome to the BT Central Auditorium. Could you please make sure that you have all mobile devices switched off. There are no fire alarms planned for today. And in the event of an alarm sounding, could you please leave the auditorium by the two fire exits at the front of the room.

Before we start we need to draw your attention to the usual disclaimer on forward-looking statements. Please see this slide 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.

MR

Good morning, everyone, and thank you very much for coming here. I'm pleased to be able to say that we've had another year of real delivery for all our stakeholders despite the economic headwinds and uncertainty.

Financially we have grown both profits and cash - and we have done this while continuing to invest in the business, including our £2.5bn fibre rollout program which is one of the largest private sector commitments in the world without state support. This investment is taking fibre broadband to cities, towns and rural areas, bringing significant economic benefit to the United Kingdom. We have also invested by adding content to BT Vision, expanding into fast-growth economies and continuing to improve customer service.

I am very pleased that we have agreed the 2011 pension funding valuation and recovery plan with the trustees, as well as contributing a £2bn lump sum into the scheme, more than half the total deficit, giving greater certainty to the fund, our pensioners and to our shareholders.

We have done all of this and seen an improvement in our credit rating, which we expect will continue to improve through further strengthening of our balance sheet.

We believe we also have a responsibility to give something back to the communities we operate in - through 50,000 days of employee volunteering, through our environmental and energy savings, and through support of charities such as Sport Relief and digital inclusion projects in the UK and around the world. We do contribute to making a better future for our communities.

So now to the business of the day and our results for 2012. Revenue for the year was down 4%, but on an underlying basis, excluding low-margin transit revenue, revenue was down 1.9%, an improvement on the 3% decline last year.

In terms of profitability: EBITDA was up 3% and we delivered double-digit growth in profit before tax, earnings per share and free cash flow.

Net debt had been on the decline during the year, but after the £2bn payment into the pension fund in the fourth quarter, net debt for the year ended up at around £9bn.

Reflecting our performance in the year, the Board is proposing a final dividend of 5.7p, up 14%, giving a full-year dividend of 8.3p, up 12% compared with the 7% increase last year. As we have said before, we are committed to progressive, sustainable dividends. And as such we plan to grow dividend per share by 10% to 15% each year for the next three years.

We're also announcing a share buyback of around £300m in the current financial year to counteract the dilutive effect of employee share plans maturing this year, and to add to shareholder returns.

To look at our three-year performance, these results show strong cumulative performance over the last three years, with earnings per share up by over two-thirds, driven by the transformation of our cost base. Free cash flow more than tripled despite the significant investments we have made in the business. And despite making £3.6bn deficit payments into the pension fund, we were still able to bring debt down by £1.3bn. This performance has been reflected in the share price, which, with the dividends paid, has yielded a total shareholder return of 224% over the period.

So, before I hand over to Ian and Tony who will take you through the results in detail, I wanted to remind you of what we were doing for London 2012. We are the official communication services partner, delivering a single communications network across 94 locations, including 34 competitive venues. We are providing four times the infrastructure capacity of the Beijing Games, making London 2012 the most connected games ever. And with 78 days to go, we are on time with our delivery. Take a look at what we've been doing.

(Video playing).

IL That's always an advantage of being the Chairman, you get the best videos. Now on to the results. About a year ago I stood here and we talked about what we are looking for, our outlook for next year. And I thought it was worth reflecting on that and how we've done against it.

First of all in revenue we gave you a range of revenue down zero to 2%. Well we've come within that range clearly with a 1.9% result, at the bottom end of the range, but within the range. And I think that reflects the difficult economic conditions we've been operating in.

But against that we've over-delivered on the other lines and over-delivered strongly. We said that we would beat the previous year's EBITDA of £5.9bn; we've come in at £6.1bn. We said actually we'd be over £6bn in the year we're now entering, and clearly we've delivered that a year early.

And in free cash flow in particular I think we've had a strong beat. We said we'd beat the previous year's number of over £2.2bn; we've come in with a very strong number, I think, this quarter and this year at £2.5bn. And what we'll talk about is how we expect to take that base and to move it forward.

But firstly the quarterly results. Revenue down 2% ex transit in the quarter. We'll go through the individual lines of business and talk about where was up and where was down.

EBITDA, one of the strongest quarterly performances we've had, up 4%. I think a good number. And profit before tax up 13%. It's interesting to reflect that's, I think, 10 consecutive quarters we've actually seen double-digit or 10%-plus growth in PBT and EPS, so 10 consecutive quarters of that.

And free cash flow up in the quarter 47%. Of course, free cash flow tends to bounce around quarter by quarter but they contribute to that very strong year-end total-year number.

Now let's look at the individual lines of business. First of all with Global Services. Underlying revenue ex transit is down 2%. We'll talk about some of the growth areas and what's going well, but it is fair to reflect that we are seeing the impact of what's happening in Europe, no great shock. And maybe in one or two of the sectors, I think the banking industry is a bit weaker, things like trading systems. So whilst, and we'll talk about it in a second, what we've done on the order book is encouraging in the quarter, clearly the economy is just more difficult.

In terms of net operating costs, we have seen an improvement in net operating costs, down 3%. And I think given the environment we're operating in, really that pushes us to intensify our efforts even more. And we absolutely will be doing that, really particularly on the difficult stuff, like combining networks, taking them out. It is a very difficult task to do that and we are doing it and we are achieving it, but it just takes time and effort. And we'll see the benefits over the next few years of having done so. But also in areas such as procurement, process improvement, which will result in us taking people out. There remains a lot more we can do in terms of improving efficiency and effectiveness, and I think the environment means we probably have to.

That being said, we've delivered £183m in free cash flow. Now that's roughly in the range of around £200m, we said. Now part of the difference, and we're talking here very small differences, is because we sold the business called Accel Frontline. That actually generated profits and cash and revenue, and that accounts for part of the difference. But again, if you look a couple of years ago, if you remember what we said, we said this year we'd be cash flow positive.

So we've come a long way with Global Services and we think there's a long way still we can go. And we'll talk about the outlook for Global Services.

Turning to some of the metrics for Global Services, I think some really encouraging metrics. First of all, and I appreciate it will always bounce around quarter by quarter, but the order book £2bn in the quarter, that's up 8% year on year. And the interesting thing about that is actually the fact that there wasn't one big order; actually there was a very strong volume of orders. Normally when we've been over £2bn we've relied on a £400m, £500m, £600m order to get there. Actually, and it's a very good thing, the largest order we have was sub £150m. And then the next largest order was only about £50m. So what we got is a big volume. It also reflects what we've been saying to you, the very big, big deals just don't seem to be there at the moment. And that's not a bad thing in many ways and I think it reflects the strength and depth and diversity of our order book.

And actually the other factor and you see it in the full-year orders, whilst full-year orders are down slightly year on year, more than all of that is accounted for by the fact we had less renewals this year. This is why I said to you a couple of quarters ago if you looked at the profile of our renewals, there was actually going to be very few renewals this year and actually next year. For instance, basically in each of the years, only two of our top 20 contracts actually were due for renewal.

So actually in new contracts, with new names and growth orders for existing names, we've actually seen a year-on-year increase. And there's some really good names in there. Anglo American I want to call out, very important in terms of what we do in the EMEA region. NATO, vitally important. And we're glad to see NATO not only renewing with us but expanding the business with us. National Air Traffic Control, I think that goes without saying you want us to do a good job there, and we do. And of course Etihad for another good name. So good diverse range of names, lots of contracts. And I think that's an encouraging thing.

