BT'S FOURTH QUARTER AND FULL YEAR FINANCIAL RESULTS
18th MAY 2006

Chairman – Sir Christopher Bland

Good morning and welcome to BT's results presentation for our fourth quarter and full year.

This morning, I will focus on the full year results and then Hanif will take you through the fourth quarter and the financials in greater detail. Finally, Ben will set out our strategic priorities and share with you some of the key trends affecting our business.

First, I must draw your attention to the cautionary statement.

I remind you that during this presentation we will make various forward looking statements.

Factors which could cause our actual results to differ materially from the results we currently expect are identified in detail on the screen and in your presentation pack.

This is an excellent set of full year results, delivered in a competitive and fast moving environment.

We've accelerated the transformation of our business and our revenues for the full year have grown by 6% to £19.5 billion. Excluding the impact of the acquisitions of Albacom and Infonet and the mobile termination rate reductions earlier in the year, our revenue growth was 3.4%.

In addition we have grown profit before tax by 5% year on year and earnings per share by 8%, reflecting ongoing operational efficiencies, lower net finance costs, a lower tax rate, and an increased share of profits from joint ventures and associates.

We generated £1.6 billion of free cash flow this year. This is 8% lower than last year's level because of the exceptional working capital performance in that year, but it nevertheless reflects very strong working capital performance in quarter four this year. As a result, at the year-end net debt stood at £7.5bn, an improvement of 5% on the prior year.

I am also pleased to announce a full year dividend of 11.9 pence per share, 14% higher than last year.

The underlying increase in Group turnover of more than 3% was driven by an impressive 26% underlying growth rate in our new wave business.

Traditional revenues have declined by 4%, driven in part by competition and regulation but also by our strategy of migrating our customers to new wave services.

New wave revenues now account for around one third of the group's business, compared to just 14% three years ago.

We have seen particularly healthy growth in broadband and networked IT services revenues, which demonstrates how successful we have been in transforming our business.

During the ongoing transformation of the business we have consistently delivered progressive growth in our earnings. This is the 16th consecutive quarter of year on year earnings growth.

Over the last four years earnings per share have more than doubled to 19.5 pence, with a growth of 8% in the past year and this has enabled us to adopt a progressive dividend policy.

We will pay a final dividend of 7.6 pence this year, bringing the full year dividend to 11.9 pence.

Our dividend payment has grown nearly six-fold over the last four years and that dividend represents 61% of our earnings per share this year.

As we continue to grow earnings and cashflow, we are focused on rewarding our shareholders. We have been returning an increasing amount of cash to shareholders over the years. In the past year, over £900m has been paid as a dividend and another £338m has been used to buy back our shares and this represents a growing proportion of our free cashflow.

We remain committed to our aim of a payout ratio of around two thirds of underlying earnings by 2007/8 subject to the group's overall financial position. We are still comfortable with debt levels of around £8 billion.

Any free cashflow in excess of that required to pay dividends will be available to fund our continuing share buy back programme and for any M&A activity.

These results demonstrate we have delivered real value through transforming the business. Our strategy is working and we are confident that we can continue to grow our business and reward our shareholders.

I'll now hand over to Hanif who will take you through our quarter four numbers in detail.

Hanif.

<u>Group Finance Director – Hanif Lalani</u>

Thank you Sir Christopher, good morning.

As Christopher said, an excellent set of full year results, rounded off by an outstanding quarter four performance.

Revenue <u>rose</u> 7% year on year in the quarter to £5.1bn. Excluding the acquisitions of Albacom and Infonet, underlying growth of 5% was achieved - our highest rate of growth in over <u>four years</u>.

EBITDA was almost <u>1% higher</u> at £1.5bn. This continued the improving trend we have seen over the last five quarters and gives us our first quarter of positive EBITDA growth in the last eleven quarters.

Earnings per share rose 8% to 5.7 pence, delivering our 16th consecutive quarter of year on year growth and we generated £1.1bn of free cashflow in the quarter, 1% higher year on year driven by a very strong working capital performance.

So how did the Lines of Business contribute? BT Retail recorded <u>another</u> strong quarter. Revenues declined by 1% an improvement on the trend we have seen in previous quarters. Gross margin of £613m was 3% higher than last year, driven by successful margin management.

Re-investment in new wave and ongoing success in a very competitive broadband market, led to a rise in SG&A costs of 2%. EBITDA pre leavers rose by 5% to £222m, a third consecutive quarter of growth. Operating profit grew by 10% to £175m.

The 2005/6 full year EBITDA growth in BT Retail was 5% and <u>next year</u> we expect to <u>continue</u> that growth. We'll continue to develop and roll out innovative services but more about that from Ben later on.

At the same time we'll focus on improving margins and transforming our cost base. In particular, we have been repackaging and simplifying our services to reduce the volume of calls coming into our call centres, optimising our pricing structures, reducing overheads, and increasing the Channel effectiveness by driving up the number of on-line relationships that we have.

Let's focus on BT Wholesale. Total revenues <u>rose</u> by 2% to £2.3bn driven by strong growth in broadband, with net DSL additions of 665,000 in the quarter. New wave revenue now accounts for <u>over</u> a quarter of our external turnover, driven by broadband and managed network services.

Gross variable profit of £1.8bn was maintained, with recent price cuts offset by lower unit costs. This resulted in EBITDA pre leavers being marginally higher at £989m. With increased leaver costs and depreciation rising £51 million as a result of 21CN investment. Operating profit was £447 million, 10% lower than the prior year.

Having maintained our EBITDA in BT Wholesale this year, we intend to do the same next year. The new Openreach organisation is now fully operational and is well placed to deliver on its commitments. We will publish Openreach numbers separately from quarter one, with a re-statement of 2005/6 available to you before then.

The preparatory work for the South Wales roll out of 21CN is now complete. We are prioritising our roll out in order to bring forward opex savings and deliver higher bandwidth services earlier.

We also have a number of business as usual cost reduction initiatives within BT Wholesale. These include zero based budgeting, supplier rationalisation and greater operational efficiency.

Let me now move on to Global Services. Continuing double digit growth lifted revenue by £212m to £2.4bn. New wave revenue, driven by continued growth in our strong order intake, now accounts for 60% of the external turnover in Global Services.

This quarter, EBITDA rose 5% pre leavers as the growth in new wave and MPLS more than offset the impact of the declining traditional business.

