

BT Q2 2012 Results Presentation

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Voiceover 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 20F for examples of the factors that can cause actual results to differ from any forward looking statements we may make.

IL Hi, good morning and thank you very much for coming to BT auditorium this morning.

First of all just to give you the overall numbers. I think it's a pretty straight forward set of results. Underlying revenue is up for the first time for quite a while. Profit, cash flow up and slightly ahead, I think, of expectations.

What we'll try and do as we go through the numbers is just highlight to you any areas where there are some particularly one-off or unusual items so you can be clear about that. But Tony will go through these numbers in a lot more detail.

What I'd like to do is go through the divisional performance and start off first of all with Global Services. Revenue in Global Services was up on an underlying basis excluding transit, up 3%. A big part of that however, whilst it was on any metric a significantly improved performance, was due to a milestone recognition which came forward from Q3 into Q2. Basically we delivered really well and we accelerated the recognition into Q2. That was worth £60m. Excluding that milestone basically, revenue was flat. As I said, that's quite an improved performance from previous quarters, but it did come out of Q3.

Net operating costs were flat, they were up 2% excluding transit, but again if you exclude the milestone cost, because there's a cost associated with the recognition, they have improved about 1%.

Overall that meant that EBITDA in Global Services improved, up 15%. In terms of the operating cash flow, down in the quarter, but as much as operating cash flow tends to be pretty choppy quarter by

quarter at Group basis, even more so on an individual line of business basis. And we remain confident and our guidance is for around £200m of free cash flow for the year as a whole.

In terms of operational metrics, the 12-month order intake in Global Services was £6.6bn and £1.4bn in the quarter. That was probably £100m, maybe a bit more than that, less than we expected, but we did expect to be significantly less than last year because this time last year, we highlighted it to you, there was a £600m contract with the Ministry of Defence, a very large contract.

There's also a couple of other things happening, one in particular, which is we're seeing quite a big change in the mix - we mentioned this to you at Q1 - between new contracts and re-signs. If you look for the first half of last year, about a quarter of our business was actually new contracts, i.e. new customers and that's increased to about half of the customers in the first half of this year. So we've moved from a quarter to a half. And that's the other side of very low level of re-signs.

Actually what's happened in terms of re-signs, if you look at our Top 20 contracts for instance, only three of our top 20 contracts are due for re-sign this year. And only two of them are due for re-sign next year. So a lot of the re-signs have already happened. So a lot of them won't be coming up, so that will change that mix but we have actually seen new contracts with new names increasing and that shows some of the success in the market.

And that's coming in a number of places. First of all in the UK, which we don't talk a lot about, we are seeing UK business improving. Of course it's a challenging environment, but if you look at somewhere like the retail sector which tends to be the bellwether of value and one of the more difficult sectors, we won Best Buy Europe, that's Carphone Warehouse stores and Best Buy Warehouses, that's a good win. But in addition to that in the retail sector, Travis Perkins came back to BT, a big win with the Co-op and also Kingfisher; B&Q came back to us. So a number of significant wins in the retail sector and that's good because it's quite a bellwether sector, which a few years ago we weren't doing so well in.

But outside the UK, if you look first of all in Asia, the AsiaPac investment is proceeding well. The pipeline's up significantly and we're starting to turn that pipeline into real orders. A couple I'd draw your attention to, one the name's on the board, CLSA, which will be known to a number of you, a big bank coming out of Hong Kong and it's for a global network for them. But also the Fiona Stanley Hospital Complex in Perth, one of, if not the largest health project in Australia. We are providing IT services using our health expertise actually on a global scale. And that actually adds to a contract that we won and we're providing in Singapore. So, health goes beyond the UK.

Outside AsiaPac, in Latin America we've seen good wins there as well, and we've said that we are going to invest in Latin America, we're recruiting about 250 people, we're bringing a large range of our products to Latin America, and some targeted investment in network.

We intend to double our revenue in key Latin American economies and we think it's a real potential area of growth. And we're already seeing some of the benefits. I mentioned last time about our large server contract in Latin America for Brazilian Post Office, but actually a lot of it is also about our global multinational customers who are coming into Latin America or more importantly expanding in Latin America. A couple of them are shown there. SAB Miller and Novartis, big customers for BT, but we had big wins in Latin America because they're expanding their presence. We like to go where our customers are.

And on the subject of network investment, it's not just Latin America, we are targeting network investment in terms of additional MPLS points of presence, Ethernet and city fibre networks across the world. Places like Middle East and Asia and in Latin America. It's not like the old days when this is billions of pounds of expenditure, these are tens of millions of pounds. We've looked at where our customers are going. We looked at where our customers are, not just the country, not just the city but within particular cities and responding to that. And that will do two things. One, it will cut our costs, because actually we'll use our own networks to provide services. Secondly, we think it brings revenue opportunity because we've looked at where we have lost contracts because we weren't as competitive and didn't have the right network topology, and I think gives some opportunities.

Turning now to Retail. In Retail, revenue was down 3%, an improved performance in our Consumer division, and I'll talk about that in a second. I'll also talk about BT Business, where the trends are slightly worse and I'll talk about which particular trend.

But one thing I should point out, MTRs, of course we talk about ex-transit for the business as a whole, but we've had a reduction in prices to end users in our Retail business, which we just reflect in the revenue, we don't adjust for that. And that's worth about a 1% hit to BT Business and about 0.5% hit to the revenues of Consumer. So that's in the numbers and we've just had to absorb that.

A couple of areas I'd like to mention are Ireland and Enterprises. The Enterprises business, particularly Conferencing, continues to do very well. And Ireland's done particularly well. We actually saw before the effects of FX, revenue in Ireland grow, which was a very good performance and profits growing in Ireland. So a very good performance, it shows what you can do by self-help even in a difficult economy. We're particularly doing well in the large Corporates space there.

Net operating costs for Retail down 6%. We show a chart actually on the right hand side, this chart here, which shows a continued decline in the cost base for our Retail business. We've been at this for about six years, we think there's still more to go and it is about improving process, improving service and delivering. And you've seen substantial opex savings in Retail.

