



BT GROUP PLC

Q3 2014/15 RESULTS CONFERENCE CALL TRANSCRIPT

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	Tony Chanmugam	Group Finance Director
	Graham Sutherland	CEO BT Business
	John Petter	CEO BT Consumer
	Joe Garner	CEO Openreach
	Luis Alvarez	CEO BT Global Services
	Clive Selley	CEO BT Technology, Service & Operations

Damien Maltarp

Slide 1: Thanks and welcome everyone. My name is Damien Maltarp and I'm the IR Director for BT. On the call today we have Gavin Patterson, Chief Executive, and Tony Chanmugam, Group Finance Director. Tony will go through the headline results and financials, and Gavin will go through the lines of business. In the room with us today we also have the CEOs of our lines of business.

Slide 2: Before we start I'd like to draw your attention to the usual caution on forward-looking statements. Please see the slide that accompanies today's call and our latest annual report and Form 20-F for examples of the factors that could cause actual results to differ from any forward-looking statements we may make. Both the slide and the annual report can be found on our website.

I'll now hand over to Tony.

Tony Chanmugam

Slide 3: Thanks Damien. Good morning everyone, and thanks for joining the call for our Q3 results.

Slide 4: This quarter we've delivered strong growth in earnings and cash flow, and we've made good progress in cost transformation. This has contributed to EBITDA growing at a faster pace than in the first half. As you know we're currently in an exclusivity agreement with DT and Orange over the potential acquisition of EE. Our due diligence is going very well, and we'll update the market in due course. But to pre-empt any queries, we're not giving away any further details on the deal today. I'm pleased to announce that the triennial pension valuation has now been agreed, and I'll give you more information on this in a few minutes.

Slide 5: First of all, slide five, this gives an overview of the Q3 financials. Revenue was down 3%, this reflects a £49m negative impact from foreign exchange movements, and a reduction in transit revenue. Our main revenue measure, which excludes FX and transit, was down 1%. On a year-to-date basis it's flat, which is in line with our outlook of broadly level for the full year. The revenue decline this quarter was almost entirely due to the timing of contract milestones within Global Services, which benefited Q3 results last year. We flagged this at the time. In the other divisions, Consumer had another good quarter, with revenue up 7%, primarily driven by growth in broadband and TV. Business and Openreach posted small declines in line with the trends we saw in Q2, whilst Wholesale's revenue decline was less severe. EBITDA was up 2%, driven by the benefit of our cost transformation programmes. This was an improvement on the first half, despite the tougher comparator, because of the milestones last year. Below EBITDA we continued to see the benefits of our focus in recent years on more efficient capital expenditure and debt reduction. These have led to lower depreciation and interest charges, which drove a 10% increase in our EPS. Normalised free cash flow was up £354m, which reflects improved working capital and lower tax payments. As you may remember we had a large employee share option plan maturity in August. Share options are tax deductible when they are exercised, so this benefitted our tax payments in the quarter. Net debt was £6.2bn, down £1.4bn on last year, helped by the strong free cash flow in the quarter. Below free cash flow we spent a further £52m on our share buyback programme, taking the total to around £250m so far this year.

Slide 6: Turning to operating costs on slide six. This chart shows that operating costs were down 5%. On an underlying basis, excluding transit, they were down 3%. This is a much improved performance on the 1% increase in Q1 and 1% decline in Q2, and reflects a better rate of cost reduction in the second half of the year. Underlying net labour costs were down 5%, the biggest decline in two years. This is due to the savings achieved from our group wide restructuring programme, with good contributions from Global Services, Wholesale and Business. We've done this by re-engineering our processes and reducing the cost of failure. Savings have been achieved despite recruiting thousands of engineers and insourcing nearly 1,900 jobs in the past year. As we held a detailed cost transformation event in December, I won't give you further details of our various projects to date, but I can reiterate that we still see over £1bn of gross cost reduction opportunities across the business.