A combination of higher leaver costs and depreciation reduced operating profit by £10m to £143m.

This year, Global Services grew its EBITDA by 3%. Next year we intend to accelerate that growth further as we go through the year.

BT Global Services is well on its way to becoming the network IT services provider of choice across the world. Operationally, Global Services needs to complete the integration of recent acquisitions and increase its ability to replicate solutions globally.

At the same time significant cost efficiencies will be achieved through removing duplication within the service, networks and marketing organisations, and also by moving to a global sourcing model.

Let me return to the quarter and our group P&L performance. Group revenue rose £314m while group operating costs were £300m higher. This was driven by higher payments to other operators and volume growth which offset the cost efficiencies achieved. This resulted in EBITDA pre leavers rising by £14m or 1%.

These movements plus the £28m rise in depreciation reduced our group operating profit by £14m to £725m.

Leaver costs were higher than the prior year due to greater take up of our release schemes in quarter four this year.

Net finance costs of £101m were £40m lower than last year as a result of lower net debt and a higher pension credit. So, profit before tax of £562m was slightly better than last year.

Our lower effective tax rate reduced the tax charge for the quarter by £14m, resulting in profit after tax growing by £16m. This, together with a buy back programme, delivered a 6% rise in earnings per share to 5.1 pence.

An outstanding quarter four has given rise to an excellent full year position with revenue, profits and earnings all up, year on year.

Depreciation was 1.5% higher than the last year and we expect this to grow a little bit faster next year.

Leaver costs were £33 million lower than last year. In total, over 2,000 people left BT as a result of our schemes. Next year, we expect leaver costs of around £160m.

Net finance costs were £127 million lower year on year. Next year, we expect a further improvement of around £200m as a result of lower average interest rate and a higher pension interest credit.

The effective tax rate for this year was 24.5%. We expect it to remain around this level in the medium term.

Free cash flow. Net interest paid in the quarter was £73m higher than last year as a result of the timing of bond maturities. Tax paid was £84m lower than the unusually high levels of tax paid in the prior year.

As a result of the preparation work for 21CN and demand for broadband, capital expenditure rose £57m to £792m.

Once again the fourth quarter proved to be a very strong period for working capital improvement. At £697m, it was £77m better than the prior year as a result of shorter collection periods, robust debt management and a more effective procure-to-pay-process.

Total free cashflow of £1.1 billion in the quarter four even managed to surpass the very strong performance last year. As a result, net debt was £359m lower than last year and stood at £7.5 billion at the year end.

In the full year, free cashflow was 8% lower than last year, primarily due to the very strong full year working capital performance in 2004/5.

As in every quarter four, we had high levels of cash receipts from wholesale and major corporate customers, and this often gives rise to an outflow of working capital in the following quarter. Overall we improved working capital by over £100 million year on year, despite the cash injection required in the initial stages of many of our network IT services contracts.

Let me move on to pensions. There is no additional insight into the funding triennial valuation at this time as discussions continue with the Trustees regarding the implications of the crown guarantee. Our intent is to move to a position of clarity a certainty for all. In the meantime, let me remind you of the IAS19 position and provide you with the underlying assumptions.

The IAS19 deficit at the end of March 2006 after tax was £1.8bn compared to £3.4bn at the end March 2005, a reduction of around 50%.

We are assuming a rate of 5.0% to discount our liabilities. Pay inflation is assumed to be RPI plus 0.5% for the first three years - a rate we have been able to achieve over the last few years - then RPI plus 0.75% thereafter. Average life expectancy post the age of 60 is assumed to be 23.8 years for men and 25.4 for women. In addition we have assumed a further improvement in life expectancy of one year for every 10 years.

So in conclusion, earnings per share is a very good measure of a company's success. In this regard the actuals speak for themselves – 16 consecutive quarters of year on year growth.

Our performance to date and in particular this quarter's performance demonstrates that the ongoing execution of our consistent strategy is working.

With that let me hand over to Ben.

CEO – Ben Verwaayen

Thank you Hanif and good morning everybody.

Four years ago when we started to talk about a transformation, one of the first things we did was to develop a consistent strategy. You have seen these charts many times. Most of you were kind enough to give us your feelings about how we are doing, your concerns, your items. You talked about sharp corners in the road. Some people even talked about cliff edges. Let's see how we have done around those points in the journey so far.

If you look to the trends, and you look to the focus points, it's an interesting lesson.

The first point to remember of a long time ago is, can BT grow as a business? Well, we have done nine consecutive quarters of revenue growth and this quarter with 7% was a very, very good one, a very strong one.

Remember that we talked about free cashflow. How are you doing on free cashflow? Can you maintain that? Over the last four years we have £7.7bn in free cashflow.

Then people talked about what's happening in the market? Do you remember we talked about VoIP. People think that we have come to a standstill because of VoIP or fixed to mobile. Yes, but what happens to everybody's habit around e-mail? All those things happened. We sign 5,000 VoIP contracts a week now.

New players in the market. Yes, we talked about Hutch coming with the basket. People talked about Skype, and Tele2. I believe that these have now left the market already. All these things happened, and our dependency went down from 17% on calls to 9%.

We talked about broadband. Can you maintain the growth? In the last 12 months we have had 58% growth in broadband take up. This quarter has been the second strongest quarter both for Wholesale and Retail in the take up.

Then we talked about how we are going to transform the company. A long time ago, we talked about culture, remember? Can a telephone company do new tricks? Can we go and be a networked IT services company? Well, we signed over £24 billion. That's a whopping number - £24 billion!   We, probably Andy, can also translate it into dollars.   That's a bigger number! Right?

In long term contracts. Household names and the latest of course was how are we doing on EBITDA. Well look to this chart. It's familiar to you because five quarters in a row we have used the same chart and we have continued to say improvements.

So I guess what I am trying to say to you is that we understand the transformation is a thing we have to do. In a very dynamic competitive market and no single issue, no single competitor, no single market segment - even by itself - tells the story. The combination tells the story of BT.

Look at our revenues. You can see what has happened to our revenues. You can also see a trend here too. I think a strong underlying trend.

Now, let's look to our segments to see how are we doing with the various segments of our market. If you look to BT, it is totally different whether you are a consumer in the UK or a multi-national in Singapore.