But going now to our Consumer business, I think there's some very good metrics in Consumer. First of all, market-leading share of broadband, 166,000 adds, 63% share of broadband adds for LLU and DSL. That's actually up 46% year on year, and compared to two years ago, up 130%. So it's a really strong performance.

And something I want to try and put to rest, we keep on saying that Plusnet represents something less than 20% of our net adds. The number is 13%. And I know one or two of you despite the fact we say this, keep on insisting that all our net adds are Plusnet, the number is 13%. It has been for the last three quarters, 13%, which is somewhat less than one in five. So that's the number, it's a very good performance for Plusnet, it's a lot better than others and it's a good contributor. But it is only a contributor.

A bigger contributor is Infinity, 88,000 net adds, very pleased with Infinity and it is making a difference. It's making a difference, in Market 3 exchanges we particularly see the impact. We see new customers coming to us because of Infinity and it obviously must help to retain existing customers.

We've got over 300,000 Infinity customers. Within Retail they also have responsibility for rolling out fibre in Northern Ireland. And that's going very well. Delighted to say that Derry~Londonderry is the first fully-fibred city in the UK, and probably one of the first in the whole of Europe. And actually already now three-quarters of Northern Ireland, three quarters of Northern Ireland is now fibred and that's going to increase from here.

That's a real sign of what you can do when public and private work together and actually get on and do it. My congratulations to the Northern Ireland Government in terms of that. I think they showed a lot of foresight and they've really moved forward with it.

Another area where we're pleased with performance, BT Vision, 41,000 net adds and that's the best for more than two years. To put it in context and you guys will know the numbers, but if you take Virgin TV net adds together with Sky, they were actually less than half of that. So we are doing pretty well with Vision in terms of just adding on.

All of that, if you take the extra sales of broadband and Infinity and Vision it leads to increased ARPU and the ARPU is up 6% year on year. So overall revenue maybe down in Consumer, but I think the operational metrics are certainly encouraging.

BT Business is slightly different. It was a slightly disappointing performance in Business, but I want to be clear where it's occurred. It's occurred in IT Services. IT Services business for us and hardware was growing quite markedly and it seems not to be at the moment. And I think that may reflect some caution, particularly on the hardware side for a lot of SMEs.

So that's where we've seen really the change from previous quarters. Actually the underlying performance in our traditional telecoms business is very solid. Line loss was down 40% than a few years ago. Actually we're holding, at least holding our market share in the traditional business.

Call usage per customer is actually stable, which again is quite an unusual trend, and broadband net adds, up 50% year on year. So good traditional metrics, it's what's happened in IT that's affected it. I should also mention you can see that it's a mix thing in terms of IT because less IT hardware is not particularly injurious for your overall margins and that reflects in the fact that the profits for the first half actually in BTB are up, despite the lower revenue.

And now moving to Wholesale, we said to you last quarter that you could expect this year that it would be tough for Wholesale and it's proving that.

What's happening? Well, basically it's going through the periodic sort of change that can happen, which is a change of product mix. LLU is moving off, moving to Managed Services, but also Private Circuits are moving over to Ethernet. And whilst we're seeing very strong growth in these areas, it is actually a combination of that product mix, but also the costs of transferring people over to the Managed Network Services, some dual running and transition costs. So that's what's happened. And it's why when you look at the operating costs, which excluding transit are actually up, it's that mix issue that's happening.

So, it's a tough time, but it gives a real opportunity for Wholesale to change and to improve. But the overall strategy in Wholesale remains the same. We are the largest provider of Wholesale services in Europe and we think we've got real opportunity in a number of areas. I mentioned Ethernet, both fixed and to the mobile sector. Because one thing we're seeing is that capacity need is increasing all the time. But also in areas such as IP Exchange, small just now but growing at a very, very fast rate. The world is moving IP and we think IP Exchange could be an important part of the Wholesale offering going forward.

Now Openreach, I think a very strong performance in Openreach. Revenue up 4%, both internal and external revenue up, compared with 5% last quarter, but one of the best quarters we've had. We've

seen the growth where you'd expect, in Ethernet, in LLU and a first time mention I think on a revenue slide, fibre.

Net operating costs in Openreach were up 1%. That really reflects two things. First of all, leaver costs. Actually more than all of that increase is accounted for by leaver costs. But also a big increase in volume in terms of sending engineers out to do these extra connections, so there's a big increase in volume. However, in terms of the overall revenue increase in Openreach, it's coming through increased rental levels and that's important because that's long term sustainable.

In terms of the growth indicators, delighted to say another quarter of good old copper growing again, 11,000 additional copper lines. About 100,000 over the course of the last year and now well over 6m homes now passed with fibre. And we're delighted to announce that we're going to accelerate the fibre programme. We'll do it within all the overall estimates we gave you, cash flow, capex, overall programme costs. But we're going to bring it forward by a year.

Why are we doing that? Two reasons, one is we're pleased with how it's gone so far. Secondly, because we can, both financially and in terms of execution we're able to deliver it quicker.

I'd like to take a couple of slides to talk about the fibre programme. First of all innovations on speed, and I'm going to talk about delivery in a second.

In terms of speed, fibre-to-the-cabinet, Band Plan changes that were necessary were agreed with industry fairly recently and in 2012 we'll be rolling it out. That will see us basically roughly doubling the speeds to around up to 80Mbps and upstream speeds doubling to around 20+Mbps, so big increases in speed and really very little cost associated with doing that.

Fibre to the Premise, the wholesale product, is commercially launched this month. Initial speeds of up to 110Mbps and we said that in the Spring that we'd be looking to launch a 300Mbps product, and we are trialling a gigabit service. I'm not entirely clear that that will have a wide application for people, but we're trialling it, the technology will be there if/when customers are prepared to pay for it.

When we talk about speed, I thought I'd show a couple of charts that might be interesting. The top chart is what the speed distribution was before we started any of this fibre stuff. In terms of roughly half of the people were getting somewhere between 2 and 10Mbps and a bit over a quarter were getting between 10 and 50Mbps. If you look at that grey bit up there, that's about 12% of the population getting 2Mbps or less.