Slide 7: Now moving onto the pension, slide seven. I'm very pleased to say that we've reached agreement with the Trustee over the June 2014 funding valuation. There are four key features I want to draw your attention to. Firstly, we've agreed with the Trustee that the deficit is £7bn. After tax relief this is £5.6bn. We reached this agreement against a challenging market backdrop, with a continued low interest rate environment. This is a good outcome for both BT and the Scheme. Secondly, these valuations are done every three years, so the key factor is what is paid *in* over that period. Last time we agreed a deficit of £3.9bn, and paid in more than £2.6bn over the following three years. This time we'll be paying in £2bn, a reduction of £650m. Most of this will be done upfront, with £1.5bn being paid across March and April. This has the benefit of being tax efficient. It's also a good use of the cash and liquid funds sitting on our balance sheet, which totalled £2.8bn at the end of December. Thirdly, we're agreed an extended 16-year recovery programme. Last time, the agreement covered a 13-year period. We're a much

stronger company now than we were three years ago, our revenue trends are better, our cash flow is higher. The Trustee has recognised this in agreeing to a longer recovery period and this also helps reduce the risk of overpayment of the scheme, and ending up with a trapped surplus. And lastly, you may remember that last time round we had arrangements in place whereby if the deficit grew in later evaluations we had a schedule of additional payments we would make. This is not a feature of the agreement now, in fact we have the opposite. If future valuations are lower, for example if bond yields were to revert to more normal levels; we have an agreement to also reduce the deficit payments. As we said before, we don't want to overfund the Scheme. So overall we feel we've come out in a good place with the repayments plan, and we have certainly for the next three years, and this is key.

Slide 8: Now moving onto the deficit payments in a bit more detail, on slide eight. The top chart shows the payments we would have made if we continued with the 2011 recovery plan. The bottom chart shows the new recovery plan. There are three points on this I'd like to highlight to you. Firstly, over the next three years we'll be paying the same £2bn figure as previously agreed, but benefitting from doing it in a more tax-efficient manner. Secondly, the total size of the payments in the first ten years of the new plan is the same as in the 2011 plan. And thirdly, the increase in the deficit this time round has effectively been added to the backend of the payment plan, and, as I said, if the deficit reduces we'll reduce our payments for the outer years, this is shown here in green.

Slide 9: The slide now takes you through the valuation and the assumptions and movement behind it. Since the last valuation the assets in the scheme have increased by around £3.3bn, however the liabilities have grown by around £6.4bn. This increase is due to the very low discount rate of 1%, which is being driven by the continuing low interest rate environment. The overall effect is to bring the deficit to £7bn.

Slide 10: Slide ten shows some of the other features of the new plan, compared to the 2011 plan. I'll start with shareholder distributions, we had a similar agreement last time, whereby if shareholder distributions exceeded the threshold we'll make matching contributions to the Scheme. The threshold has been amended, allowing in aggregate, share buybacks of £300m per year, and cumulative increases in the dividend per share of 15% per year. As you know, this is the maximum of our guided range for this year and next. This provides us with materially more cover than rolling forward the previous agreement. The agreement around disposals and acquisitions remains the same, so if net proceeds are more than £1bn in any year, we will pay one-third into the Scheme. It's worth highlighting that we've had discussions with the Trustee on the EE transaction, and they are supportive.

Slide 11: Finally, moving on from the pension, I want to quickly remind you of our outlook on slide 11. This has not changed from what we announced last year. In '14/15 we expect underlying revenue, excluding transit, to be broadly level with '13/14, EBITDA to be between £6.2 and 6.3bn, and normalised free cash flow to be above £2.6bn. We expect growth in all these measures in '15/16. We therefore remain confident we can continue to grow the dividend per share 10 to 15%, both this year and next, and now I'll handover to Gavin.

Gavin Patterson

Slide 12: Thanks Tony and good morning. In a moment I'll take you through the performance for each of the lines of business, but before that, if you turn to slide 13, I'll just pick out a few of the operational highlights for the quarter.

Slide 13: Openreach broke a couple of records this quarter. It had the highest growth in landlines on record, and it also saw its best-ever fibre performance, adding 375,000 fibre customers. This strong market demand for fibre is helping to frame our thoughts as we look at how we will significantly boost fibre speeds in the future, and I'll say more about that shortly. BT Consumer grew its top and bottom line for the fourth quarter running. This is how we said to measure the success of BT Sport and it is clearly delivering. And Global Services had a strong quarter for orders. Mobility is, of course, a key growth area for us, and I'm pleased that we're making good progress on our due diligence in relation to a possible acquisition of EE. We'll make further announcements on this in due course, and in the meantime our consumer mobile plans remain very much on track.