So how are we doing in those different segments. Well, first of all, you have to ask yourself what are the requirements of the specific customer groups? What do our customers want from us? Our consumers are very focal. They want simple converged services. They want value for money and they want very clear pricing. At the same time there is market trend.   In the market trend, there is a lot of competition … a lot of different stories …and there is a lot of people who try to bundle.   Which is great.

Now our strategy is to become very much a broadband centric service company. Services, and if you bring services to the market - that's very sticky. We have 3.7 million customers on BT Privacy. We have a million customers now choosing automatic adjustments on the Friends and Family. We have half million customers online.   We have bored you to death talking about a number of customers that are under contract. And yes, I am going to bore you a little bit more. It's up again this quarter, 68% and our ARPU was up. First time in eleven quarters our ARPU is up. In a very competitive market with all the things we have talked about.

Let's take a slightly historic perspective here. Let's look to the broadband market. Because, in a way, this is an astonishing story. 2002 is not that long ago and in that year we had wholesale prices around thirty. I remember a story from the Chairman. When he joined the Company, the proposal was to make it higher to around forty. Today it's eight and a bit. Coverage is 99.7% which means that you have a 3% focal point of the market.

You have of course a take up that has changed the landscape from a mere 200,000 to 8 million and, if you talk about speed, it's from 512kb … well to be honest we had the debate here in this same room about what 126kb was to be called … broadband or midband or whatever band it was and we now talk about 8mb.

We are going to build the largest national footprint by upgrading about 5,300 exchanges, the largest national footprint of the highest stable speed in the world.

But that's not the real story. The real story is the last bullet! This is not about pipes. This is about surfaces and look to change from a single e-mail service to a whole portfolio of new services. This is the relevance of broadband, it is not the speed of the pipe, it is what it does for you. Therefore this is a market that will evolve into a service market.

Now, let's look to what happened in this particular market because we may lose perspective a bit. I am therefore going back in time. I am going back to 2003. This is what happened in 2003. Cable was the big player in the market with over 30% and our market share was approximately around 25% and a bit. You know that other players came to the market and had great offers. They were the talk of the day. So we had the time that Tiscali got over 20% of the market share. You know what? They had a very good offer at that certain period in time.

Then the next one to come up was Wanadoo. They had 20% of the market share because they had great offers and we talked about it all the time. It is a market driven by campaigns which had quite a few quarters. Then some of the other guys in one quarter had more than 30%. Then came AOL and they had great quarters, great offers and over 20%. BT's market share remained constant. Including cable we have been stable around 25% in all the periods. Lots of movement in the rest of the 75% but BT is more or less stable around the 25%.

I think we need to get to some conclusions here. This is an absolutely very vibrant market. It's a market with more than 200 ISPs and we should celebrate that. That means that people get a very focussed offer and some people have very different needs than others. This is not a game between a handful, these are 200 ISPs and it seems to me that the fluctuations in the market ISPs tends to win market share from each other rather than from BT. Just look to the facts.

Second, yes there is unbundling. Look to the footprint of unbundling. They focus on 70% of the market. It happens to be that 70% of the market has a big overlap with cable and it happens to be that in markets. Where cable is strong the BT market share is smaller than in other parts of the market.

I think we have a very good proposition. I don't think that the stability as I have indicated over time is based on one single item. It's based on the combination of value for money. Of course value for money is important but, it's building on trust and, most importantly, it is bringing it to the next level by new exciting services.

Let's look to the services.

There is a whole range of services here. Services around communications, entertainment and managing your life. It is growing. It is important that you keep growing these services because this is how you address the fundamental power of broadband and that is to enhance capability for people.

I don't think that we have seen for the last decades, innovation around voice. When Ian and his team come back to you, in June, I believe, with a whole range of discussions around the hub and portfolio of the hub, I am pretty sure he will show you also this one. I am going to steal a little bit of his thunder and let you listen to the next innovation around voice.

[Presentation]

Hi, this is Chris and you are listening to me talking over a standard broadband line using VoIP technology.

And this is me now, talking to you using high definition sound technology. The quality of voice calls should be much better.

And this is what I would sound like if I was on the mobile.

[End]

So BT Broadband only will bring you high definition voice and that's a very important next step.

Now of course it is so much more than just communication that we talk about and I know that a lot of people have a lot of interest in BT Vision. BT Vision is so much more than just a TV experience, it gives you communications, it gives you all kinds of capabilities that you don't have today. It enhances capabilities, it gives you the tool set to create your own content and share it with other people. There is a lot coming and it is a project that gets a lot of attention for a very good reason, because it's an interest project. It's on time, don’t worry about that, we’ll launch it in the autumn and we are getting stronger and stronger and stronger in our portfolio.

Just look at this.

[Video presentation]

So DreamWorks available on BT Vision. Contract signed. But it’s more than entertainment. I mean let’s look to the facts. Broadband opens the World to you and you to the world, which means the positive side and the not so positive side.

The not so positive side means there are 100,000 viruses on the internet. If you go online you know what, banking fraud has doubled over the last twelve months. A quarter of all credit card fraud happens online, so security is an absolute paramount. BT offers award winning security as part of it’s package.

Look at this.

[Video presentation]

On-line banking. A bit risky for you. BT Broadband now helps protect you against fraud, even viruses and other online threats, so you can relax. Just setting up our joint account.

“Get BT Broadband with wireless capability up to 8mb and our best ever security all from just £14.99 for the first 3 months, call 0800 317 316 now to find out the download speeds in your area.”

[End]

So, as I said it is so much more than just the line.

Now let’s look to our SME market. That’s a market also with a lot of change, because come to think about it in the old days you needed to be big and have buildings in many, many places to be global. Nowadays you don’t need that. You can be a very small company and find your suppliers in one part of the world and find your customers in another part and a few employees that you may have in a third part of the world.

So you are going to live in an environment where communications and IT are coming together, which means for many of our SME customers hassle. Besides that the employees that you do have become mobile, they need to go to all places. So the services they require from us are no longer standard services, that is a smaller market. It is lines and calls less and it is services more.

Now the good thing is that under contract when you look to the voice market here in the SME part 57% now. We started much later than the consumer market so that’s a good number and by the way for those who are very much attached to it if you want to know a market share invoice it is less and less relevant, but in this particular market no loss of market share here.

But more important is do you have the answer for the new world. Do you have the capabilities to go to the SME market and say, we understand your needs, we can bring together the communication needs, your mobility needs and your IT needs and I think we are. Virtual CIO is one of those instruments and I think we will talk more about details of our SME market when we have a special half day on that.