Talking about the areas we said we'd expand. We talked a couple of years ago about expanding in the Asia Pacific region and we're doing just that. We've been hiring people, we've expanded our product range. And we really are seeing the reaction in terms of customer wins and also our positioning in the marketplace.

Then we said after that, Latin America we'd do the same. And we've got particular strength in Latin America in VSATs, but we have a number of very large customers down there and we're seeing good growth.

And then we said very recently that we would do the same in Turkey and the Middle East and Africa. We think there's real opportunity and it's a very fast-growing region.

And across all these regions, when you put it all together, first of all we're seeing some of the impact. Full-year revenues are up 16%

across these three regions. But probably more critically, the order book is up over 60%. And we think we can add about £0.5bn of business in terms of revenue over the course of the medium term in these areas. So it will have a material effect overall. And it reflects both our existing customers expanding in these regions, but also new global multinationals actually expanding out of these regions and we will help both of them.

I'm very pleased with this chart. This is something that was announced just a few weeks ago. What it shows, it's by Gartner, and for those of you who know Gartner, they are probably the organisation that CIOs look to most of all. And they do a survey by actually talking to customers about who is making the right moves and the progress. And I'm delighted to say, if you look at the chart on the left as you look at it, that's the Global Managed Network Service Provider. We are ranked now as the absolute leader in Global Managed Network Services across the globe. We've overtaken actually a number of our competitors in that field, and that's happened over the course of the last year. And I think the investments we're making and the success we're having is showing through what the customers are saying, and that is very encouraging.

And the situation is also true for Europe. I think you'd expect us to be strong in Europe and we are. So two very encouraging charts. And apparently I'm not allowed to point to you where Cable & Wireless are, but if you want to go to the bottom left in both charts you'll probably see them.

Now turning to Retail. Revenue was down 3%, with improvement in a number of the trends. I'll talk about Customer and Business in more depth but I'd just like to pick up on Enterprises. Enterprises, as you know, is a standalone business in areas like Conferencing, Redcare, Payphones that we do, and it saw 2% growth really on the back of very strong conferencing business. Both audio and video conferencing have done well and that was encouraging.

But I think the real standout has to be Ireland. That's a business in the whole of island of Ireland. And for revenue to be up 4% and strong EBITDA growth as well, well it shows a couple of things actually. One it shows in the Republic we're doing very well. We're winning large contracts with both the government and the corporate sector. And it shows that, and we've got to remember this, whilst economies may be difficult and the Republic of Ireland economy is difficult, you can absolutely override that if you do really, really well, and the team there have.

But also the other area, and accounting for about half of the growth, is actually in fibre. In fibre in Northern Ireland we've got roughly 9 out of 10 homes in Northern Ireland are actually fibreed. And you can see the impact we're starting to see on the business. And I'll talk more about our public-private partnerships that we are doing in some of these areas. So that's encouraging.

I think also encouraging is net operating costs down 5%, and that's driven effectively the EBITDA growth in Retail. That's seven years running we've achieved good cost reduction, and it shows what can be done, and the Retail team will tell you they haven't stopped yet. And we've done that whilst we've taken complaints down, as we've taken failure out of the process and improved our processes. And that really is vital for us. It is a little microcosm of what we're trying to do across the business.

Turning to some of the operational metrics in consumer, and it's worth saying first of all that the performance in terms of revenue from consumer is one of the best for some time, down 2%. It's a decent improvement. And that's come really off the back of these operational metrics.

First of all, our active consumer line losses are 30% better for the full year. I've got to say, Q4 was a bit worse than that; that was really the result of what happened in Q1, Q2 and Q3. But we certainly did see some impacts from every aggressive pricing and advertising by Sky. And that meant Q4 wasn't as good. But these numbers will bounce around quarter by quarter. And it was particularly the first half of Q4 where we saw that.

And we did, however, deliver a 44% broadband market share. Now that means for the year as whole over 50% market share, 600,000 new broadband customers in the year, so basically a 10% increase in our base. And actually we saw basically 10% across Retail increase in broadband revenue. So really strong numbers there. And I think we've seen the same story, which is if you take Sky and BT together, you basically get over 100% of the market. So the rest of the market, on average, although there'll be some winners and there'll be some losers, are struggling.

Another area where people often look at is actually BT Vision. Over -- sorry, I forgot about Infinity, first of all, apologies. First of all, Infinity. Really good numbers for Infinity. Over 550,000 customers in Infinity. That's up 38% year on year and a lot of the base that's been built by Openreach has really come on-stream just very, very recently, so we've certainly got more to go for going forward. But we're encouraged by what we're seeing in Infinity and encouraged also by take-up and particularly where we're working in public-private partnerships.

On BT Vision, we've got now to over 700,000 customers on Vision. And it is just worth reflecting, that's up 23% in the year. And actually the net adds in this quarter are higher than Sky and Virgin combined. So we are actually doing pretty well on Vision and in a reasonably difficult TV market. But interactive TV is very much the way of the future and there's a lot still happening on Vision. YouView is coming later, but in the meantime we have Vision 2.0 which is going to be far more interactive and recommendation search engines and things like that that will really help the viewing experience. Multicasting will be later this financial year, and that will give us the ability to stream a lot of programming. So there's a lot happening on Vision. And of course a number of new contracts we've signed for content. So a lot happening in Vision and we expect to see that building overall.

And consumer ARPU continues up. It wasn't so many years ago that people said - can you ever increase ARPU? And we continue to do that. And that really is on the back of the RGUs being purchased in terms of Broadband and Vision, and that's been a big driver.

In the SME market, the SME market does remain tough, no great surprise there. However, the revenue number that we've had has been impacted by a decision we made in Q2 last year. We've decided to withdraw from very low-margin hardware trade sales and to really focus on the core business. And because it was Q2, it's going to affect Q3, Q4, and you've seen that in the numbers, and it will affect Q1 and Q2 of next year. If we put it in context, it accounted for -- that together with the flow through of [MTRs] in our pricing, accounted for about two-thirds of the decline in our SME business, so it was a pretty important part of it.

And actually if you look at the rest of the SME business, we've seen good growth actually in IT Services in Q4, but also good growth in our core metrics, well, good performance in our core metrics against a declining market. We've actually gained market share in calls and lines and broadband has done well, so some encouraging things. And whilst we know the first couple of quarters are going to be affected by that withdrawal from the trade sales, we remain very positive about the future for our SME business.

Wholesale. Wholesale numbers are a bit better than they have been. We said this was going to be a tough year for Wholesale and absolutely this been the case. And you can really see it in the chart on the right-hand side, the line of EBITDA as to what's happened with it. And you see it is flattening out more now.

And in terms of revenue, revenue ex transit, there were -- whilst it was down 2%, it would have been down 1% but we had to take a £13m retrospective charge relating to regulation. We just took that through normal profits, normal revenue. And that made the revenue decline a little bit worse. Against that, £750m of orders. That's one of the best numbers for some time, so that was encouraging for the full year.

Whilst net operating costs are down in total, if you exclude transit they're not. And it's exactly the same thing I said for a number of quarters. What we are seeing in Wholesale is a move away from some higher-margin to lower-margin products because basically of technology changes. And that is something we're just going to have to accept is happening and it's something that just flows out the system. And it's not any different really from what we expected. But also we got some double running of costs and that will move out of the system in the not-too-distant future.