Slide 14: Turning to slide 14, and taking a closer look at Global Services, where there are some pluses, but also some minuses. Underlying revenue was down 7%, although the decline was partly due to the timing of contract milestones which we flagged last year. UK performance was a little disappointing, as it continues to be impacted by lower public sector revenue, but continental Europe is looking brighter. It grew again this quarter, reflecting some improved volumes and new customer installations, and we again saw strong growth in Asia and the Middle East. The cost performance was also encouraging, down 6% on an underlying basis, reflecting our continued focus on improving efficiency and our processes. EBITDA was down, but excluding the prior year milestone, it's been broadly flat over the first nine months of the year. And cash flow of £52m was down year on year due to working capital movements. As I said, operationally Global Services had a strong quarter, with orders up 36%. This included some good wins, including an expansion of our relationship with the Royal Mail, a renewal with Proctor & Gamble, and the renewal of our Network & Services contract with ENI, the Italian multinational. We're winning in the market, and this is recognised by industry analysts. For the 11th year running we've been named by Gartner as a leader in their Global Network Service Provider Magic Quadrant, a recognition of the breadth and quality of services we offer our customers around the world.

Slide 15: Now turning to slide 15, BT Business results were broadly in line with recent trends, with good cost control offsetting a small revenue decline. Voice revenues are still a headwind, 5% lower as customers continue to move to data and VoIP services. This was partly offset by growth in data and networking revenue, with continued growth in fibre. IT services was flat, as we continued to refocus the business away from hardware sales. These were down year on year, offset by growth in software and professional services. In terms of our products we continued the roll-out of BT Cloud Voice, our business grade IP Voice service, which we launched last quarter. Early take up is encouraging, and you'll see us launch more of these services as we continue to refresh our portfolio of

broadband and voice services. Cost control was strong, down 4%, and this meant that EBITDA grew by 4% in line with Q2. Cash was also up in the quarter, and as you can see from the chart the 12-month rolling cash flow continues to improve. Operationally the order intake was solid, up slightly in the quarter, but more importantly up 8% on a 12-month rolling basis.

Slide 16: Now, turning away from the business market, to BT Consumer on slide 16. It was another good quarter for Consumer, which again grew its top and bottom line. Revenue was up 7%, with Broadband and TV up, and calls and lines revenue also growing. Consumer ARPU was also up. We continued to see strong growth in RGUs as our existing customers add products. Costs were down 1% with a solid cost transformation performance. Added to the revenue growth this meant that EBITDA was up 43%. We were up by 10% against our performance two years ago. Operationally it was a good quarter, with 209,000 fibre net ads, with well over half of those taking our higher-priced tiers. We again added almost half of the growth in the broadband market as a whole. Line loss was better than last year, and around 30% better than Q2. Excluding the quarter when we launched BT Sport, this was our best line loss performance for more than five years. We continued to improve our TV proposition, and added 45,000 customers in the quarter. We launched TV Everywhere, which means customers can watch TV channels on their phones and tablets, and we also launched Netflix and a range of new packages. In terms of Sport, both the residential and commercial BT Sport base grew in the quarter. Since we launched BT Sport, just over a year ago, twenty-five thousand commercial premises have signed up, with one in three pubs showing it, and that's more than Sky. And finally, viewing figures have also been encouraging, with our Premier League viewing up 17% year on year. So overall it was a good performance, providing us with a strong platform to build on as we look to broaden and deepen our customer relationships.

Slide 17: Looking at slide 17 now. It was a better performance for BT Wholesale this quarter, but the business is still facing challenges from regulation, and continued migration to LLU. Underlying revenue was down 5%, much improved on Q2, as you can see in the chart. Two-thirds of the decline is due to the impact of Ofcom's narrowband market review, which will start to anniversary out in Q4. IP Services revenue grew well, up 45%, with our IP Exchange product now carrying over 1bn minutes a month. And cost control was good, down 5%, including a 19% reduction in SG&A. But this was not enough to offset the decline in revenue, which meant EBITDA was down 7%. But this again was an improvement on the circa 20% decline we saw in the first two quarters.