But I wanted to say today to you is, look to mobility because convergence is really happening.

Many people talk about BT Fusion, that's right, we are excited about the technology and what it does and we are excited about the ability it has in the consumer market. But I am even more excited that it's part of a family, a growing family of converged solutions.

For the SME market and now also for the enterprise market, we are going to launch the pan-Europe office in the palm of your hand, the same capabilities as you have on your desk top. We have contracted Alcatel to build, based on the technology of convergence that capability for the enterprise market.

It is part of that convergence that's happening, but not just at home, not just in the office, it's happening in the cities as well.

Look at this, wireless cities. We talked about last time going to twelve cities, we had two under contract a quarter ago, sorry. Last night, I have to say we issued a press release to add four more cities to it, we also said there's much more interest in the UK, we get flooded by cities who want to join with us, join forces, for a good reason, because it's so much more than just opening up your lap top and being able to communicate.

Look to what you as a community can do in a Wi-Fi enabled environment. How you can bring the service to your citizens. Much more focused and much more reliable on issues like security, crowd control and pollution and all kinds of new services that you can bring in a wired enabled city. And I am very proud to say that last night Steve Andrews and team were selected as the "world's best wireless broadband operator". It tells you that we have come a long way in this particular mobility part of the world.

Now carrier is a truly important part in delivering all of this and we have talked about 21CN many times and what I want to do today is to make sure that we get a good feel where we are, because as with other big projects you get a lot of talk about it and I think the facts are always better than the talk.

So where are we? Well this chart that you will find also in your pack so you can study it, basically says the following:-

We are doing fine. We will start as we planned in Wales this year and we will roll out what we said we would roll out there. 21CN fully with all aspects and then what we will do is we will consult and test and work with all the other players in the market, so we ensure that the interoperability is working in real time. It's one thing to go on a chart and have technicians work things out. It's another thing to go to a lab and say "hey supplier does my box work with your box" and say, tick in the box yes it works.

The reality is that there are so many things happening in the real world and people have so many different things in their homes and their offices and as market parties that we want to be 100% sure that what we give is interoperability seamlessly. So we do what the market requires us to do and at the same time we keep space and speed in to what we do. So I am very confident that we have now an agreement with the industry to understand which steps we need to take and that's an agreement that's two things.

First of all it gives us the opportunity to get the efficiency that we want and we harvest them and we do it in a way that is very workable for all the other players in the market.

Because if you come to think about it what are the long term benefits. Of course the core here is important, the efficiency, that's how we have built the business case on the efficiency. But there is so much more, because 21CN is not just a physical network, it's not like a piece of hardware that you put in a building and connect it with fibre or with copper or whatever. It creates a layer of software around it, so it won't not just be the BT network but many more people around that may or may not even know BT that can innovate new services in an open architecture that surround the BT 21CN.

If we catch worldwide attention it's not just for the physical aspect of it, it's for the philosophy to create an open network environment in architecture that the last people to innovate in weeks or months not in years. So it will open new markets, it will accelerate the speed to market and what it will deliver for me as an individual customer is personalised services. All underpinned by efficiency improvements.

Now one of the parts that we had to do is the equivalence. We need to guarantee the equivalence, that was the deal, that was the deal we made and remember there were two pillars under that deal. One pillar was, you bring the equivalence and assistance and the rest of the stuff and we have delivered it so far. I think in most cases we are ahead of our obligations and I think that we understand what we need to do and we understand that we need to create a market and we welcome that. I think we do the 1.5m LLU lines this year. As I said last time that's a good thing and that's totally within our own forecasts.

At the same time, you know what, we get deregulation, we get true deregulation in the same focus and speed on that part of the agenda. But I think we are doing fine on both elements.

Now the corporate world is of course a story of growth for us. Growth around the globe.

What happened in the corporate world is basically, that it is no longer good enough to connect one with the other and say hello and that's it. It is really to work on a global basis so it is collaborative capabilities. It is the capability for a financial transaction which depends on milliseconds to take place wherever on the globe.

Things we couldn't do three years ago, we can do today. So you are on the same network. Whether it's Peru or Paris you need to be able in the same milli-second to put your financial transaction through, that is the requirement. You can look to a visa transaction and you want to make sure that you have the same stability and capability, that's the requirement.

You look to a company that's globalising like Fiat, that's the requirement. Set me up wherever I want to be set up and make sure that my financial system, my security, my HR systems are all in safe hands wherever we are. That's the capability we bring to the corporate world and we are doing, I think, a very good job.

Now we have enhanced our capability. You know the acquisitions, what we call the smaller acquisitions between brackets. These are very important ones, and guess what, we do better in integration than we thought ourselves we would.

If you look to Infonet, how we are doing there, Albacom is a true success story in Italy. Look to Atlanet that was within the Fiat deal. We have not lost a single customer there or a single employee and we do really, really well in getting in the verticals where you have to understand industries in depth we are doing really, really well in using that capability across the world.

Look to what we do sometimes geographically. In Ireland it was the additional capability that we got by Cara for example we have more than a 60% market share in WANs and LANs.

So these have been very, very good and helpful additions to our capabilities.

But I want you to look at this chart, because this chart tells you the story about BT Global Services.

Now this is also a chart you can look at. Equally nice, little bit more complex but it's a great story. It's about a company in transformation while delivering and I hope that what I have made come through today is that I hear all the critics and I hear all the cynics and I hear all the stories and I have heard them for four years, and I understand and will take them seriously each every time.

But this is not a company about a single story about a single subject. This is a story about a combination. As technology is moving from being a single,focused type of technology where you could predict life cycles of technology translated in to new services, this becomes a bouquet. You can have one bundle of roses or you can have bouquet. Different tastes and a different treatment if you want to let them flourish. We are becoming a bouquet company in that respect.

And why? Well because we do have a traditional business still to take care of and look to the trends. Now we could say this is a trend change, I am not saying that, this is stable, that is stable. We understand what happens in the traditional business. We have to take cost out, we are good in taking costs out. We did £400 million in the last year and we are saying in the coming three years we will do another £400 million every year. We know how to do that, we know where to get that. And as I said, if you look to the revenue and the dependency of what went down, this is what you want if you want to build from the old to the new.