So overall Q4 EBITDA, if you exclude this regulatory charge, down 5%, and that's an improvement in overall trends. I think next year will be a better year for Wholesale than the year just gone.

In terms of Openreach, a really good year for Openreach, a good quarter it finished off with. Revenue up 4%. Ethernet growth coming through very positively. And there's a little bit of a trade-off between Wholesale and Openreach in that. LLU obviously growing, and then you've got WLR on the other side.

But can I call out fibre? We are seeing the impact of fibre in the business. But we're also seeing the impact of copper growth, 74,000 net adds in the quarter in terms of copper. And if you look at the chart showing the moving annual total of copper, it wasn't so long ago we were losing 500,000 copper lines a year, and now we're north of 100,000 a year positive. And that's very encouraging. I think there are two reasons for that.

One, fixed broadband is what people are choosing and I think it's quite clear for the sort of bandwidth requirements, they need that. But secondly, the UK population is increasing. And I think that's one of the longer-term factors in the UK, unlike a number of other European countries, we're going to see population growth in the UK over a long period. I can't guarantee that copper will increase every quarter, but we will see actually a much higher population, more households, and all other things being equal, that should be a push in the right direction. So, I think, demographics are a bit more encouraging for the UK.

Operating costs are down. There's still more to be done on operating costs, but they're down 3%. And that's meant a very good EBITDA, up 12%.

Now it's been a really good year for Openreach, but something I want to highlight is the impact of the regulatory controls that have been announced. Now whilst we're appealing a number of them, assuming they go through as they are today, and you've all seen them, it's going to hit Openreach by £200m plus, both in revenue and profit. And that is a headwind by any definition. And I just wanted to tell you that beforehand. And probably it's not a surprise to most of you; it will be in your numbers in terms of what it is. And of course on a Group-wide basis we can manage that and all our estimates include that.

Fibre. Well, we're absolutely delighted to say we now have fibre passing more than 10m homes in the UK. Now the team have been working very hard over the last quarter. We've basically done not far short of about 3m fibre lines in the last quarter, so it's a real step up in pace. And I think now over a third of the UK has fibre, so that's encouraging. And now Retail and all the other CPs can start selling to that base.

We still believe there's a potential over a five-year period to get to about 90% of homes in the UK, if BDUK money is made available in the right way.

And we are doing pretty well on BDUK. We announced in March that we were the preferred bidder for Rutland. We said in April that we've been appointed by Lancashire. So we've very pleased with both of these. We won't win all BDUK contracts, let's be very clear. It just is the way of things, we'll not win all of them. But I think we've shown in what we are doing that actually we can really deliver.

Look at Northern Ireland, 9 out of 10 households. Cornwall's going really well. And you compare and contrast that with some of the other public-private partnerships or even just public, and we're actually really delivering in a big way. We've got industrial scale so we'll be bidding heavily for that and looking at the opportunities.

And there's a lot of other things happening on fibre. We of course doubled the speeds up to 80Mbps, 20Mbps upstream in April, and that's gone pretty well. And people have just started selling to that base so obviously the quarterly numbers don't reflect that in terms of the adds.

But we'll be launching shortly a 330Mbps service, so that's a very fast service. And that will be a commercial launch.

And we'll also later this financial year, sometime in the next calendar year, be launching the FTTP on-demand service. I think that's a real opportunity basically. Where there's fibre to the cabinet, if you want fibre in the home at 330Mbps speed or whatever speed we do later, it will be available to you. And I think that's a really good compromise between some people who want the really fast speed and other people who want a lot of coverage. Because for most people, as we stand today, 80Mbps is more than enough, but there may be some businesses, etc., want fast speed. Fine, it's available to you. And I think that's a really exciting move forward.

The other thing we've announced, and it's very long term, is that we will do our first fibre-only exchange. Now let me explain why that's important in the long term rather than the short term. If you were designing a fibre-based network today you would probably have not much more than 1,000 points of presence. We've got 5,600 exchanges. Now I want to be really clear, that does not mean you move from 5,600 to 1,000 exchanges because you're not doing it from that clean sheet of paper.

However, it does suggest in a fibre-only world you would ultimately need a lot less exchanges. And what we want to do is start practicing and start actually bringing to customers the sort of products and services you can do, get the experience of it. It's going to be a number of years before we do it in Deddington, and then gain that experience and the learnings from it and then look to do it to other places. A long-term thing, but we really want to mention it to the industry in advance and give them lots of notice because they'll have to make some of their own decisions about technology in the future.

Pension fund. Well the trustees' funding valuation, I'm pleased to say it was finalised. We announced that in the results today. Remember what we said six weeks ago was we had a provisional valuation and it had to be just finalised and it has been finalised. Actually on finalisation it's come down slightly from £4.1bn to £3.9bn, so that's good news. It doesn't change the next couple of years' payments; that will remain at £325m. We agreed to keep that whatever. But what it does mean is the payments beyond that, the ones that were £325m go down to £295m.

IAS19, all of our favourites. The number may be a bit less than some of you had, and that's really because we've adopted -- we've made a few changes in both directions, but we have adopted what's now best practice in terms of the calculation of the discount rate which basically matches the maturity a lot better of the pension scheme. And so it's a better way round of looking at it. Otherwise assumptions are as there.

The thing I would say is CPI, CPI 0.75% below RPI and then 1.2% thereafter. The Office for Budget Responsibility is forecasting a differential of 1.3% to 1.5%. So we are certainly on the more conservative end than the OBR. If the OBR's right then obviously one would get a lower valuation for IAS19 and also frankly for other things in the pension.

So looking at the outlook, first of all on revenue. We do expect to see improving trends in revenue, and that's despite the challenging economic environment. It is more difficult than we thought just over a year ago with the economic environment.

The other thing that's impacted us, whilst we expected some effects of regulation, it's been worse than we thought, is regulation will hit us £100m to £200m Group-wide. It's a bit more in Openreach but we get some of it back in the rest of the Group, in terms of revenue both in the year we're in and next year.

And also the withdrawal I mentioned that will affect the first half rather than the second from IT hardware trade sales.

The last two factors are together probably about 1% off revenue, so they're significant. That being said we still expect improving trends in our overall revenue.

On EBITDA, we expect to see growth in 2013/2014, very simply improvement for the numbers. And that really comes from a number of places. But I should highlight that in GS we expect continuing solid EBITDA growth. And I did mention earlier, offsetting that bit is the regulatory impact in Openreach, although they'll be working hard to offset that themselves.

Free cash flow. What we've tried to do with free cash flow, if we -- as it stood, the definition of free cash flow, which included the pension tax credits, we'd actually have the free cash flow going up to nearer to £2.9bn before coming down again. And we tried to say well that didn't really reflect the underlying business. So what we've tried to do is talk about normalised, i.e. take out the impact of the lumpy pension tax credits. And, as you see, these are the numbers when you restate it.

We've gone from 2011 at £2.076bn. We actually increased it to £2.307bn. So that's what I mean; that's a really good number for 2012.

And we're going to hold the number next year. We're saying it could be broadly level. So at that higher level, higher than your expectations, we'll hold it there. And then we'll increase it beyond £2.4bn the following year.

Now what that means, put another way, is given we've got pension payments of around about £300m is we've already hit the level where we are, even post pension payments, £2bn a year plus in free cash flow. And that's a very different level from where we've done in the past. And what we're saying is, we've over achieved in cash flow this year, we're going to hold it and then we're going to grow it.