Now if we wind forward and we look at our fibre programme, and we say we did the two-thirds fibre programme and also we think there's

potential if you take all the various sources of government funds, whether it be the BDUK, EU money, local authority, put together we think there's opportunity to get to more than 90% of the UK with fibre.

If you do that, you do Band Plan and also something that a lot of other telcos will talk to you about, vectoring. What position can we be in? Well, first of all on the low speed ones, that 12%, that grey, you can hardly see, probably less than 2% of people will be on less than 2Mbps. And actually the trials we're doing with TV white space on the Isle of Bute are very encouraging. And I think that could take that number down significantly more.

So we'll have cracked a very large part of the slow spot problem and that will put the UK in a really strong position. But on the higher speeds, if you see over half of the UK would be getting over 100Mbps. About three-quarters of the UK would be getting over 50Mbps, i.e. over 50 or over 100. So, dramatically changing the whole speed environment in the UK and really very much delivering the goal of making the UK one of the best connected economies, not just in Western Europe, but frankly in the western world. And that is very attainable in our view.

So that's innovations on speed. I also wanted to talk a little bit about innovations on delivery. Because we've been doing this programme for quite a few years and you get better at it as you go along. And it's not that there's one silver bullet. It's about doing a number of things better. We've put a number of examples [on the slide]. I'll pick up a couple of them and I bet a number of you are wondering what's behind me. You thought potentially you'd come into the Balfour Beatty presentation by mistake.

Let me give a few examples. This is, some of you will have heard about it, Liv Garfield's shovel. This is the shovel that's extra, extra sharp. It means you can cut through tarmac. So it means that actually when our guys are doing the digging they can go through the tarmac, don't have to call out civil engineering crews. It may not sound like the most high tech innovation of all time, but it makes a difference.

A bit more high tech is this over here. This is a small DSLAM made by ECI and something we're looking at deploying. This will allow us to do areas that have got quite small populations around the cabinet, and we think that it will make a lot of areas that were previously too small to do, to make them financially viable.

And the one I particularly like is this. This is called a Polybase and I want to thank a chap called Craig Chapman. Craig's one of our planning team and Craig came up with this idea. He looked at some of the things that were done on the waterways and came up with this idea. And basically what it means is the big green cabinets, you put this in the ground and the big green cabinets sit over it.

And in the past we always had to dig the hole and put in concrete and then wait for it to set. That would add a week, maybe two weeks to the whole process of actually putting in a green cabinet. By putting it on that instead has a number of benefits. One you can do it when it's really cold, because concrete has a problem setting when it's really cold. Secondly, we don't need people to go away, come back, get civil engineering things. Also it saves us probably £100 to £200 per cabinet.

It's another one of these innovations. Again it's not, it doesn't change the whole world, but when you're doing it on such an industrial scale, we're doing 300,000 homes per month, that sort of thing does make a difference both to the cost of doing it, but actually the speed at which we can do it. So thank you to Craig.

Moving from fibre to pensions. What we tried to do on this chart is just give you all the various bases. The grey numbers are IAS 19. Light grey is net, dark grey is gross. IAS 19 number has moved up. I think probably not as much as a number of you expected. The assets have fallen by about £1.6bn compared to last quarter. And I think a number of you picked up that the discount rate had also moved against.

I think probably what wasn't picked up and maybe we could have been a bit clearer about it, is the effect of inflation going the other way. We actually did see inflation fall as well. So the net effect is whilst IAS 19 has increased, it's probably increased a little bit less than you might have thought it has.

The other metric that we're giving an updated number on is the median valuation. That is taking the assets we hold today, applying the expected return from the Towers Watson Global Asset Model and comparing that to liabilities. That is surplus of £1bn, and that is a couple of billion less than it was six months ago. Why? Well, because asset values have fallen, so no big surprise. But it is still in surplus.

Of course when the Trustees do their valuation, they will put in a lot of contingency over and above that. But that's the latest numbers we've got and pretty much all we can tell you about pensions at this moment.

So overall, a pretty reasonable set of numbers. We've tried to highlight where there's some one-off benefits, where there's some one-off costs to give you a good idea. But the fundamentals are, this very much reinforces the outlook we gave to you.

I think it should give you great comfort in it, but we aren't changing anything. We continue to expect underlying revenue to be down 0% to 2%, EBITDA to grow, cash flow to grow and of course we've announced dividends to grow as well. With that, I'll pass you to Tony.

TC

Thanks, Ian, good morning everyone.

I'm going to run through the financial results for the second quarter. Starting with revenue, revenue before specific items declined by 2% in the quarter. This includes the impact of £127m reduction in low-margin transit revenue.

Underlying revenue, excluding transit and the impact of foreign exchange movements and disposals, was up 0.4% against the prior year. This includes the impact of contract milestones within Global Services, including the acceleration of around £60m of milestones from the third quarter. This is exactly in line with what Ian already mentioned.

As a result and due to tougher comparatives for some of our lines of business, we expect the underlying revenue trend in the third quarter to be lower, before improving in quarter four. This will deliver our full-year outlook of an underlying revenue reduction between 0% and 2%.

In the first half, transit revenue declined by £229m, which is broadly in line with our outlook of circa £400m decline for the full year. EBITDA grew by 3%, reflecting the continued delivery of cost reductions, and I'll say more about this shortly.

Profit before tax grew by 15% to £570m, reflecting the growth in EBITDA and a lower interest charge. Our effective tax rate of 24% was in line with the first quarter, and our expectations for the full year. Earnings per share before specific items grew by 10%, to 5.6p.

Turning now to free cash flow. Cash capex was marginally higher than last year, but below accrued capex of £652m. This reflects the timing of the payments.

The cost savings we're achieving are allowing us to do more for our money, and we still expect to spend around £2.6b for the full year, even with the accelerated fibre spend we have announced.

Working capital and other were £62m better than last year, and with the growth in EBITDA, this contributed to free cash flow before specific items of £671m, a £95m improvement against the prior year.

As I've said before, despite the progress made on smoothing our cash flow profile, there remain some fluctuations due to the nature of our business, and our cash flow still tends to be weighted to the second half of the year.