And in the meantime this is going up, and up, and up and accelerated. I think that we can bring it together. We can bring it all together. I think we can bring the whole BT story together in one single slide, and the slide is very simple. It talks about a strategy, it's a strategy totally based on convergence and innovation. Top priority is convergence and innovation. It's a company about momentum. Facts support the momentum. Sixteen consecutive quarters of year on year per share growth, nine consecutive quarters of revenue growth, five consecutive quarters of improvement on EBITDA.

It's a story about a company that understands competitive markets and dynamic markets and is capable of winning and competing and look to what we have done on new wave and look where we are as the supplier of choice in a business that we didn't do four or five years ago.

And last but not least, this is the main question. Are you positive that you can continue the positive trends? And the answer is Yes. We think we have the ingredients to keep growing a top line, a middle line, a bottom line and therefore our dividends.

Thank you Ben. Right questions are now taken.

QUESTIONS AND ANSWERS

Question 1

Mike Williams - Citi Group
Firstly I just wondered very quickly what you have seen in the broadband market since Carphone's big splash of five or six weeks ago and secondly, Carphone Warehouse have been typically very clever, they have used a product that they have no existing exposure to, ie broadband, as a hook to drive volume on established high margin products in the voice market place. It strikes me that BT has a similar opportunity to emulate that strategy but using mobile and video as the hook to drive broadband within an overall bundle. I wondered if you would agree with that assessment. Secondly how aggressive you are prepared to be and when we can expect a commercial offer?

Ben Verwaayen

First of all there are 200 players in the market, I'd like to make that point and this is not about PR, this is about the market. Second remark, I don't think that in the first month we have seen any change in the trends but perhaps Ian - you can make some more in depth remarks here.

Ian

Yes, the trends in April and May so far look very similar to what we have seen in the quarter that we have just reported on, so we are not seeing it coming through in the market share. You're right it is a very clever offer and BT will continue to expand into some new areas and we have got clever things, but not just in marketing terms but actually things that will really make life better for customers. We'll also appeal very heavily to the whole of the UK not just a proportion of it, so it's competition, it's what we expect and so far the trends are the same and you'll see some interesting offers from us coming up.

Question 2

Cyrus Mewawalla – Westall Capital
As you roll out 21CN I suspect a lot of media companies are going to wish to free load off it, which brings me to the issue of net neutrality. Now my understanding of net neutrality, correct me if I am wrong, is that the two parties derive an economic benefit from your network. One is media consumer, I get Broadband internet access and I pay you for it, but one is a media company that competes with you like let's say Google, and they may provide competing services, they don't pay for it. My understanding is that certain US telcos wish to charge media companies like Google for high speed access. Could you clarify your position on net neutrality and specifically can you clarify whether you would charge companies like Disney?

Ben Verwaayen

Well first of all the US is a totally different market to the UK. We have always made the point that we had equal opportunity for people but that means equal opportunity for customers to get services and equal opportunity to differentiate yourself, because the world is more complex even than you have described. The differentiation is sometimes in quality of service, sometimes it's about content and sometimes it's about other aspects of the marketing mix. I think the debate in the US is a very principled debate in an environment where the telcos lost out on broadband in the first place because that's dominated by the cable companies. It's slightly the other way around here and I think that we will see a different debate in the UK than what you will see in the US. Having said that, there will be an element over time of cost, that you can't have an environment that will say the division of work is such that you take the investments and I take the profits, that probably is not a long term perspective.

Question 3

Would you consider charging media companies for use of your network?

Paul Reynolds

Yes we would, I mean 21C is not just about bandwidth, it's about capability on that bandwidth and some of the things you will start to see coming through as Ben showed in his chart, is the opportunity to create new markets, so we absolutely intend to provide open interfaces to 21C and charge for them where people can innovate and provide new services on the back of that network, but you will have to wait and see exactly what those services look like. So the answer is yes.

Sir Christopher Bland

I think there is an underlying philosophical point too and it's both to your question and the previous question, which is that free is not a sustainable business model, and you have to look at the small print of TalkTalk's offer and you have to look at who pays for the capex over the long term and free does not.

Question 4

Laura Mills – Merrill Lynch
Can I ask for a couple of clarifications on your guidance. I think Hanif commented that he is expecting the leaver charge to be up a little bit on Fiscal 07 versus 06. Should we expect EBITDA to increase both pre and post leavers. And on the EPS guidance, are you expecting EPS to increase in excess of the increase that we'll see due to the reduction in the pension charge through the P&L Fiscal 07 versus 06?

Sir Christopher Bland

Profit forecast really, you are being asked for Hanif.

Hanif Lalani

I think what I said was, we expect to see EBITDA growth and if you translate that EBITDA growth down to the bottom line we expect some of that EBITDA growth to convert itself into EPS growth. In terms of leaver costs year on year, well you know that varies depending on how effective and how quickly we deploy our cost saving programmes and the key message here is that we need to take cost out of the organisation. If we have to spend more on leaver costs in one quarter in one year that's what we'll do because it's the right thing to do for the business.

Question 5

Paul Howard - Cazenove
Can you give us a bit more detail on the profitability of the IT services element of Global Services, perhaps sort of roughly what sort of operating margin the IT services businesses is operating at the moment and what the trends are in that business.

Andy Green

We'll come out at investor day during the year to try and give you more granularity underneath the Global Services business. But it's extremely important to understand that when you are innovating, you're driving a new type of business - a networked IT services business. What people are buying from us are enterprise wide IT services which are over our networks and what we sell them is a combination of those things so we will be able to show you by different types of customer groups, what those percentages are and they all add up to 12% in the rounds, as you know at the moment. But we won't be able to show you a separate services and products piece because it doesn't make any sense, it's basically not what we are offering in to the market place. We are a large scale contracting business we will be able to show you the way that operates and the way that moves forward. But as we have always said we intend to make profits, we think we do as well as anybody else in the industry in that sense, you know the types of margins that those like long term contracts run on.

Question 6 (Paul Howard)

Are you starting to see the maturity of some of the older contracts that were signed?

Andy

Yes we are starting to see the maturity of obviously a number of the older ones. We have had a huge contracting period you know over the last three years. We've told you that some of those take up to four years to fully turn round at the last investor day, but that's beginning to come through and that's why we've sixteen consecutive quarters of EBITDA growth, as a result of that and despite going through that whole period and that's why we are talking about over the year seeing an acceleration of EBITDA out of Global Services.

Sir Christopher Bland

And good renewal news.