Operationally this quarter included a contract with O2 UK to support the upgrade of their core network to IP, which helped orders to grow by around £200m compared with Q2.

Slide 18: On slide 18 Openreach delivered another stable financial performance. This was despite the on-going impact of regulation, without which, revenue would have been up around 3%. Fibre was again the standout number, up 36% year on year. Despite the 2,400 additional engineers we've recruited in the last 12 months we again reduced our costs, but EBITDA was down slightly. As in Q2, this partly reflected a smaller benefit from the

sale of redundant copper. In terms of operational performance Openreach's physical line base grew by 111,000. As I said, this is the highest rate of growth on record. But it was also a record quarter for fibre. Total net ads were up 11% year on year, 44% were provided to our external CP customers, that's the highest ever, demonstrating the market-wide demand for fibre. This strong fibre growth is not only good for BT, it's good for other operators, for consumers and business, and for the country as a whole.

So, I've spoken about how our business did in the quarter, I now want to spend a bit of time talking about the future of our network in the UK.

Our network vision is being shaped by the clear market demand for data. We believe data demand will continue to grow by more than 30% a year each year for the next ten years, just as it has over the last ten years.

Slide 19: And on slide 19 we have set out how our network will evolve to meet this demand. It all starts with customer needs, and for our customers, our future network will mean seamless, ubiquitous connectivity for all devices, fixed and mobile, both indoors and outdoors. For consumers, the network will deliver compelling bundles of voice, broadband, TV and mobility. And for businesses, it will deliver very high bandwidth and secure, dedicated connectivity. We already serve many thousands of customers in the business market using IP. Our goal is that by 2025 all our voice customers will be served using an IP to the premises solution, and will migrate off the traditional telephony platform. In terms of network architecture, we're building a seamless, converged single platform that's able to serve customers wherever they are. There's no distinction between fixed and mobile, one common access platform is able to deliver both. And the access network itself will be an integrated copper, fibre and mobile solution, using indoor femto cells and handing over to macro cells where needed.

Now we've already built a single flexible IP core network to support both fixed and mobile integration, and this has again broken capacity records, most recently achieving three terabits per second on a single, existing 370 km length of fibre. So building on our existing investment, our future network will ultimately simplify our estate, replacing legacy networks and platforms, and saving us costs in the longer-term.

Slide 20: Turning to slide 20 now, I want to expand a little bit on the access element of our network vision. Throughout our fibre programme we've been matching our investment to the needs of our customers. We believe our investment should be demand led. We've currently passed around three-quarters of the UK premises with fibre, delivering superfast broadband speeds of up to 80Mbps to these households, and we're working with the government to extend this reach to 95% of the UK. At the same time as extending the reach we're looking at ways we can future proof our network to meet customer demands for speed in the future, taking speeds from superfast to ultrafast. We talked last quarter about G.fast technology and the potential to achieve speeds around 800Mbps downstream by taking fibre to the distribution point, the last network point closest to the home. And our initial trials of G.fast have been very encouraging, and we can now see a way to deliver G.fast from other points in our

network, including, most importantly, the street cabinet. This will mean we're able to deliver ultrafast speeds of multi hundred megabits per second, rolling out more fibre where it's economic to do so, and building on our existing NGA investment. Now to examine the prospect further we're going to undertake scale pilots in Huntingdon and Gosforth later this year, covering around 4,000 premises. And this will allow us to fully test the technology, hardware and processes of a G.fast deployment. Providing these pilots go well, and we expect them to, we can see speeds of half a gigabit, or 500Mbps, being available across most of the UK over the next ten years, and for homes and SMEs who want even faster broadband, we're going to develop a Premium 1Gbps fibre broadband service as well. This will be a significant investment but it won't be linear, and we've looked to manage this broadly within our existing capex envelope. And we will only make this investment if the appropriate regulatory environment is in place to allow us to make a return on this investment.

So, just to wrap up, our Q3 results have reinforced our confidence in our full year outlook. The investments we're making are delivering for us, and the success of these is helping to shape our future network vision. Our agreement with the Trustees has provided certainty on pension contributions over the next three years, and in terms of mobility, our negotiations around EE are progressing well. And our plans to start selling consumer mobile services this financial year are fully on track. With that we'd be happy to take your questions.