Our outlook for the year remains unchanged, which is for free cash flow before specifics to be above the 2011 level.

We incurred cash specific items of £42m, relating to Global Services restructuring, and our property rationalisation programme. After

specific items we generated cash of £629m, which contributed to our net debt reducing to £8.3bn. This includes cash and investments totalling £1b and we have no material debt maturities until 2013 financial year.

Turning to specific items, during the quarter we recognised a £410m specific charge against revenue, with an associated reduction in our costs, which related to a retrospective regulatory ruling in Germany. Consequently, there was no net impact on our EBITDA or our cash flow. The regulatory decision covered the period from September 2006 to November 2010 and has no impact on our current or future financial performance.

Specific items also included a £19m loss on the disposal of our stake in Accel Frontline, a business whose activities are not a core part of Global Services' strategy.

We also recognised the tax credit of £81m, relating to the upcoming reduction in the UK corporation tax, which I mentioned last quarter.

We now expect a cash outflow in respect of specific items, of £180m for the year, against our previous expectation of £150m. This reflects a change in the profile of our restructuring activity within Global Services, but does not change the overall size of the programme.

Moving on to costs. The change in our cost base includes £35m from the impact of foreign exchange and disposals. Excluding this, our cost base declined by 4% in the quarter. This is despite an increase of £15m in leaver payments which has doubled compared with last year, and around £55m of costs relating to the accelerated contract milestone I mentioned earlier. Excluding the milestone acceleration our costs have reduced by circa 5%. For the half year we reduced our total cost base by £377m.

Total labour costs excluding leavers reduced by 3%, after adjusting for the impact of FX and reclassifications. This is despite the impact of insourcing activities as well as a higher volume of activities in Openreach, which in turn resulted in additional contractor costs.

Openreach direct and third party labour costs increased by 2%, and provide an opportunity for further reductions next year. We will continue to find opportunities to insource work and make the best use of our existing labour resource. This is the right thing to do, and saves us money. Typically we see cost savings of circa 20% to 25% from insourcing activity, and I see opportunities to bring further roles into the company.

As I have said before, there are further opportunities to reduce all aspects of our cost base, particularly by looking at our processes from an end-to-end Group perspective, rather than by individual line of business.

For example, I mentioned at Q4, that we were conducting an end-to-end review of our broadband fault processes. The net result was that we freed up around 25% of the circa 1,000 jobs we reviewed.

Finally, our financial strategy remains the same. While we are not immune to the economic environment, we remain committed to improving the underlying revenue trends, growing EBITDA and growing free cash flow. This will allow us to continue to invest in the business, reduce our net debt, support the pension fund, and pay a progressive dividend.

At the half year we're therefore declaring an interim dividend of 2.6p, this is an 8% increase.

Thanks for listening, I will now hand back to Ian for questions.

IL Thank you. Tony. As usual questions, can you say from whence you are and if we can try and keep it to not any more than one question that would be really appreciated.

Can we start up there?

Paul Sidney
Credit Suisse

Thank you. Paul Sidney from Credit Suisse. Just one question. I was wondering if you'd seen any increased activity from Fujitsu following the publication of your new pole & duct rates.

And just as, I guess, a follow on from that, how do you see Fujitsu's business plan playing out? Any further thoughts?

IL I'm not aware of anything. They obviously took part in our trial, but maybe, Liv, do you want to talk about Fujitsu?

LG So I guess, all we could probably say, I guess, in line with any customer is that they're involved in the trial, they're looking at the product and we believe that they're pleased with where we've ended up in terms of the product spec.

It looks like, I guess, we believe that they think the pricing's fair as well. So across the piece it seems like we've got a way forward. I suppose it comes down to BDUK bids, so we look forward, to working with them as they become successful in the future.

IL I think one of the things to understand is that we're three years plus into a fibre programme. The first year we learned a lot. It took us a year to start industrialising it, and I think you see there are a lot of things we're getting efficient about. But we look forward to bidding for BDUK work.

Wilton Fry
Merrill Lynch

Hi there, it's Wilton Fry from Merrill Lynch. A couple of questions, probably the first one for Gavin. Can you give us an update on the status of BT Vision 2.0?

The second one for Ian or Tony on LatAm. Can you tell us how much revenue you're currently generating from that region and what sort of margins you're typically getting, especially on that new business you highlighted today? Thanks.

IL Well, we're doing this for profitable growth. Generally it's a couple of hundred million pounds of revenue in Latin America. I won't give you the exact number, but of that order of magnitude. And we think there's real opportunity for good profitable business. Gavin, do you want to talk about Vision 2.0, YouView?

GP Vision 2.0 is our next generation of Vision for those not aware of it. It's got a new interface, much easier to find content, better search and recommendation capabilities. We are currently in beta test, so it's being tested with several thousand customers at the moment. And subject to that being successful I would expect it to launch early in our Q4.

Guy Peddy
Macquarie

Hi, this is Guy Peddy from Macquarie. Just a quick question on the Global Services, if my mathematics are right, you made a contribution of £5m by bringing forward that recognition. That implies a margin of about 8% is that what we think is a sustainable margin for that? Or is it just a pure one-off?

IL Well, what we've said with Global Services is the really important thing is overall cash numbers. I think the days of giving EBITDA margin for Global Services is something that we are well past. So that particular milestone, that was a particular margin we recognised on that. I wouldn't make a big thing about one way or the other. Nothing really to add.

Tony, did you want to say something?

TC Yes, I was just going to say, one piece of milestone, the numbers are approximate, but one milestone, extrapolating a margin based on one milestone is a dangerous number to make. If you look and see where Global Services margins are already at, they're higher than that margin on that particular piece of milestone activity.

IL Thanks. A couple in the centre?

Robert Grindle
Deutsche Bank

Hi. It's Robert Grindle from Deutsche Bank. You seem to have had some good success with large corporate customers in both the UK and Ireland. Is that market share driven, or are you seeing companies, after delaying projects, finally get going on them?

And it's certainly related. You also mentioned the lower IT and hardware equipment sales at the SMEs. Could people be considering not spending their own stuff and moving onto the Cloud, or is that just a case of hard times?