And within that, one thing we just wanted to point out was Global Services. Its cash flow will be lower next year. A lot of that's due to working capital, before returning to growth again in 2014.

So you've seen this chart before, I'm not going to talk through it, except to say we're doing what we said we would do. There are still a lot of operational improvements available in our business and that's what we're still driving for. You will see improving revenue trends and you will see continued improvement in our EBITDA, in dividends, in cash flow, all the good stuff coming through.

We think there are many opportunities for us. And if we execute particularly in our investments in fibre and also in the Far East, we also remain convinced that we can become a growing business again at the top line as well as continuing to grow at the bottom line.

Thanks very much. Over to you, Tony.

TC Thank you, Ian. Good morning, everyone. I'll take you through the results for the fourth quarter and full year in a bit more detail.

Starting at the top of the income statement on revenue, revenue declined by 4% in the quarter. This includes the impact of a £47m decline in transit revenue and a £27m decline for the disposal of our investment in Accel Frontline last August. Consequently, underlying revenue, excluding transit, was down 2%. This reflects the lower revenue from calls and lines that has continued throughout the year, as well as the challenging economic environment we're seeing. It also reflects our active decision during the year to move out of some low-margin IT hardware trade sales, as well as the impact of the £13m retrospective regulatory charge in Wholesale. For the year as a whole, as Ian mentioned, our revenue decline was within the guidance range we gave at the start of the year.

We delivered another quarter of growth in EBITDA, which was up 4%. This reflects our costs transformation programs which led to costs declining by 7% in the quarter. I'll say more about these later.

Depreciation was down 2%, which contributed to operating profit growing 9%. Profit before tax rose 13%, which in turn drove a 10% increase in our EPS to 6.8p.

Specific items were a credit of £107m, mostly due to the impact of the recent change in the corporation tax rate on our deferred tax balances, with a further £14m of restructuring costs in Global Services, taking the total for the year to £64m. This was slightly more than our outlook of £50m, reflecting the complexity of our network rationalisation program.

Additionally it's taking a bit longer than we originally envisaged. And for 2013 we therefore expect around £40m of further restructuring costs in Global Services relating to our Infonet and Radianz networks. If you remember, we acquired these a number of years ago and we are in the process of migrating customers off these legacy platforms. We expect to generate further savings as this process completes.

Turning now to the next slide and free cash flow. Free cash flow for the quarter, cash capex was £63m lower than last year, reflecting the timing of supplier payments. Interest and tax were together broadly unchanged against last year, with lower interest being offset by an increase in tax, reflecting our higher profits and an increase in the effective tax rate.

Working capital and other showed £162m improvement compared with last year. Most of this reflects the phasing of working capital within the year, but it also reflects lower regular pension contributions. You may remember that we said these would be lower this year after we made some overpayments last year.

The cash cost of specific items was £53m, bringing the total for the year to £204m. This was more than our £180m target, largely due to a cash payment relating to a historic regulatory decision. For 2013 we expect a cash outflow of around £100m for specific items relating to the Global Services network rationalisation and the ongoing cost of the property rationalisation programs.

Turning to the next slide, which is about free cash flow for the year, at £2.5bn this was well ahead of the target at the start of the year and ahead of the £2.4bn target we gave last quarter. It has risen by £300m or 13% over the year, with the main drivers being growth in our EBITDA and lower interest costs as a result of lower gross debt. Cash Capex was £70m lower, benefiting by around about £40m from the timing of cash payments -- Capex payments, which boosted fourth-quarter cash flow. These improvements were partly offset by an increase in cash tax after we benefited from larger tax losses in the previous year. Working capital and other were broadly unchanged.

Turning to 2013 for the next slide, as Ian mentioned, we're now providing our outlook for cash on a normalised basis. This removes the impact of the tax benefit that we get when we make pension deficit payments. Because of the £2bn payment in March, our cash tax will be much lower in 2013 and therefore our reported cash flow much higher. Stripping out this benefit therefore gives a better view of the underlying cash generation and trend within the business. Our 2012 free cash flow of £2.5bn becomes £2.3bn when presented on this new normalised basis.

I'd like to highlight some of the moving parts of the cash flow that we expect in 2013. Firstly, cash flow in the year will be impacted by the timing of capex payments which I've just mentioned. This represents a year-on-year swing of around £80m. Our cash tax will also be higher as a result of our expected growth in EBITDA. Our regular cash payment pension contributions will be around £55m higher as they return to a more normalised level. And finally, on Global Services, the timing of the contract-related payments means that 2013 won't see the same level of working capital inflow that we saw in 2012. These four effects will broadly offset the underlying cash improvements we expect to make in the year. And, as such, we expect our normalised free cash flow to be broadly level when compared with 2012.

I also want to touch on the phasing of our cash flow over the year. Our cash flow is typically weighted to the second half, reflecting the phasing of payroll costs and the timing of some large recurring supplier payments that we make. While we've been making efforts to smooth the cash profile, this phasing will be particularly evident this year for a couple of reasons.

Firstly, the timing of our working capital in Global Services means that we expect the operating cash flow for this division to be lower in the first two quarters compared with a year ago. And secondly the cash phasing which I've already mentioned means quarter-one cash flow for the Group will likely be slightly lower than last year, with this being made up later in the year.

Moving on to the next slide as far as costs are concerned. We continue to make progress in reducing our cost base. In the quarter we reduced our operating costs by £242m. That's a 6% underlying reduction. And for the year as a whole we reduced our costs by over £900m, also a 6% underlying decline.

Excluding leavers, the labour cost reduced by 2% in the quarter and by £112m or 2% for the full year. This was partly offset by higher leaver costs which increased by £40m, mainly because of higher participation in Openreach leaver schemes.

Around 40% of the reduction in our cost base for the year reflected lower transit revenues and associated costs. The remainder reflects the underlying progress we've made in reducing costs across all categories. Let me give you a few examples.

We've reviewed our consumer sales and provisioning process with a particular focus on bundled products. The program has delivered significant improvements in our Right First Time measure and it's reduced cycle times. As well as improving the customer experience, this generated savings of around about £20m in the year. When it's fully implemented the program will deliver savings of around £50m.

In addition, a review of our learning and development activities delivered savings of about £40m in the year through improved supplier management, the introduction of a new centralised training model and a more effective and efficient training program for our field engineers.

Turning to the next slide, as a result of these types of activities, we've been able to deliver big reductions in our cost base over the last three years. We've now reduced our operating costs by around about £2.9bn over the period. And including our Capex, our costs are down by £3.4bn. As we look forward, we still see plenty of opportunities to make further cost reductions. We'll continue to focus on re-engineering BT-centric processes with the aim of removing failure. This will deliver a better customer experience while at the same time reducing our costs.

We'll further rationalise our supplier base and we'll ensure that we work in partnership with our key suppliers. And we'll carry on reviewing our resourcing strategy to ensure that we utilise our existing resources more effectively. Overall, through a continued forensic analysis of our cost base, we still see plenty of opportunity for hundreds of millions of savings in the coming years.

Okay, moving on to debt. We finished the year with £9.1bn of net debt. This was an increase over last year, caused primarily by the £2bn payment that we made into the pension scheme in March, which offset the cash flow generation during the year.