Q&A

Michael Bishop - RBC

Morning it's Michael from RBC, just some questions around the G.fast announcement. Firstly are there any early indications of - I know you said it was within the overall capex envelope of the company, but do you have any indications of the specific capex for the G.fast upgrade? Then just a quick follow-on. Have you done any work around the overall cost savings of the ten year plan to move to all IP, either from a gross or net basis? That would be great thanks.

Gavin Patterson

Tony do you want to pick that up?

Tony Chanmugam

Yes sure. Look it's very early, we're launching trials. But what we remain confident is that the technology is improving, the cost points are improving. So if you compare to where we are now with what we thought was going to be needing to be incurred six months ago, it's much lower, and we're comfortable that we can manage this within our financial plans. I said this on the last quarter's call. And the reason we are confident about this is we know what our roll-out profile is, in terms of commitments we've got, we know what we need to do in relation to upgrading the network through vectoring, and we now have a lower cost point in relation to the superfast

broadband roll-out. If you put all of those together we have a degree of confidence that we can manage within the plans. Now it will not be linear, it will not be in a straight line, but it will be managed within those plans.

Steve Malcolm - Arete

Yes, good morning guys. I'll just go for one and following-up on G.fast. You obviously say there's a play to Ofcom in the statement; you say it depends on a continuing stable regulatory environment. Just interested to hear whether you think that the recent decision on margin squeeze constitutes a stable regulatory environment, or whether that's the wrong side of the line. You said that at the time you'd consider your options, you know how you're thinking about that, that margin squeeze decision in light of these investments? Thanks.

Gavin Patterson

Well you know we're very disappointed with the Ofcom decision around margin squeeze around VULA. We fully understand, looking at the broadband and the fibre side of things, that Ofcom need to be *cognisant of* potential margin squeeze, and clearly they have found that there is none. But incorporating sport we think is a mistake, it's an unfair decision and one that we are considering our options around at the moment, but clearly we're very unhappy about that. However within the announcement, Ofcom did refer to creating the condition that allow investments to continue in superfast broadband, and it is to that point that I would refer when we're thinking about future investments going forwards. Clearly investments in superfast broadband have been a success, we've had a very fast roll-out, it's available and being used by hundreds of service providers across the UK. We've got coverage of our own network that's now over 75%, we've got a clear pathway to 95%. I mean that's the most extensive in Europe, and customers of all service providers, consumers and businesses, and public sector, are all seeing the benefits of that now. But we recognise that this is not a static market, and clearly if there's one thing we can learn from history is that the consumption and appetite for data continues to grow. And if you look back over the last ten years is growing consistently at 30% a year. So we need to plan with that in mind, which is why we want to go ahead and begin these pilots around G.fast, and we'll learn from them, we'll optimise the delivery of it; we'll optimise the systems and processes. But we need to be confident that, if we're going to continue to make these investments, that shareholders are going to get a fair return out of that, so this is something we'll continue to talk to Ofcom and politicians, and, more broadly, all stakeholders about, to ensure support for that.

Steve Malcolm - Arete

Just to be clear, the decision to include football costs, it should be looked at separately. You feel that this decision has enough in it, to grant you the freedom today to make these investments without worrying too much but you want that to be maintained basically?

Gavin Patterson

I mean we make our investments in Sport looking to make a return over the long-term, and you can see that in the results. We're now in this quarter making more profit than we made two years ago, in the equivalent quarter in

our consumer business. So I think you can see in that, Steve, that we're committed and disciplined about the way we're trying to drive the business going forwards. Our issue with the margin squeeze test is we think it's simply unfair. It's lopsided regulation that seems to discourage any challenges into investing in sports rights, because those are long-term investments, and expecting them to be making returns over very very short periods is, in our view, very wrong, and that's why we're considering our position on it. However we've got to make the right decisions for our business over the long term, and ensuring that the network remains focussed on what our customers need, and ultimately responding to their desire for data and speed, I think it's absolutely critical, so we'll have to work the two things hand in hand.

Carl Murdock-Smith – JP Morgan

Morning, few questions please. Firstly I was just wondering how have the December price increases landed, within the consumer business, and have you seen any changes to churn or consumer purchasing habits as a result? And then secondly I was just wondering to what do you attribute the particular strong physical line performance in Openreach this quarter? Were you just lucky with the weather, is it a seasonal spike, or are other more sustainable factors at play? Thank you.