Andy

Yes, very good renewal news. Good point. I mean Unilever this week re-signed the contract, Edinburgh County Council, re-signed the contract, that's a very pure IT and BPO contract. Both those are very important for the way you have to address long term contracts to ensure you have profitability and the client gets business success as you go through them and I think it's really good news to see two such critical contracts being re-signed at the moment, like this and extended significantly.

Question 6

Chris Ansell – Nomura
Paul has stole my question, but I'll forgive him later. But specifically on Global your EBITDA margin declined by 140 basis points, I wondered whether you could just give us some colour on that. How much of that was due to a full year of Albacom/Infonet and how much cost do you think you can take out of bringing those networks together and how much we can see of that in the coming year?

Hanif Lalani

Sure I mean, I think that it's the two things. Firstly cost will come out as I mentioned, as we start to integrate further the acquisitions and complete that, the cost will come out as we remove duplication in service network and marketing, and all of that will help drive EBITDA forward. EBITDA margins will fluctuate and they fluctuate because we sign new contracts and as you sign different types of contracts they have a different amount of up front costs, they have a different migration cost, they have different Capex costs associated with it. So they have a dilutive impact and think directionally it's heading in the right direction. We are confident that EBITDA growth will happen but it's the life cycle impact of those contracts and a typical 'S' curve that needs to be applied, so there is a dilutive impact every time you sign a new contract that you have to take in to account and that sometimes is offset by the maturity of old existing contracts. It's the blend of those that drives that trend. But there are cost opportunities, I highlighted those cost opportunities and if you combine those it gives us confidence that we can continue to grow and accelerate growth in Global Services EBITDA.

<u>Question 7 (Chris Ansell)</u>

What do you think the margin would have been ex Albacom and Infonet so we can compare like for like?

<u>Hanif Lalani</u>

I don't have information at my tips, I think what we are doing is we have integrated those acquisitions into our operation to actually go and identify those operations as a stand alone entity today is not feasible or possible. Those are being integrated, we have got people on us, we are launching their products across the globe and so on. So I don't think that data is available. But what we do aim to do is to increase the margin from where it is today and we said we are inspired to grow that to a 15% margin over time.

<u>Andy</u>

Just to be clear on all the underlying trends, all the decline in EBITDA margin - a percentage margin - we haven't got a decline in EBITDA, is down to the traditional business in the UK, which although we won market share and we did very well, has been under huge pressure and you can see how that has been under huge pressure by the results of our competitors. But that's where the decline in percentage margin comes from.

<u>Question 8</u>

David Wright – JP Morgan
You are clearly very excited about the new wave and a lot of the Broadband services etc that you are rolling out to clients and I respect the fact that your market share of net adds has been quite stable but it hasn't been growing. Would you consider buying in market share to roll out those new services?

Ben Verwaayen

Well, we always look to opportunities. But I think we are excited about what we are doing in the market and I am not sure what you are talking about, what we would buy. If you just buy numbers?

Retail market share.

What are you selling? (Sir Christopher)

Ben Verwaayen

Well so far I think we have done outstanding on our organic growth there. If you look to a CAGR of 85% in Broadband as a market.

Ian Livingston

I think if you look to buy, you've got to look at the capabilities and one place we did make an acquisition of course we bought dabs.com in particular in the business space to improve our business side where our market share actually has grown to around 50%. We have actually grown our market share including LLU it's gone up from 28% to 31%. Excluding it's gone up by about 10 percentage points, so we've made progress, the hill's got a little bit steeper but we are doing ok, and you're still to see the stuff we're about to launch so I think our real focus is on delivering those services to our customers, that's where it is. If there is a capability or something then we might have a look but we are not desperate.

Question 9

Nick Delfas – Morgan Stanley
Apologies not to ask an operational question but just on the pension side, could you confirm if you've agreed with the DTI your statement that three quarters of the liabilities in the pension fund are covered by Crown guarantee? Following on from that, what do you think is likely to be the change in cash funding into the pension as a result of the review. Is it going to be the entire deficit over two years or is it going to be a figure smaller than that?

Sir Christopher Bland

Well it will be either the latter or a figure smaller or a figure larger. It will be one of those, and we'll tell you when we are ready, that will be some time in the Autumn. Those are complicated discussions, they involve an interaction between ourselves and the trustees. We haven't agreed with the DTI, they don't disagree with us but the important thing is to establish to the satisfaction of both the company and the trustees the extent and the nature of that guarantee. Now it's worth putting the guarantee in context. It only comes in to effect if BT goes bust. We're not about to go bust, we have no intention of going bust. So the real value of the guarantee is to the 84 year old pensioner who's been having sleepless nights because of the journalist who can only write about pension deficits with the phrase "black hole". Well the 84 year old now knows that the Government stands behind the black hole if it's possible to do such a thing. But that's the only significant value of the guarantee, other than the fact that it does reduce in a useful but small way our contribution to the Pension Protection Fund for that amount of the pension deficit that is covered, and we think that's of the order – Hanif of ….

…just over £2 million.

But that's worth having. So that's why we may have to go to the Courts with the Trustees to establish it and if we do that, or when we get solid legal advice we'll publish the results.

<u>Question 10</u>

Edwin Lloyd – Norges Bank
I have one question and one request actually. The question is on Openreach. I think this statement says that the separation of Openreach will be completed in the next six weeks. What will be the one off costs of that separation and is there an incremental ongoing cost of having it separate?

Then in terms of the request, would BT please consider dropping this pre leaver costs number. It's very small, it's not very lumpy now and I think it would just help if we didn't have footnotes to every page.

<u>Sir Christopher Bland</u>

I think the request is no. We'd consider it but we'll leave it in. You can drop it yourself, just add it back, and if you can't cope with the footnotes you're in a bad business.

<u>Hanif Lalani</u>

Openreach, we've made a specific item of it, we took £70 million in to our P&L - I think it was a couple of quarters ago, so we have provided for the one off costs associated with the creation of Openreach. As Openreach moves in to business as usual and it starts to operate, sure there are costs that it's going to have to incur and those costs become part of business as usual. We have to prioritise resources in the same way as we do in every other business and it has the same pressures of customer satisfaction, service and profitability. So for us I think that the creation of Openreach costs, one off for this year we have provided for, next year it's business as usual.