Looking at our financing requirements for the year, we have around £1.7bn of term debt maturing this year, and we'll also be buying back around £300m of shares as well as paying dividends. In terms of financing needs, we start the year with cash and investment balances of £800m. We'll obviously be generating cash over the year and we also have our £1.5bn committed facility. Despite all that, we will continue to look at opportunities in the debt market.

It's worth making the point that when you're thinking about our interest charges for the year, the timing of our maturities means that our gross debt will only come down materially in the fourth quarter.

The maturing debt also has an interest rate below our average, so this will push up our effective interest rate in the following years. Again, we'll continue to look at opportunities to reduce this where it makes economic sense.

As you know, reducing our net debt has been a focus for us, and this remains the case today. We're a prudent company and we want the financial strength that comes with a solid investment grade. That's why we're targeting a BBB+ or a Baa1 rating, which we aim to achieve through further debt reduction over the medium term.

Turning to the next slide. For the current year there are a few additional items I'd like to draw your attention to. As Ian said earlier, we expect our underlying revenue excluding transit to show an improving trend this year. We exited 2012 with a revenue decline of just under 2%. And from April we've had the impact of the new charge controls on WLR and LLU to contend with.

Quarter two also faces a tough comparative as a result of the timing of contract milestones within GS last year. As such, we expect the improvement in revenue trend to be weighted towards the second half of the year, with an overall improvement in revenue trends for the whole year.

We expect transit revenues to decline by around £200m to £300m this year. Transit revenue is very low-margin and can be volatile as it's impacted by regulated changes in mobile termination rates. For this reason we're providing a range on that.

Capex for the year came in at £2.6bn, in line with our target. It's now been at this level for around about three years and we expect this to be the case again in 2013.

Finally on tax, we expect the effective tax rate in the income statement to be about 23%. This is slightly below the statutory rate, reflecting the utilisation of historic tax losses. The £2bn pension deficit payment we made in March this year, together with the expected £325m payment next March, should reduce our reported cash tax by around £560m.

So to sum up, this has been a solid year. We've achieved or beaten the outlook we set at the start of the year on revenue, EBITDA and cash, even though the environment was much more challenging than we expected. Despite these challenges, we expect to continue to improve our underlying revenue trends over the next two years.

The visibility we have on further cost saving opportunities means that we're confident in our ability to grow EBITDA and our free cash flow over the same period. Our prudent approach to our capital structure allows us to keep investing in the long-term future of the business, while at the same time reducing our debt and rewarding our shareholders. Overall our aim is to continue to do what we're currently doing. We've made progress but there's much more to do.

Thanks for listening. We'll now take questions.

Question and Answer Session

James Britton
Nomura

Just a question really about intentions on mobile in the context of Vodafone's deal. Would you consider, well is it the right time to consider a new partner in mobile now that Vodafone will become your biggest competitor in the business segment?

And then can you just give us some clarification on how many of your business clients you actually sell mobile services into? To how many of your business clients is an integrated fixed and mobile product set, what you're delivering today?

IL

Vodafone are a big customer, a big supplier and a big partner. I think you all know that Vittorio said he would give me a call as soon as he'd finished his acquisition presentation. And he was absolutely good to his word. And he even said that next time he'd probably arrange it through the secretaries rather than the world press. They did, and we'll carry on working closely with Vodafone.

But we also work closely with other mobile players. Everything Everywhere, O2, 3, they're all big customers of ours. And we have a good MVNO arrangement with Vodafone today and we'll carry on working with them.

I think in today's society, in our industry, you can absolutely have someone who's your partner and your competitor and I think there's a level of maturity. And I think Vodafone see that as well. So we'll obviously see what's happening, but we're not going to make any rash decisions. And probably, in the meantime, we will also look to see what opportunities this takeover, if it actually completes - I'll leave that to you guys - has.

In terms of our mixed mobile and fixed, whilst Jeff has some businesses that are, there's very little where the mobile gives you the fixed. It's really in the SME business where we've got a far more combined package. And Gavin, do you want to say anything about that?

GP

Well it continues to be very much a key part of the strategy for us in SME, and we've got 100,000 users of our fixed and mobile services at the moment. But I see that as potential for future growth. So that's really all I wanted to add.

James Ratzer
New Street

I had two questions, please. The first one was just regarding BT Vision. Are you interested in giving that a bit of a kick-start by reaching a commercial agreement with Sky on the remaining sports channels?

And the second question is a slightly more philosophical question looking at Openreach. It's obviously quite strictly regulated by Ofcom on a rate of return basis. You're clearly being much more efficient on your fibre roll-out. You're talking about long-term plans on moving to fibre exchanges. That presumably means long term your capital employed is going down. How do you balance the near-term efficiency gains with the risks that the longer-term lower capital employed base could mean lower overall returns? Thank you.

IL

On the second one first, I think our bigger problem is not so much our capital employed going down, because actually we're putting a lot of expenditure into things like fibre. It seems that some of the decisions don't recognise some of the capital employed we've actually got. That's more of a challenge.

Actually fibre - bear in mind that fibre is not regulated. Ofcom made it quite clear that they looked [into this] in great depth before we started the fibre roll-out that they weren't seeking to regulate it, particularly on the grounds of the fact that they saw copper as an alternative and they didn't feel it should be regulated. To be honest, actually if it was, if you take the cost of capital and returns criteria, probably the prices would be a lot higher than they are today.

So it's not from that point of view. It's always a challenge, however, in a regulated business, if you take costs down, if you become more and more efficient, at some point some bit of that comes back - the regulator looks at that. And maybe to a degree some of the price changes that we've seen reflect some element of that. But I don't know, Liv, if you want to add anything to that?

LG All we've done in the last quarter is get ourselves ready for the prices that I guess have come. So I think we're getting ourselves in line and I don't think we're getting ourselves necessarily out of step as it stands now.

IL And on BT Vision, we'd absolutely love to enter into a commercial agreement with Sky. Sky are one of our biggest customers; we merely wish to be one of theirs. And so my door is always open and I'm sure Gavin's is as well. We would love to take the Sky channels. Not having Sky 3 and 4 personally is a bit of a problem with Scottish football, and clearly that's critical. There is an asymmetry and that's frankly why we've gone to court. And we await the court decision, but we absolutely want to be a customer of Sky in the same way that Sky are a big customer of ours. And that would seem in the converging world absolutely the right outcome.

James Ratzer
New Street Can I follow up with if you think fibre will be regulated and if so, when that might be?

IL Well I think I said Ofcom looked really carefully at this and they were very clear as to why not. And I don't hear any sign from Ofcom that they think that was a bad decision. And they made it very clear that they see copper as an alternative methodology. And it is equivalent. Everybody pays the same price, which again is something I would recommend that Sky could look at internally.

John Karidis
Oriel Just a couple of questions, please. The first one is relative to BT Retail, where are the other big subsidiaries in terms of their cost-cutting journey approximately?

And then secondly, are there any exceptional revenues or costs or capex related to the Olympics, please?

IL On the second one, we have been accruing the cost of the Olympics. There will be a bit more cost this year, particularly on rights activation, but we have been providing as we've been going along for it. So there will be some extra costs this year. But maybe the best person about costs and both questions, Tony, do you want to answer them?

TC Yes. Sure. In terms of the first question, I think it's good to look at BT overall. Three years ago we were in the fourth quartile in terms of the benchmarking within the telecom sector. We're now at the bottom of the second quartile. Inherent within certain activities, if you look at what we're doing in terms of IT and network operations, we're in the third/fourth quartiles. So there's plenty of opportunity there.