Gavin Patterson

We're never lucky with the weather Carl, come on! I'm going to ask John to talk to the pricing question, and then maybe Joe just to comment on line growth in Openreach. John.

John Petter

I think the picture on the pricing changes is best indicated from the physical volumes, and the line loss figures that we've seen are clearly some of our strongest that we've had in quite a long time, as Gavin mentioned. I think the competitive environment is a key part of this, that most of our competitors changed their prices at about the same time, some of our competitors have been far more aggressive on pricing. I think there was several increases from TalkTalk in total, quite large increases on the cost of sport from Sky, and the key thing for us is ensuring that viewed in the round, our products are strong value for money. Some of our prices come down by the way, especially some of our best offers, and the business is performing well in the round I would say, to drive that measure.

Joe Garner

Yes thank you, yes it's certainly not the weather. There are a few factors in there. First is there is a bit of seasonality in the quarter, in that it's when the students take up their lines. There's also been a strong growth in new developments and new sites, some of which still take copper, and we did run a tighter operation in the sense that we did drive our work stack down lower, and that played into the numbers too. But underpinning all of that, fundamentally, it's strong consumer demand which is feeding the healthy competition between our CPs.

Nick Lyall – Societe Generale

Yes morning everybody, it's Nick at Soc Gen. Firstly on capex, could you give us a rough idea of the run rate on fibre capex at the moment in Openreach, and maybe roughly where that stands versus last year. And is there any idea - I mean I know it's a very variable point - but any idea on the initial thoughts on capex for the G.fast line? And then secondly Global Services, just a very basic one, given the election coming up in the next couple of quarters, should we expect the UK business to stay very weak?. What are the sorts of signs that you're seeing from your UK public contracts? Cheers.

Gavin Patterson

Okay, Tony do you want to talk on capex and then maybe Luis do you want to maybe talk about the UK corporate and public sector?

Tony Chanmugam

Yes, in terms of the capex the fibre capex is broadly similar this year to last year. The mix obviously, and this is in net terms, the mix is obviously is different in terms of what we've spent on the commercial roll-out and what we've spent in relation to the BDUK funded element. But the BDUK funded element that has stayed in our books; is net of any funding we may receive., And just extrapolating on that, the reason that I'm confident that we can manage in relation to the overall envelope of our capital, and cover any further roll-outs, in terms of increasing speeds through G.fast, is that we're not going to be spending the sort of capex we've been spending to date; in relation to the superfast broadband, so that becomes available. We also know that the efficiency and effectiveness of what we're doing with our labour force helps us to drive down unit cost. And lastly, and most importantly, the technology that we've got in relation to G.fast, and how that's moved over certainly the last six months, leads me to believe that we've got technological improvements in terms of both speed as well as efficiency as well as cost. You pull all of that together I'm very very confident that we can manage within the envelope. As I said previously it won't be linear, it won't be the same number each year, but what it will be is, it will be within long-term envelope, we can do this.

Gavin Patterson

I don't know whether I emphasised this enough in my comments, but we've had a couple of breakthroughs on G.fast in the last quarter. One is the standard has been agreed, which is an important step of course, and then secondly, we've now been able to see that we can get some very high speeds deploying the technology from the cabinet as opposed to the distribution point. And obviously there are 4m distribution points, which will be an extremely time consuming process if we had to deploy it to every one of those, whereas there are only 90,000 cabinets, and they already have power and are set up for superfast broadband today. So it's operationally, while not trying to suggest it's going to be a walk in the park, it is considerably easier than we first thought. Luis do you want to talk about the UK corporate and public sector situation?

Luis Alvarez

Yes, I think that on the public sector, well I've seen any country whenever they are elections coming there is a slowdown of the number of projects that are launched in government, or the new procurement processes that are started. So in that sense clearly something that we are experiencing today. I think that the second thing I would say is that on the existing services that we have been providing this has really helped transform the way citizens and services have been provided to the community, so if we look to what we have been doing in the NHS, for example, in the Ministry of Defence. But it's also true that some of those businesses have concluded the process of deploying the services, as we did in LSB, so in that sense that is part of the impact we have seen. And on the corporate sector, well I think there are two things. One is more and more what we sell is used by corporate customers, but it's also true that some of traditional services, like voice or TDM is moving into the IP business, so I think probably that is an overall perspective of where we are.