<u>Sir Christopher Bland</u>

And I think overall we've seen real benefits, operational benefits coming through the establishment of Openreach

Steve

Yes, first of all on the costs issue, we don't expect any significant incremental costs in this financial year caused by the establishment of Openreach. In fact there are significant operational efficiencies that become available to the BT Group through the establishment of Openreach and in terms of operational performance, clearly our job is to provide a level playing field for the market but the bar is also rising in terms of our performance, our service performance in the last couple of months has shown some significant improvements and we expect that to continue.

Question 11

Michele Geraci from Pali International
Back on the footnote, as we were saying before. What is the revenue in EBITDA growth including termination, mobile termination rate and proforma Albacom and Infonet. Because really that's probably the most accurate and underlying trend that we are interested in because, mobile rate is part of the business.

Sir Christopher Bland

Well take that off-line.

Michele Geraci from Pali International
A second question from me. You didn't talk too much about Bluephone and Fusion etc is there something not going quite right, or maybe. I was expecting grand fanfare about Wi-Fi coming up next few months.

Sir Christopher Bland

We'll now talk about it long enough to cheer you up.

Ben Verwaayen

I think I talked about it, but apparently not. Maybe Ian you can do better than I could.

Ian Livingston

It's doing exactly what we thought it would. It's the start of a new generation of technology and I think it's interesting that mobile companies are now coming to talk about convergence and it's now from being something that was somewhat mocked by some of the mobile only companies, are now saying, well actually this is the way forward. We've got BT Fusion, we're going to have a corporate version which we announced the deal with Alcatel so we did talk about that. Wi-Fi absolutely will be coming probably I would guess September time but we are a bit in the hands of the mobile handset companies and getting the right chip sets. So absolutely this is the start of a real roll, a whole generation of telephones and really services for customers that will give them far higher data speed transmissions when they are in hot spots. It will give them a lot more convenience and it will really start to converge their home phone service and out and about. So I think we have really started something quite big now.

<u>Question 12</u>

Richard Barker – Credit Suisse
Could I ask a kind of two part Capex question? You obviously talk quite positively about your plans in mobility and obviously you have put a couple of releases out in the last couple of days. Just wonder if you could clarify a kind of medium term time horizon, what you expect to be spending from a capital perspective on mobility and mobile in general? Kind of related to that on the non mobility side if you like, does your view of extending fibre out beyond the local exchange, has that changed in any way as a result of the increasing competition on price and various other things that you are seeing in Broadband, and some of the developments from a regulatory perspective that we are seeing in Europe at the moment?

<u>Hanif Lalani</u>

I think that if you look at our expenditure and say can you classify it in to mobile, fixed and others, it's kind of very, very difficult, because if you look at mobile operators they actually use a lot of the fixed line infrastructure in the first place. I think what's very clear in our mind is that we have a strategy and if that strategy requires us to spend more on wireless, then we will do that and we have a target that we have got to keep our capital expenditure within our envelope around this years' level and that's what we intend to do, and we will prioritise within that. But to actually specifically identify separate expenditure is a rather difficult task to do.

<u>Question</u>

Does that mean you're saying that if you had to spend an amount of money for instance on fresh spectrum auctions that that is included within your £3 billion Capex envelope that you have talked about or would it be an incremental amount to that.

<u>Hanif Lalani</u>

I think if we talk about spectrum I think that's something completely different. I think that's something completely different. I think if you are talking about expenditure on creating Wi-Fi cities or talking about expenditure on creating wireless broadband, then I think those are capital expenditures that we would treat as normal capital expenditures.

<u>Question 13</u>

And on the fibre outside the home?

On the fibre we've completed some pretty exhaustive trials on fibre both to the cabinet and straight to the home and we have got some very, very clear operational conclusions and actually it's what you already know. For a green field site operation it's just as cheap, maybe slightly cheaper to build that in fibre and it's cheaper to operate, so it's good, so we see a real place for fibre in green field site situations. But of course the vast bulk of our operation is on copper, it's already there, it works fine and there are tons of up side with DSL technology still to come, and you see that in our plans. We are on the 8 meg DSL max at the minute, we go to DSL 2 plus and we can do that on a nationwide basis. So time for fibre in a sort of replacement for copper is certainly not here in the foreseeable future but in our green field site it is, and it works well.

<u>Sir Christopher Bland</u>

The copper network has proved remarkably resilient. When Ben and I arrived we were told by BT authority that, no argument, 512 was the maximum speed that the laws of physics would allow through copper. Well, BT has changed the laws of physics quite spectacularly and it's moving in a very encouraging direction.

<u>Question 14</u>

Steve Malcom - Arete
Two questions, one on the balance sheet and one on IP Stream pricing.

On the balance sheet, I mean compared to most telcos you now look pretty seriously under levered, there have also been stories however fanciful of private equity interest. Do we assume the Board is still happy with this £8 billion debt target, or should we assume it will be reviewing that in light of completion of triennial review in the autumn of this year, and would you consider more debt in the balance sheet given a very low marginal cost to funding.

And second on IP Stream pricing, I guess you have got a lot of very anxious Wholesale customers who are expecting a reduction in IP Stream pricing to be able to compete with some of the more aggressive new entrants. When should we expect some visibility on those price decreases, will it be when you go to a million and a half LU lines or will you give them some sort of steer so they can set their prices to challenge some of the more aggressive new entrants? Thanks.

<u>Sir Christopher Bland</u>

The private equity approaches, we still await. The balance sheet and borrowing levels, we are very comfortable with. The Board as you would expect reviews that constantly, it's not written on a tablet of stone that £8 billion and we need to review it in the light of market conditions, of interest rates, of the business outlook. We started life five years ago with £29,000 million when people like you weren't saying, you're under geared. Now it's quite nice that you are suggesting that we should put the debt levels up. It's an encouraging trend, Paul.

Paul Reynolds

On IP Stream you are absolutely right, we have lots of anxious customers waiting for a move and I have got a very anxious customer right beside me here. And Ian's in the same position in that regard as many others of the 200 service providers whose business depends on IP Stream. We have a voluntary price freeze until we reach something like one and a half LLU lines with Ofcom as we have said in the presentation today. LLU is going well, we expect that to go to one and half million in the year and so we've begun those discussions with Ofcom and I fully expect to be changing IP Stream prices in the year, downwards.

Question 15

Damian Chew – ING
A question on BT Global Services and specifically on revenue growth. I am just trying to reconcile the 12 month order intake numbers we are seeing which is roughly £5/6 billion I think excluding some of the lumpy bits and your sort of total revenue for BT Global around 8.6. Can you just try to help me understand, is there a relationship between sort of order intake and sort of the 10% revenue growth BT Global's delivering at the moment.