If you say where we are on Retail, not that I'm talking about discussing Gavin's budgets and targets next year, but he's got hundreds of millions of pounds of savings that he needs to do next year. I can see he's delighted by that.

But what I would say is within the other lines of business, we're at different stages of the evolution cycle. And we've got plenty of opportunities there, both in terms of those generic processes that go across BT as well as specific activities within the lines of business. We're not short of opportunities.

In terms of the Olympics, look, we're going to incur more costs this year than we did last year, but there are no one-off items that we are going to be declaring as specific. It's simply a cost of doing business and hopefully we'll get the benefits of that moving forward in the later years.

Steve Malcolm
Arete

A couple of questions, one for Gavin and one for Tony, please. First of all just on Retail pricing, I guess we've seen general modest inflation in things like line rental for the last two or three years, but that to a degree has been supported by general modest inflation in wholesale prices. That clearly disappears this year and next. So how do we think about the Retail pricing environment on the back of lower wholesale prices?

And then secondly for Tony, just on your points on liquidity and debt, I guess you've given very clear guidance on cash flow, dividends and buybacks. And you can do the maths and at the bottom appears about £2.3bn, £2.4bn of surplus cash, to use one phrase, over the next couple of years. Do we assume that that's used primarily to pay down debt, because obviously one way of sorting out your interest is just simply retiring debt, not borrowing money at a higher rate than the average rate? Thanks.

IL

Okay. Gavin, do you want to talk about pricing? You've got some great deals for Steve up there.

GP

Yes, of course. You're right to observe it's a very price-sensitive market at the moment. There's no question about that. And we've seen a number of our competitors go very aggressively in the last quarter, really chasing volume. And we're not necessarily going to follow that where it's uneconomic. So it will, I think, move around a little bit.

More generally in terms of the scope to drive pricing more strategically, should I say, we do see inflation coming down and I think that provides less of an umbrella. And we have made a commitment at the same time to hold our prices until 2013. And I think we're seeing the benefit of that come through in more stable operations, better value-for-money scores, higher satisfaction. So I think that was the right thing to do.

Beyond that, I think the answer for us really lies in bundling. We are under-indexed on bundles still versus our competitors. And bundles allow us to provide great deals to customers, with strong structural economics and much better churn characteristics. So I think that's where we'll focus our efforts going forwards.

TC Steve, it's very difficult to retire existing debt economically. But if you look at the maths of what we're doing at the moment, we've got £1.7bn in maturities coming through this year, the bulk of it in January 2013. Our weighted cost of the term debt at the moment is 7.5%. The debt that retires is at 5.8%. What that actually means then is the weighted average cost of our debt goes up to 8%. But economically it's very difficult to impact that in a commercial sense.

Steve Malcolm
Arete

How much gross cash should we assume that you need to run the business with? You have £0.8bn at the end of this year. Do we assume that you run on about £1bn for working capital and other purposes and we make our own conclusions on what you do with the extra cash that drops out?

TC What I'd say is having surplus cash in the current climate doesn't give you much return for that. So we've got further debt maturities, nothing in 2013/14 but more in 2014/15. We've got the buyback, so we may go into the market. But if we go in the market, I don't want to be saddled with long-term debt with a high cost to carry.

IL If your other question was were we thinking of doing something if we had the cash sitting there, no. If it was a question about was it burning a hole in our pocket, no. But we'll nibble where we can at buying back some debt. But it's really very tough, it's very tough, very tough because prices go.

Andrew Lee
Goldman Sachs Just a question first on your guidance. Clearly visibility on the top line is more tough and therefore you've set directional guidance which is necessarily broad, but you've been pretty explicit on your free cash flow guidance. And just trying to get a sense of your confidence in that free cash flow guidance. If your revenue declines improve to 1.8% rather than 1.9%, are you still confident you'll deliver the free cash flow number?

And then just secondly, you've highlighted fibre, Ian, many times through the presentations. I just wondered what your thoughts are on the fact that your competitors haven't been pushing fibre yet and whether you expect that fibre push to accelerate through 2013 and if that's in your guidance as well?

IL We live in an uncertain world, but I'd just say to you, as you go down the P&L and for cash, these things are more within one's control. I think our ability to deliver a more efficient business is within our own control. And we may be at bottom end of the range on revenue, although we were in the range, and we beat the cash flow quite handsomely. I think that should tell you something about our continuing level of confidence.

And on fibre, TalkTalk have started, I think, doing a lot more on fibre. Fibre's there. As I said at previous meetings, we win either way, frankly. If our competitors don't push it, BT Retail does well. If competitors do push it, Openreach does well. Either way we win on that. But it's not for us to disclose what they're saying to Openreach because that's up to them. But, it's available to everyone to use and my advice to them would be to do so.

Carl Murdock-Smith
JPMorgan Cazenove

Two questions. Firstly, Ian, just why do you think the broadband market overall is growing faster than it was a year ago?

And then secondly for Liv, on the pace of the fibre rollout. Very impressive. How did you manage it with seemingly no impact on opex or capex in Openreach, and what should we be expecting for the pace of the rollout going forward? Thanks.

IL

On broadband, I think, the UK is actually one of the most connected societies anywhere in the world. As much as some newspapers like to do the UK down all the time, if you look, there was a recent survey from BCG that said the Internet was the largest proportion of the economy in the UK in the world, beating places like South Korea. So people are using it, particularly for e-commerce a lot in the UK. But also pricing is really effective. If you just open any newspaper, the degree of advertising is immense. And thirdly, we're offering more and better, and I think the fibre is part of that.

So you would think in today's economy that broadband would tail off. And I think it's surprising it's been as strong as it has been, but encouraging. And of course also on our network, the market share of the BT network and compared to cable is very, very strong. And certainly what we're seeing is I think our network doing very well relative to cable.

And in terms of the Openreach team's sterling effort in delivering 10m, Liv?

LG

Yes. Sometimes things come together don't they, right? So a lot of work in Q3 came out in Q4. So there's definitely a bit of spine work goes in, it takes a while, it comes through. So that's fair. We also had to begin to push ourselves harder to make sure that we were ready for the BDUK bids, if they come through. So part of it was a sense for ourselves. We're delivering efficiently. We remain on track for our financials for the fibre program and we're good at deploying at scale.

Will you see it continue? So you're not going to see every single quarter the same scale because it does depend on which areas. We're going to go to less dense areas. That's the reality. We've done a good chunk of the UK now. We're going to begin to go to slightly more troublesome places.

We're also going to begin to see some of the BDUK activities come through. Again, they've got intervention funding for that reason. And of course we did lots of FTTC. So we have a fantastic machine now doing FTTC. We're gaining that same level with FTTP. We're going to need to do more in the coming year. So you will see the pace begin to flip around. So it will move through the quarters like it did this year.

Maurice Patrick
Barclays

A question on YouView just around how you think about the timing of it and if all the investment in that is included inside your EBITDA outlook. I assume it would be, but just checking.

IL

Yes, it is. Of course we do a lot on Vision. I may ask Gavin to talk about YouView. But yes, as I was stressing, there's a lot of things happening in Vision already and we're doing pretty well on the net adds. But, yes, our investment is included. But Gavin?

GP

To your point Ian, YouView is only part of the TV story for us. We're rolling out Vision 2.0, as Ian referred to in the presentation itself, which has much better search and recommendation capabilities. And that's beginning, as I say. We've got several thousand customers on that and that will grow over the next few months.