IL I think in the second one, I think it's a case of hard times. I don't think one can put this down to the Cloud because you still need a lot of the hardware for the Cloud. No it's, I think it's, SMEs tend to be an area that they can make decisions and delay things. In terms of performance, let me ask Jeff to talk about UK. But, I don't think things are getting easier. I think we're doing better. But, Jeff, you want to talk?

JK With regard to the UK, we went into this year very focused on our UK products business. We did talk about earlier that we have added sales resources to our UK base. We're seeing smaller deals so therefore, you have to respond to that. So, we have added there.

But, I'd say we are more aggressive in our products. I'd even say we're using the new technology in the rollout. So, we've just had our first big win in super-fast. And we're hopeful our clients will take advantage of those speeds in creating new experiences for their customers. So, it's a blend of all those things. It is a tough market. I think we're responding as we need to.

**James Ratzer
Newstreet**

Hi. It's James Ratzer from Newstreet Research. One question on the cost base. Although your costs are still coming down, it looks like the rate of reduction has slowed slightly this quarter. Should we read anything specific into that? Is that you're finding it a little bit harder to reduce costs, or are you reinvesting some of the cost savings you've been making in reinvigorating top-line growth?

IL I'll ask Tony to go into detail. But, I think we are making some investments but costs are coming down at a pretty good clip. Tony?

TC The quarter is distorted with the impacts of FX plus the costs associated with the milestone payment. But, costs bounce up and down quarter by quarter. On a like-for-like basis, if you take out the impacts of FX, you take out the impact of the milestone payments, we've done £500m or so in the first half of the year, £287m in Q1, £213m in Q2. There's a slight movement downwards, but they will bounce around quarter on quarter. And what I'd say is £500m over six months is a pretty decent number.

**Maurice Patrick
Barclays**

Maurice Patrick from Barclays. On Wholesale, could you help us understand of the change in product mix, how much of the lower EBITDA is, or the higher opex, is a structural product mix?

IL Say that again?

Maurice Patrick Of the higher opex within the new products inside Wholesale, how much is a structural margin element, higher cost, and how much is the temporary migration so we can understand the forward looking element.

IL It's difficult to give a split, but certainly that's not unusual with new products. New products tend to start at lower margin. It takes a while, but the costs come down over time and you sell more of them. I think it's almost one of the things in our business.

What we did want to say to you is you'd expect this was not going to be one quarter -- we said that last quarter. It's not going to be one quarter. And that's what we expect. We think there's quite a lot of opportunities. But, this is going to carry on through this year. Nigel, do you have anything to add?

NS No, I think you've covered it.

TC What I would say is that the cost base is impacted by the migration cost we highlighted in Q1. And that will continue during the course of this year. What we should start to see is a stabilisation during the course of next financial.

Chris Alliott
RBS

Thanks. It's Chris Alliott from RBS. Couple of quick questions on the fibre again. In the assumptions in terms of bringing it forwards one year, are there any sort of material expectations for the sort of government and/or EU funding built within that?

And then secondly, you've kept it within the capex envelope. Has that actually been retained within the Openreach capex envelope? So, you've been able to find the cost savings on capex or the capex savings within Openreach to be able to do that, or is there some sort of shifting around within the Group? Thanks.

IL I think you can assume that in our overall capex envelope, we have some contingency for further investment just generally. And we've also become more efficient. So, I think that's how we're able to do it within the overall capex envelope. We can accelerate it because if we do try and put aside money for further investment because we see opportunities we'd like to go after them. And when we give you an overall number - it's around £2.6bn - that was incorporated within that.

In terms of government money, well no, actually this two-thirds is going to be very largely we're just doing on our own. There are some. and I mentioned Northern Ireland, examples where we've got funding to support, also in Cornwall, where we're rolling out very quickly as well. And there will be a few places. But, the vast, vast majority of the delivery is actually going to be our own commercial programme. Bear in mind we said that two-thirds would be done in our own commercial

programme. And we could do that without any funding at all. So, it's basically executing that programme and executing it more quickly.

Nick Delfas
Morgan Stanley

Thanks. Nick Delfas from Morgan Stanley. So, first of all, on Global Services, I don't know if I'm the only one, but I don't quite understand the interplay between the order book and revenues. So, could you talk a little bit about the lifecycle of the order book and whether the reduction in the order book means we should expect lower revenue growth going forward?

And also, on the operating cash flow, it's still quite negative. It doesn't appear to be getting better. When do you expect to reach a flatter profile for Global Services or any other targets you can give us?

And then second question is.

IL I think that was two questions.

Nick Delfas Well, third maybe. Gross cash at the end of the year, what do you think it'll be if you hit your targets, so gross cash and investments?

TC That's a nice try.

IL I'll let Tony answer the last question. In terms of Global Services, the contracts are a bit shorter in terms of duration. But, this movement towards new names rather than re-signs actually means you can, in effect for a given slightly lower order book, you still have the same positive revenue effects. And it will happen this year and next year through really a very few renewals coming through.

But, Jeff, you want to say anything else about in terms of shape and nature of order book?

JK Yes, so, Ian said earlier they are smaller. And like I say, we've changed the mix in the sales teams. But we're also tracking improvements in net incremental revenues. And he cited earlier 50% this year versus last. I think we did a reasonably good job of getting many of our renewals out of the way and extend the deal horizons.

And as many of you know, when we sign those renewals, typically, you're given forward price concessions to get that done. And so, it's nice not to have that barrier as well. So, it's all going to blend. But, as he said, it's nice to see new customers coming in because it net adds to what you currently have.

And then in our vertical structures, we're seeing some nice growth on our existing customers as well.

Nick Delfas There's no read-across then from the order book to revenues that we can use, given the information you give us.

JK Well, what I'm trying to do is blend that order book, both in renewals and get our best mix. I'd say the only thing that I would cite is your win rates on brand new are different than obviously your renewals. And so we continue to look at that. But, it's lumpy. The £640m last year with DFTS kind of distorts the Q2 number this year. So, it will continue to be lumpy. And we're seeing some deals slide. I've had a few deals that moved out two quarters. They're going to close. It's just when they close.