Andy Green

It is a complicated story so the order book we give you is the major contract order book that used to be in an organisation in Syntegra and solutions in the old world which was the big contracts. That's the only thing we have been able to Sarbanes Oxley correctly. We've been working all year to give you what the underlying rate if you like of those smaller contracts around $1-20 million contracts that were taking place all over the world. A great deal of our growth is coming in that area in that underlying contract base so when we come out with the investor day we will give you a track of what we have been able to get Sarbanes Oxley and then we'll start to report that forward as we go forward. The other thing you have to understand that there is a lot of traditional business in the mix there too and that's coming down. So overall we've always said that the business in that space needs, you know, 5-6 billion is a perfectly comfortable range for it to continue to grow well and we see the market continuing to do well, and the underlying smaller contract base has been doing extremely well across the world and that's what's driving the revenue growth.

Question 16

Tajesh Tailor – Societe Generale
Just wondered if you could help us sort of try and understand a little bit better how much of BT Wholesale's EBITDA is actually exposed to some sort of competition from unbundling in the UK essentially.

Paul Reynolds

Let me take it off-line.

Hanif Lalani

If you want to pick it up and say how much of the revenue is coming from the Broadband space then it's about 200 million.

Question 17

Mark Cardwell – Bernstein
Back to the high speed question you were telling me before. Your chart said you were going to do 60% coverage of ADSL 2 plus in 07, if I get that right. Can you give us a sense of where the coverage can go first of all and the time frame to get to near 100 or where you think you want to take it and secondly what speeds are you finding in the trials you can actually achieve, is it a function of distance, are we going to have some people at 20 mgbits and some people at 16. Can you just give us a sense of what you're finding there and then relate it to the high speed stuff on the IP TV and the things you announced today and the content. Can you tell us what you are doing about sort of packaging of content and where you are going in terms of capabilities you are building internally for putting content together in the IP vision offers, how that's progressing.

Paul Reynolds

On DSL 2 plus ultimately we can take it everywhere. I'll give you a very clear answer on the speed things. We did with DSL max, we were very upfront when we finished the trials on the proportion you get 4, 6, 8 and so forth and we'll do the same with that. We think we can get it across the country but we are going to go for massive roll out the second half of next year and that's going to give us all the head room on speed, and I'll give you a table when we are ready and we have done the tests on who's going to get what. It will be variable because that's the way DSL technology works. Some of the country is going to get the high speeds and some of the country won't in that type of technology but lots of head room for lots of the new services.

Question 18

Is it all in 07 and 08 or does it take longer to deploy.

Paul Reynolds

As you saw from the chart we are doing 60% in 06 and 07 and we'll do more in the year after.

Ian Livingston

In terms of packaging and content, Mark, we'll be putting together I think a very effective set of films which a lot of people buy for a 1,000 plus films plus a range of TV series and things like that. But I think one of the things that probably differentiates what we are offering from run of the mill video content, good as that might be, is really interactivity and for instance self generated content I think is going to be a far bigger thing in the future and community based content than it has been and the ability to interact with the content and participate in it. So I think what we fully intend to do is use IP TV not to replace the broadcast frame because to be honest broadcast does that reasonably well, is actually use IP TV to allow you as an individual to actually interact with the services you get and to do them on your terms, when you want, as you want and with a relationship you want, and that's a very different sort of TV experience. It's why we have called BT Vision the next generation TV it really is a step beyond TV, not just replacing it.

Question 19

Do we look for BT to be a big brand then in packaging that sort of thing, or are you looking to put branded channels or branded stuff out …?.

Ian Livingston

I think typically something about the films we were bringing together different film studios will be under BT Channel, there may be one or two things that, you know there is an individual music channel that's got a great brand with it. But typically this will be BT and BT Vision layered and customers get the benefit effectively as an aggregator.

Question 20

Stuart Gordon – ABN Amro
A couple of questions. The first one is that you are always saying your comfortable and happy with one and half million LLU lines. At what position in terms of numbers do you become unhappy and very uncomfortable. Is it double that, treble that. The second one is obviously you are talking about BT Fusion and other new offerings. Is it your intention to use them as a hook as Wholesale offerings to other ISPs that would stay with BT for Wholesale IP Stream?

Ben Verwaayen

Let me first say about the state of our happiness. One and half million is what we have said would be the mark for a change in the regulatory landscape so that's a pretty important number. LLU customers are customers of ours. I mean that point is very often forgotten but I would like to remind you that they are Wholesale customers and we are very happy to have them. At the same time for some or other parts of our business this will open some opportunities after one and half million. Also to consider different models in the market as well. So I am happy with one and half million, I think if you do the numbers and I think you and I did the numbers when I was over at your place, you may not have believed me but there is not a space for twelve people to be very happy in the LLU market there will be some consolidators. I think one and half million and a bit more is probably a space when in that market, that will happen.

Paul Reynolds

Yes, we have taken strategies, different strategies depending on how the market goes there, so with BT Mobile that's gone straight to Wholesale offering, others we have taken where we think there is real premium of being a Retail offering. But our minds are open to what we white label so I expect us to white label some of the things that are currently Retail products into the Wholesale market and we'll just take a commercial judgement on the timing of that.

Final question.

Question 21

James Harper - Redburn Partners
Two questions please. The IAS19 pension benefit is now becoming quite a large element of EPS for 2007. Can you just confirm that the payout ratio for the dividend will be based on reported earnings despite this large non cash item?

The secondly a question for Ian. Just in terms of DSL obviously we are seeing competitive offers for TalkTalk, potentially for Sky from Orange, maybe from Vodafone and O_2, if you believe the press. What's more important to you, maintaining market share or maintaining prices.

Sir Christopher Bland

The answer to the first question is yes.

Ian Livingston

I don't think it's about maintaining prices, we haven't maintained prices for a very long time. You know customers keep on getting better deals and you shouldn't believe everything you read in the press by the way, it's not a good idea. We see that we can offer our customers more for less and make more money out of it. I mean that's actually what we have done this year. Do you remember we were sort of £100 million above consensus in Retail despite what was unquestionably a pretty tough market, so we think we can complete that trick and that's where becoming more efficient and offering better services you can hold your market share and make more money.

Christopher Bland

OK, thank you all very much.