We've got multicasting, in other words being able to stream linear channels over our network, coming later in the year. And then we've got YouView. So we've got some boxes which are in pre-test at the moment. We would expect that to continue to go through a testing regime over the next few months.

And to answer the final question, yes, the investment is in our numbers.

Nick Lyall
UBS

Could I ask firstly just on the dividend, why not higher at the moment? Why the progressive divi? Why not push it up earlier?

And then secondly back on YouView, like Maurice's question. There doesn't seem to be a sense of the delay in YouView, if it is a delay, affecting any launches. Is that the case? And are you in a position, do you think, because YouView is possibly delayed and more and more outmoded of maybe talking down or negotiating down your investment in advertising others for YouView? Would you consider that?

IL

On YouView, no. YouView has always been part of what we were going to do, and absolutely we're not talking down investment. We remain excited about it. But, anything you want to add to that, Gavin?

GP

No, not really. It hasn't fundamentally been delayed. It's going through a normal process of testing. I fully expect it to come out over the summer months. So I think there's been one or two stories in the press recently that it's delayed again. I don't see that. There are a few more things to resolve, but we have got boxes. We've got them upstairs here and we're trying them out. We've just got to iron out the wrinkles, as do the other partners.

And it's a decent, it's a really good product ultimately. When you get to see the EPG and what it will do, pulling together backwards-looking programming, links into portals that allow on-demand, both paid and non-paid, it will be a revolution in the TV market. So we certainly believe it's worth waiting for and we will invest in it.

MR

Yes. I think in relation to the question on dividend, we think the most important thing, as we've been saying for some time now, is the dividend should be sustainable and progressive. And we think you should be able to rely on a dividend increase of 10% to 15%. And we think that is of good value to the shareholders. And this is after the continuing need to continue to invest in our infrastructure and our business for growth, to continue to deal with the pension fund deficit and reduce its volatility in impact on us, and to be able to retain a conservative balance sheet that allows our credit rating to improve and over time for our future cost of funding to reduce.

And I think when you see also what's going on in the Eurozone at the moment and the uncertainties we face for some considerable period of time, I think we do need to be conservative. And therefore at the end of the result of investment, the end of the result of really reducing the deficit in the pension scheme is a dividend of that sort of level we think is absolutely the right thing to do at this point in time.

IL

I think it also reflects what our shareholders said to us. They said we want to be able to take it to the bank. We want to see growth. Yes, we want to be rewarded. Some of them said they want to see some more of the share buybacks and I think we've reflected that. We had to make our own decision, but we listened to them. So I think very much reflecting about taking it to the bank, looking long-term consistent increases, and that's what we'll provide.

Robert Grindle
Deutsche Bank

It's actually a follow-up on the use of cash actually. The Mexicans see distress value in Holland. The Chinese see distress value, if you listen to the press on your doorstep, in Ireland. Vodafone sees distress value in the UK. You do have a strong balance sheet. You are generating a lot of cash. Would you not look at distress value as a way of using some of that cash?

And I'm afraid I have to ask a pension question. The Pensions Regulator's got a bit grumpy about, or is suggesting companies don't change the actuarial valuation date. You had good reasons to do that because of your top-up, but there was a side benefit to that in terms of the valuation. Is there any knock-on impact from what the Pensions Regulator's been saying or do we just address this again in three years' time?

IL

Well actually the Pensions Regulator said it didn't want people changing it just to reduce the payment stream, if you read the whole sentence. And we have not reduced the payments; quite the opposite, we've increased it. We've actually paid off more than half the deficit in one shot. So no, it's entirely in keeping with what the Pensions Regulator said. So I don't have a problem in that sense.

Robert Grindle
Deutsche Bank

Well a follow-up then is it did clearly impact the deficit. Would it be possible to know what the deficit would have been at December?

IL

Well at the time we said it really depends what assumptions one made about future, because one of the real problems was working out what exactly would have been future gilt yields and what was the assumptions you make around it. Clearly the deficit at that point may have been higher. But since then, even despite recent days, gilts have gone the other way again. So, everybody knows the gilt market is affected by QE, that's no great shock. And we'll see in three years' time as to where we are with it. But what we have done in the meantime is in one lump put in over half the deficit funding, and the great news is, because we can. And it's been, I think that's been worthwhile for everyone.

In terms of distressed assets, often distressed assets are distressed for a reason. And I still think that the majority of, maybe over 100% of the benefit, we can give to shareholders is by really good operational execution, I think. But Mike, do you want to add anything?

MR

No, I agree. We should focus on what we do well. We should not be distracted by things that might look cheap. We should stick to our core business, improve our customer service, get our growth going, continue with this reduction of debt and get the dividends to you guys right and the shareholder value up. That's what we should do.

IL

We've always said that we have a strategy, not an acquisition strategy. And if there's ever little things that you want to put in to do that, we've done that in the past and we'll do it again, but really looking to say if you can't improve the business as a result, that's got to be your key measure. And we'll leave it to you guys to be the investment houses and things like that. That's not our job. Our job is to run a really good communications business and that's our aim.

Stephen Howard
HSBC

I just wanted to return to the topic of regulation. If you look at the charge control review for LLU and WLR, I was just wondering whether you were disappointed, or maybe actually I should just ask how disappointed were you in that particular document?

There's one sentence that really stands out for me, and I may be guilty of selective editing here, I warn you in advance. But they say – 'fortunately in the UK we are beyond the point of initial incentives to encourage investment in new technology. Accordingly our main focus is to protect consumers at a time of technological change'. I'm wondering, is although admittedly you're not price regulated on fibre today. But what insurance policies are you putting in place to ensure that once the capital is deployed, shareholders' interests are protected for the long term? In other words, how can shareholders be confident that you can convince the regulator that investment is for life and not just for Christmas?

IL

I think one of the most important things is look at the pricing. The wholesale pricing is really low and it's available to everybody at the same price. As I said in the presentation, I suspect if you actually started regulating fibre, the price would go up quite considerably by any European or international comparison we've got. The reason we've gone for it is a very simple commercial reason, we want to get volume. Once you've got fixed cost, you want to get that volume. And that's really what we're going after.

And Ofcom also recognise that - they looked very carefully at this issue and said well we recognise that copper is an alternative asset that people can take. And frankly, that acts to effectively create a much larger market. So they didn't feel the need to regulate it. And that maintains position and there's no indication I've had from Ofcom that they've got any different view from that.

I don't know whether you're asking for an answer to the first bit, which was how disappointed we were. Liv, why don't you say how disappointed we were?

LG

Yes, not probably for public consumption. Pretty harshly disappointed. I think there's lots of stuff that was missed out on the cost base that we feel quite hurt about that we think should be considered. And I think we don't agree with some of the maths equations in terms of some of our costs, such as repair charges, that factored into it. So obviously we'll make sure that we make that very clear in the ongoing debates that come up. And I think there's some real merit to some of the arguments that we have.

Stephen Howard
HSBC

If I can just follow up. There's an interview with one of your leading Wholesale customers about retail competitors on Tuesday, in which they're suggesting that Ofcom should move the charges on wholesale fibre down, one presumes sharply, as soon as the first phase of the build is complete in 2015.

IL

Yes, I read that interview as well, I think to which I would quite clearly say, given there's a double-digit year return, if she was wanting to invest in fibre, we would be delighted to buy from her at cheaper prices. We'd be very, very, very happy. So we look forward to them making the investment and we'll buy, because normally their timescale is a lot shorter than double-digit year returns.