IL I think it's difficult, Nick, straight read-across because of that change in mix, if you actually have less renewals coming through, you will need less. But, Tony, do you want to add anything and also his attempt to get some more cash numbers?

TC Yes, one point that Jeff alluded to was the fact that the absolute levels of new-name revenues that we've won are broadly flat. So, effectively, what we're saying is, while the order value may have moved downwards, if you look at the level of the new-name revenues won in absolute terms over the back end of last year -

IL Six months, its actually up a bit.

TC Yes, and it's moved. So, do you get the point? The absolute levels of new-name is staying fairly flat, which is a good thing. So, the read across in terms of revenues are not distorted by the fact by early resigns.

IL Cash?

TC Cash, in terms of the cash numbers, this should give you greater confidence that we'll achieve the outlook we gave you.

Nick Delfas So, you're going to have a pile of cash at the end of the year as a Group.

IL In gross cash, yes, it's something that we have had. Now, I think it's good to be liquid in this uncertain environment because I'm told the occasional banks aren't as good as they might be. But, you guys can probably tell me better. I think it makes it a slightly inefficient balance sheet for sure because what it means is we're earning cash at a very low level, and we're paying out until we pay off some of the debt or whatever. But, we will have a decent amount of gross cash.

**Andrew Lee
Goldman Sachs**

Thank you. Question on retail, you saw strong Infinity net adds this quarter. And the Vision net adds shot up with that. Wonder if you could just talk about the relationship between the two. What's driving what? Is Infinity helping you to cross-sell your TV product, or are more customers coming to your stores and phoning up and asking for Vision?

IL It's a bit of everything. It works both ways and also just the strength of individual propositions. But, Vision helps sell broadband. Broadband helps sell Vision.

GP What I'd say is there's clearly a market for customers that want to buy dual play, and there's clearly a market for people who want to buy triple play. And we've got to be strong in each. And I think what we're finding is we're just getting better at selling Vision in conjunction with fibre or copper broadband. So, it's a mixture of both. We've got to be able to compete in both those marketplaces.

Andrew Lee Can I just ask one question on costs to follow up to James'? You spoke about the efficiency measures you're pushing through, continue to push through in the company. If we strip out the transit costs, should we expect underlying opex to continue to fall over the next two, three years?

TC Yes.

IL Obviously, it ultimately depends on the revenue number. But, yes, the underlying cost base. We're increasing efficiency still.

**Stephen Howard
HSBC**

Thanks. It's Stephen Howard at HSBC. I've just got a question on your interesting pie charts on page 12. Looking at the lower one of those two, so you're saying half the country addressable with 100+Mbps service. And, if that's the case, it gives the UK pretty good fighting chance of meeting some of the European Commission targets, which are for 100+Mbps, I think 50% adoption by 2020.

My question is, when you talk to the regulators, whether at the Ofcom or at the Brussels level and they talk about this desire to see 100Mbps, do you get the view, do you get the impression that what they're interested in is the absolute number, or do you think what they really want you to do is roll out much more fibre to the premise? In other words, are they satisfied with the tweaked-up, souped-up fibre-to-the-curb proposition that just about gets the number, or do they want actually to incentivise you to put in a lot more capex with a more thorough-going FTTP deployment?

IL When I talk to Ofcom, actually they don't raise it as an issue. Ofcom are pretty customer focused. And what they want is availability to people and see what the customer does. Bear in mind, even with FTTC, we're bringing fibre to within 400 yards of the average household. And that gives a number of options at that point.

I think you see it in fact with that announcement we made, Jeremy Hunt came out at the same time, very much welcoming it. We'll have a mixture of services. So, we've announced 300Mbps service. We've announced a number of exchanges offering fibre-to-the-home product. Certainly, when you've got things like blocks of apartments,

we'll be running fibre directly to them because that makes a lot more sense.

In terms of the ultimate mix, and we say this to all regulators and we say this to government, it really depends ultimately on what customers want. And this plan is not to meet an EU target. This plan is because we think we can make money from it because, actually, we're trying to go to what customers want and look like they are prepared to pay for it. And if customers suddenly want to pay a lot extra for 100 or 300Mbps, then we'll provide that service, but it's got to be real utility for the customer.

And bear in mind high-definition TV takes, what, 6Mbps? If we were offering three-quarters of the country over 50, that's a heck of a lot of bandwidth for them. And maybe in 20 years, it might be different, but we've got that fibre very close to home, and that gives us options from there.

[Over there]. Thanks.

Jerry Dellis
Jefferies

Yes, it's Jerry Dellis from Jefferies here. Sky's saying that they've signed a wholesale fibre deal with you for next year. Just thinking that, as we get into 2012 and the GEA income starts to build up, how do we think about the sort of marginal economics of that? How much of that GEA income feeds down to the profit line?

IL

Well, Sky are going to have to talk about whether they have or haven't signed a deal. You have to take their advice on that because we wouldn't talk about wholesale customers. In terms of, feed through, we spent the capital. So, most of what happens now - I'll ask Liv to add in. But, a lot of it should come down to EBITDA because this is about return on capital. It should feed through. Steve?

Steve Malcolm
Evolution

Just coming back to Chris's question on this bringing forward the fibre built to 2014, just to clarify a bit, are you saying that the acceleration all comes from the contingency that you'd built into the 2014 capex, or is there a bit of mix on FTTP/FTTC? Is there cheaper price as well? Can you just give us more of a sense of how you brought that forward?

And also, how does that affect your thinking on the remaining 23% of the country? You said you'll do 90% if the government gives you all the subsidy available. Does this acceleration influence what you might be able to do economically for that bit, which I guess is where the Fujitsu questions lead as well? Maybe sort of educate us on your thinking there. Thanks.

IL

Okay. We're not assuming in all of that some major change in mix. But, we'll see as - given that speeds have improved, obviously, that does - we'll continually look at mix, and I think, as we do the fibre-to-

the-premise roll-out and see customer demand compared to -- we'll have to look at what the mix is. But, the major issue is, yes, we are doing it within the £2.5bn we expected.