Tony Chanmugam

Just a couple of other things, it's Tony Chanmugam here. The first is when you look at those headline numbers, remember the UK number, that's where the milestone appeared in, so you've got to take off a few points because we had, roughly speaking, a £60m milestone in last year. Secondly, we're also anniversaring out the local government contracts that we talked about, and that's also impacting here. So I think you've got to make those two adjustments. Still the numbers are down, but the numbers are not as bad as they physically appear at the moment.

Nick Lyall – Societe Generale

Sorry Tony, is there any chance of giving us an idea on what that *transition* from the government contracts might mean? The milestone's clear but the second point you mentioned?

Tony Chanmugam

Yes, we called out we lost a big -, well we didn't bid for a large local government contract for the renewal this year, and last year we completely downsized on those. If you take those two together we quoted a number a hundred million, so you've got to reflect on that and the cannon drives that through.

Nick Delfas - Redburn

Yes morning. Just a question on G.fast. Is your proposal, effectively, to run three networks in parallel, so you'll have the copper networks from the central office, the VDSL network from the street cabinet, and also G.fast from the distribution point, or are you going to write off and take out the copper network at some stage, I'd just be interested in that. Thanks very much.

Gavin Patterson

I'm going to ask Clive to comment on that.

Clive Selley

What we envisage is that as G.fast rolls-out that will serve a higher bandwidth demand in customers. That service will be made available from cabinets and points closer to the customer, and it will co-exist with VDSL2+, so this is a strategy that reuses the existing assets, and I think Gavin referred to that, so we have street furniture cabinets, which already have ponds laid to them, so they already have fibre and they already have power. We will forward power to nodes closer to the customer, and not put in new electricity feeds from the electricity suppliers. So this is about leveraging the existing assets, understanding that customer needs will differ customer to customer, that VDSL2+ will serve many many customers for many many years and meet fully their needs. So it's about co-existing VDSL2+ and G.fast. In addition to that the customers, and again I think it was referred to earlier, customers with very high bandwidth demand, perhaps small and medium enterprises and high end customers, we will offer a fibre all the way product, and that will offer gigabit speeds.

Nick Delfas - Redburn

So is your pitch to the regulator effectively that you're going to need to keep all the copper plant even though you've built all these other plants for VDSL2+ and for G.fast, and you should be given a return on all that old copper plants that's not being used as well?

Clive Selley

So the bulk of the copper plant is in what we call the D side, that is between the cabinet and the twenty-nine million homes in the UK, and that will continue to be used, both for VDSL2+ and for G.fast.

Gavin Patterson

Sorry Nick, and just to be clear, we won't be "pitching", we'll be explaining it as factual, so it's something we're expecting to be interested in. We know across governments both, in fact all parties are particularly interested in where the network goes next, to ensure that it continues to be a real competitive advantage for the country as a whole.

Nick Delfas - Redburn

If I could just follow-up with one small thing. You talk a lot about the capex envelope, should we assume that that's up to £2.5bn a year, or what is the capex envelope?

Tony Chanmugam

We're not given specific guidance, but we've said the capital's going to be broadly flat, we're spending £2.3bn.

Robert Grindle – Deutsche Bank

Morning all. Yes question on pensions actually. It's a bit difficult to work out what the longevity did actually, because you've changed the disclosure there it seems very -, much more sophisticated. But in your notes it says that longevity is offset by other stuff. Is it just a case that the whole longevity beast has been slain, perhaps through your hedging, or is it that longevity going up was still a material number that was offset by all the good work you did on the pension fund? You changed some of the terms from the employees etc. So any idea if longevity -, was it a big number offset by another big number, or it's just we cannot worry about that anymore. Thanks very much.

Gavin Patterson

I'm going to ask Tony to comment on the pension in a second. The net-net is -, this is a very good deal, and we should be focussed on the next three years, where we'll be paying in £2bn, relative to the £2.6bn we paid in the previous three years. So I think it demonstrates the confidence in the future of the business. I think ultimately this will begin to right itself when more normal interest rate conditions begin to return. But Tony do you want to talk about the longevity point?