And look, guys, you do the analytics in this, you know the price of UK fibre and you know the comparison with the rest of Europe. The UK is in a really good position. We're talking about fibre being retailed at £18 per month. That is a really good price. So I don't think there's really an issue.

As I said, I think if Ofcom had regulated it based on the cost of capital assumption just now and return on assets, the price would be substantially higher than it is today. That's the truth of it.

Paul Sidney
Credit Suisse

Just two questions, please. Compared to 12 months ago, given the outlook for Global Services remains challenging, have you got plans to accelerate the cost-cutting program in that division versus what you thought 12 months ago?

And secondly, given the launch of YouView and the potential explosion in video content, do you see that potentially being a problem for your network? Thank you.

IL

Well, I'll do the second one and then I'll ask Tony and then Jeff to talk about GS. No, we don't see it being a problem. We have a very good content distribution network. We've invested heavily in that. And that allows us to cache stuff locally and that's been a big help. And if you see with iPlayer on our TV, lots and lots of demand. It's a great service, no buffering - it's because of local caching.

So there'll be lots of reasons why data usage in our network will increase, and unquestionably it will do. That's a good thing. To be able to charge for it all the time would be an even better thing. But it's a good thing that it's increasing because there's big demand and we can scale our network. We had a 21C network and it wasn't necessarily all it was made out to be. But one of the things it was, was a really strong IP core in our network, and that's made management of bandwidth really a lot easier for us.

And Tony and then Jeff, do you want to talk about GS?

TC

I think it's worth reflecting that over this last three years we've had over £700m swing in cash from Global Services. Some of that's come through revenue. Some of that's come through cost savings. But when we look at what needs to be done, it's not acceptable that we've got a business worth £8bn generating less than £200m. It's not acceptable. We know we need to move that on.

Part of moving that on will be continued focus on cost savings. Sometimes you don't see the impact of the cost saving activities, because when you look at costs you have your gross savings. You then have a movement associated with margins. You then have the investments, so within Global Services we've had investments, as Ian highlighted, in AsiaPac, in EMEA, in LatAm. And you also have the impact of inflation.

So when you see a number, you see a small number, but it doesn't mean that cost savings aren't taking place. That said, we had a 1% reduction in the year, 3% in the quarter. I think that 3% in the quarter indicates the sorts of trends that we need to move onto.

JK

I would add to that we referred in the presentation to network consolidation. Those are long programs, very complex. So we'll see the benefits of things like RXN and Infonet closures across the world. Another example I would use to get to what Tony was talking about; we have certain back office functions. CDSS is a great example of that, where we take our consolidated inventory management billing systems and we take the contracts and move that to, in essence, a shared service. And we've got both an insource, where we're taking that captive, and we also have a supplier that we use. We've focused on the top 40 contracts. We've got a lot of other contracts around the world that can take advantage of things like that.

IL One other thing we should say about Global Services, and I think it's important. We'll be pushing for because people talked a lot about regulation in the UK. We would wish regulation around the world to be regulation in the UK. And certainly one of the areas where we're pushing very hard, and I think the US is absolutely high on our list and we've spent a lot of time with the FCC and a coalition of partners, like the No Choke Alliance, that really costs should come down in a lot of these areas.

It's not in our existing plans, but it's something that we really are looking for going forward because there is a regulatory imbalance. And certainly we offer a lot of these incumbents the sort of prices and availability in the UK that they don't offer and it's about time we had a bit of a levelling up.

Guy Peddy
Macquarie Just a couple of quick questions. Firstly on Infinity, by the sounds of it you're obviously discounting or subsidising that product currently. So do the economics for the BT Group work without a successful wholesale product?

Secondly a question for Gavin on BT Vision. Can you just give us a breakdown of what people are actually doing currently with BT Vision? How many are watching premium channels or what actually is the consumer doing?

IL No, we're not subsidising Infinity. Actually we get good ARPU uplift with Infinity. People get a little bit confused between how we market the product, which is very clearly. We've set the prices linked to our Option 2 and 3 broadband. But understand we've actually got three levels of broadband. We don't have an Option 1 Infinity equivalent. It's called Option 1 but it's priced at the same as Option 2 broadband. So you get a really good mix change, apart from the fact we expect to have significantly lower churn from Infinity. So we will make good money out of Infinity at a retail level. No question about that.

And the extra cost from Openreach is actually covered by the higher ARPU that we achieve on Infinity. So I think that the question is wrong from the start, to be honest. Gavin, do you want to add anything to that? And also what are people doing with Vision?

GP I'm not sure there's much to add on the Infinity question. I think Ian's answered it.

In terms of Vision, it's a multitude of things, to be honest. It's not a silver bullet in that respect. I would call out catch-up as a service that is very popular, be that on iPlayer (where I think the BBC would consider us to be one of the best, if not the best, example of iPlayer deployment across the country) or another catch up service. That's been very successful for us in the last 12 months. But also things like the movie service have continued to grow, particularly new releases. We've got a good selection there, and added HD and 3D in the last 12 months and those have proven popular.

There is a significant group who take premium channels like Sky Sports. We'd like it to be more. We'd like to broaden the offer by adding [Sky Sports] 3 and 4, as we were talking earlier. And as I look across the year ahead, I think the more we can weave linear and non-linear programming together, I think we'll begin to bring more and more competitive advantage to the service.

So it's not going to come all together, but if I look at the collection of Vision 2.0 with its better search and recommendation capability, if I look at YouView with its reverse integrated EPG, and then I look at multicasting, where we'll be able to significantly increase the range of HD and SD channels that we offer, I think you're beginning to get a strong offering that, coupled with fibre, really ups our game and gives us something that is very, very competitive against cable and Sky.

Simon Weeden
Citi

A question first on the stock buyback - I just wondered whether or not the stock buyback you've announced is going to count against the agreement with the trustee about how much cash you distribute to shareholders over the next three years? And also whether you can give us the average exercise price for the options that you're seeking to counter the dilution of?

And then the second question, because that was only one, balance sheet.

IL

That was not one at all. I've even forgotten what the first one was.

Simon Weeden
Citi

The BBB, BBB+, what do you require to get that in terms of credit metrics to get to BBB+?

IL

Okay. That definitely is three. I'll ask Tony to talk about BBB+. In terms of the buyback, in our agreement with the trustees, the buyback of shares related to employee share schemes was excluded from the metrics. We've got an SAYE scheme that is due soon and that's going to be the majority of it. I think from recollection it was 68p. The great thing is we'll have 20,000 employees who will, on average, at today's share price, make a profit of £8,500 each. So there are a lot of team members who will do really well and I think that's a really good thing that they'll share in the benefits.

TC

The way the rating agencies work is on a ratio of net debt to EBITDA. Incorporated in the net debt, they add back operating leases, which is roughly speaking about £4.7bn and the gross pension deficit, which is £2.4bn.

What they'll then do is look at the EBITDA number and then they'll add back £0.3bn for the operating costs and the operating leases. That will get you to a ratio of round about 2.5 to 1. That's at the bottom end of the range that we're currently on. To get to up one notch, whether it's Baa1 or BBB+, you have to get that ratio near enough to 2 to 1. So if everything else stays equal, that would mean that you'd have to have a debt number with a six in front of it.

IL Thanks for your time and have a very good rest of the week.