But, most importantly, the most important part is the fact we put contingency in our numbers. And we've tried to say to you that it's our job to sort of manage within all of these things. We'll deliver the numbers to you. So, we're pleased we can do that. The programme is not costing massively more as there were some people who expected. And so, when we do things, we tend to put contingency rather than excess. So, we can manage within contingency both the overall capex and within that number. So, we're happy we can do it.

We set aside money for investment. And we drive down costs. And that's the way we try and run our business.

TC Ian, could I just add a comment?

IL Sure.

TC Steve, one of the things we're doing is we're improving the efficiency and effectiveness of our base spend. That means that what the £2.6bn bought us last year and what it's buying us this year, we're getting far more value for our money. The unit costs, for example, of fibre roll-out are materially reducing.

The second piece is I don't think we will be needing to compromise any of our investment programmes as a result of bringing this forward. We have sufficient capacity within the capital envelope to do the things we need to do to invest in the business in the right way. So, no one should take this as a read that we're compromising.

Steve Malcolm I guess the question is more do you think you can do the next 23% of the country which I'm guessing you've got very high retail share in. And given the lack of maybe alternative infrastructure competition, more economically, have you been able to bring forward this bit, or does it changing the thinking of -- ?

IL No, I've given you a sense of it. Yes, it will cost us more money. I think there is -- I've said in the past I think to do to 90%, probably there's something like £1bn in total. But, over a number of years, I don't think it'd be a higher run rate than we've incurred just now, maybe actually a lower run rate. But, what it will need, it will need BDUK money. It will need EU money. It will need local authority money.

And this is exactly what we've done in Ireland and Cornwall and we're looking to do in a number of other areas. So, it will require both. But, I think that potential is there if that money is forthcoming. And certainly, we will bid for a lot of areas to do it. And I think because of our sheer, the industrialisation of what we've done it should give us a good opportunity, assuming it's a level playing field to do it. I don't

see why we shouldn't have the opportunity to win it because we're doing this very well just now. Thanks.

Pass it here and then down.

Carl Murdock-Smith
JPMorgan Cazenove

Hi. It's Carl Murdock-Smith from JPMorgan Cazenove. Two questions about Openreach. Firstly, you've had a couple of good quarters of revenue growth there. You're saying that most of the revenue growth there's coming from increased rentals, which is also very positive. So, are you able to kind of strip out the connections and the migrations revenue there just to give us some idea of the potential for medium-term revenue growth, especially with GEA kicking in soon as well?

And then secondly, on GEA, TalkTalk have talked previously about a couple of operational issues around the product, the need for the second box in the home, the need for the faceplates, the BT branding on the box, that kind of stuff. I was just wondering if you could provide us with an update in terms of maybe motivating your LLU partners to kick on, on fibre.

IL You mean Openreach branding on the box.

LG So, yes, I can talk about the second part.

IL Yes, right, why don't you talk about the second part, including the Openreach branding on the box.

LG Okay. So, yes, you're right. We've had comments right at the start of when we launched GEA regarding what people would need to make it more industrialised. And as you would expect with any product launch, you just can't physically do everything on day one. So, you've got to write down a list of all the product fixes you'd like, and you've got to work with your customers.

And we're pleased that TalkTalk are now live with the product, as you probably see from their results, they are selling the product actively, and that's great. At the same time, we've made improvements. So, I think, and you should ask them how they feel about it, but I think they would say they think it's a good, reasonable fit-for-purpose product. They would continuously like to see changes during the course of time. And some of the things that they've talked about doing is part of the self install. And we've kind of said we're looking forward to working with them on that. And we'll help make that available as and when. It's something that's got the right standards in the marketplace.

It's Openreach branded, definitely not BT branded. So, there's no issue in that sense. We are the engineers that go into those houses. We have an Openreach-branded engineer turning up with the

Openreach-branded box. So, I don't think that's an issue per se. But, I will obviously pick it up with them. And I'll leave Ian to answer the comment in terms of whether we're going to give more guidance on revenue.

IL Certainly, BT Retail, in fact, our other ISPs seem to be quite happy with the product. To be honest, and I've said this before, it's up to these guys if they want to do it. We win either way. If they win, answering the question there, we get the stronger revenues through. If they don't come in, we win because actually our retail market share I think reflects the fact that we're offering a product that they can't meet. It's their choice. I think, and TalkTalk have said that they're, certainly said to us, that they're happy with the way the product sits just now.

In terms of rentals, actually, all of the increase in Openreach's revenue was rental. Now, of course, there's a chunk of ongoing connection cost which can go up or it can go down. But, last quarter, actually, it was slightly down, not up, year on year. So, effectively, it's over 100%. I can't guarantee that connections will not, if the whole market grinds to a halt, it could certainly come down. But, actually, in terms of that growth, that growth is coming from a higher rental base.

Nick Lyall
UBS

Good morning. It's Nick Lyall at UBS. On the Retail fibre product, can I ask why are customers buying the Infinity product at the moment? And when you ask them, are they buying it to use it much more in terms of capacity, or is it because it's priced the same as DSL?

And second, on the increased adds, could you also give us a bit more information on where you think they might be coming from? Are they coming from low-end subs because of TalkTalk's difficulties, or is it more top-end subs and you're fighting properly against VMED's product and Sky?

IL Well, we're clearly doing pretty well against all the products. What were VMED's adds over the last six months in total? Sorry?

Nick Lyall Not large.

IL I think it's about 800. We were over the same period 300,000 and something... we can round it at 300,000. So, we seem to be doing okay against VMED and its network and hopefully we can carry on doing that okay.

In terms of TalkTalk, Plusnet obviously does well at TalkTalk. I think we're taking across the range. They like the price, and also, they use it more. There's no question about it. There's an uplift in use. But, price and value and capability are all good things. But, Gavin, anything you want to add?

GP Take the words right out of my mouth. I would say, at the moment, you're seeing a lot of family adoption. So, when there's multiple use in the home, it makes a real difference. So, given how important the Internet is to education these days and how fundamental it is to learning, you see that houses which historically had relatively slow speeds, single digits, are really adopting it a very high rate.

IL And I think there isn't one single application people use it for. It's clearly a family thing about multiple applications. Actually, it's about running a whole load of things together. But, we'll have to see. But, so far, it's encouraging. And in fibre areas, certainly, there's a very good take up. Early days, but an absolute tick in these numbers from when we started. Can we pass it right up the back?

Simon Weeden
Citi

Thank you. It's Simon Weeden from Citigroup. Couple questions, one is you're doing a fair bit of recruiting that you've flagged. Is there a chance that direct staff numbers will be higher by much than they were last year or this year? That's the first question.

Second question is on fibre-to-the-home. You've mentioned a couple of times preparedness to pay and market readiness for acceptance of higher broadband speeds. And I wondered if, as you progressed with it, you're sticking with your 25% approximate sort of proportion that you want to do with fibre-to-the-home and also whether or not you're seeing the better economics that you need on the revenue side to compensate for what would -- presumably must be a higher overall cost to connect.

IL I think it's too early to say where we're going to end up in fibre-to-the-home or premise. We've only just started with the commercial product. We've got customers on it.

I think it's unproven about whether customers will pay that extra piece. I think you look at Virgin's 100Mbps product and it's not bringing the punters in a huge way. So, we'll have to see. There's some areas that just are sensible fibre to the premise areas, full stop, partially because their cabinet - they're fed directly from - they're multi-dwelling units, things like that you'll do anyway.

So, there's some areas, and strangely enough actually, you may find some of the more rural areas actually on the higher proportion of fibre-to-the-premise than residential areas because the green cabinet's further away. So, we'll just have to see.

There's another part to that question.

Simon Weeden

That was the second question, yes. The other one was staff.

IL Staff, yes, of course. We'll have to see. We'll have quite a few people leaving us. I suspect it'll probably still be down. But, it's not, to be honest, actually it's not even a number we particularly follow. What

we look at its costs. And but what we are trying to do is bring back jobs wherever we can where it makes good sense.

We've got our transition centre where we, for instance, retrain and redeploy literally thousands of staff, which is really good because whilst we've got our leavers cost this quarter that's quite a bit higher than this time last year, and it has been a source of increased cost, you remember, Simon, what leaver costs used to be like.

So, shareholders benefit because we're not paying lots of money to people to leave the business. I'd far prefer to pay my money to retrain and redeploy the people. And that's what we're trying to do. So, that 520 is on top of other things we've done. So, we've taken some more staff on. We're going to be losing some - but, we also have staff retiring. We have a lot of people who are close to retiring. And so, at any given time, you'll have some thousands of staff leaving. Tony, anything you wanted to add?

TC

Just a number of dynamics, which Ian just highlighted, but just if I can re-emphasise, the insourcing activity that's bringing jobs back in the Company, we've brought back 2,000 or so jobs over the last two years. That will continue. So, that will change the dynamic. Effectively, the removal of staff you see through the leaver payments, the key point on there is the leaver payments might be up. But, part of it is because GS leaver payments last year were included in the restructuring cost. That explains part of the dynamic associated with that.

And I think the last point to highlight is that the labour cost, the direct labour cost, because we're bringing jobs back in the company, we're also trying to improve the focus of how we do the work. And that will mean that, in some instances, there's further activities brought back into the Company that were inside indirect labour costs but now in direct labour costs. So, the whole dynamics are quite different. I would not get fixated by one element of that cost base.

IL

Okay. Anyone left? Good. Down here, please? Thanks.

**James Britton
Nomura**

Thank you. James Britton from Nomura. Can you just clarify how quickly you'll have to move your marketing over to average broadband speeds? And perhaps you can just clarify where we are on average broadband speeds for DSL and the Infinity product. And is that actually going to help you to push people over to Infinity more quickly?

IL

I'll let Gavin answer in detail. But, actually, we've not been a big - advertising a headline speed. So, overall quality and experience has been the major driver. Certainly, Infinity has way higher average speeds and will have a lot higher when we do the upgrade in terms of

Band Plan and will compare very favourably with the DSL product. But Gavin?

GP We market our copper product on its completeness fundamentally. So, speed is one aspect of it. But, we find that things like latency and reliability, things like the additional services we offer in security and parental protection are just as important to customers. And I think, as you say, as we move increasingly to having coverage on super-fast broadband, I think our Infinity product becomes our lead. So, do I think it's going to be a big issue? No.

James Britton Can you share any stats on the actual differential of speeds at the moment?

GP Well, Ofcom publish data every half year. I think they're currently doing their testing. Six months ago, we were all about the same and about on copper averaging about eight I think, just off the top of my head, something like that. And on fibre, it's well over 30. So, these are throughput.

IL So, four times the increase. Anything over here? Are we done? Excellent. One last question then.

**Darren Ward
Echelon**

Thank you. It's Darren Ward from Echelon Research. Cash flow, you seem to have beaten quite usefully what many of the people in this room were going for, for the quarter. And yet, you've come in a bit under consensus on the dividend for the half year. And I just wonder if you could share any of those thought processes behind that and particularly whether expectations of 23% growth for next year's dividend need moderating at all?

IL Whose expectations of 23%? What we said is, and we'll continue to say on the dividend, we will deliver good solid increase in the dividend. 8% is that. But we recognise a very well-covered dividend. And the company's getting stronger and stronger, and that gives opportunities in the future. But, in the meantime, you could look forward to decent increases. And we're delivering that.

It's a very well-covered increasing dividend, which is something is a little bit in shortage in the sector. And that's what we'll carry on doing. We recognise over the long term we have optionality about the size of the dividend and the dividend increase because it's, what, three, four times covered at the moment. But, we'll work that through. And as said, we've got to look at all the factors but certainly have a lot of confidence in the future of our business. And investors can look forward to consistent performance.

We've talked about dividend pretty much every quarter. And it's sort of one of these things, almost nothing more to add. But, we'll carry on talking to our shareholders. And as we said, we'd like to get our

pension sorted out for sure. We've talked about where we want to be in rating. And that still absolutely holds.

So, with that, thanks very much for all your time and all your questions. Have a very good day. Thank you.