Tony Chanmugam

Yes, there's not much to say. It's not a material movement, there's a little bit of offset with other factors.

Paul Sidney – Credit Suisse

Good morning. Just one question please. BT will announce many potential different projects over the next few years - potential M&A, content acquisition. How should we think about BT's priorities for use of cash, and, just a kind of a follow-on from that, how should we think about that influencing your views on the credit rating and shareholder distribution? Thank you.

Gavin Patterson

Well it's the same as we've set out for the last couple of years Paul. So we're focussed on free cash flow ultimately, and growing that on a sustainable basis, and there are four areas we look to to use that cash. Progressive dividend, paying down the debt, ensuring that the pension is adequately but not excessively, funded, and investing in the future of the business. I think we're managing to balance the needs of those four priorities reasonable well at the moment, and indeed the fact that we're talking about the pension today and the investment in G.fast I think is two examples of that. In terms of the credit rating, sorry, to be more specific, we remain focussed on getting to triple B plus, which we think will require us to reduce our debt by another couple of billion, but obviously if and when we come back and talk about EE we'll need to update you on that.

Paul Sidney – Credit Suisse

And just to clarify, was that two billion on your reported net debt?

Tony Chanmugam

Yes the number is -, it's Tony here -, it's not an exact science, but with simple reduction with something to put our debt within something with a five in front of it, that would be what we would need. So obviously anything that we do with EE maybe will impact then to some extent. But as the business stands now something with a five in it should give us an upgrade on the credit rating.

Barry Zeitoune - Berenberg

Hi good morning, I've got a few questions. The first is just on the regulatory point around G.fast. If fibre-to-the-cabinet is going to be regulated in 2017 would that impact your view on investing G.fast and investing fibre in the infrastructure, in terms of pricing regulation? And then my second question is, just to your comments on G.fast earlier, where you mentioned reconfiguring the cabinet architecture, rather than necessarily rolling-out to the distribution point. I was just wondering whether you could expand on that and whether it would mean significant changes to where cabinets are today, rather than actually rolling-out all the way to distribution points, and whether that's the way that you're thinking about the roll-out?

So the final question is, I realise that you're not commenting on the EE deal, but, as a separate point, DT and what it's doing from a technology perspective, in terms of hybrid technology using the mobile macro network, to increase broadband speeds for their home customers, is that something that you would look to also bring over to the UK, possibly with any kind of tie-up with DT helping that? I mean I realise it's technology by Huawei, but I'm just interested in whether there are things you can do in the interim between now and 2020, other than G.fast, to improve speed that's maybe not so commonly thought of today. Thank you.

Gavin Patterson

That was a triple play of questions, with a few doorbells in-between Barry, but let me see! On regulation, look it's too early to speculate. We've just entered the current three year period of regulation on Fixed Access Market Review, so it would be too early really to speculate about Ofcom's thinking I think for 2017. We will continue to make the point that we made the investment in superfast broadband, let alone ultrafast, in 2010, and that as shareholders we haven't seen a full return from that yet, and we made the investment on the basis of a fair bet. So in 2017 we'll be seven years into that, and, as we've made the point in the past, this is double digit year payback. So we know that there is an appetite for more and more data, we know there's an appetite for more and more speed, and we need to respond to that, not just for our own downstream unit customers, but also the market as a whole. So we would expect, I think, support from a number of CPs who can see the demand amongst their own customer bases. I think it's also worth making the point that any benchmark, and this is Ofcom data, that looks at our wholesale prices today, and compares them with other European markets, concludes that we have amongst the lowest wholesale prices in Europe. So if it comes to 2017, and they're looking to regulate pricing, it's not a

guarantee that prices will come down at that point. So that was the first question. Now the second question was about cabinets wasn't it? And I'm going to ask my good friend Clive to comment on that.

Clive Selley

OK, you asked a question about cabinets and the future of cabinets. So what we see is that the rate reach achievable with G.fast is way better than was originally anticipated. So what we now forecast is that we will be able to serve some considerable number of customers, with much higher speeds, using G.fast electronics from today's cabinets. That won't suffice for all customers, some customers will be on very long copper loops, and in order to get the same high-grade, ultra-broadband service to them, we will have to locate mini-cabinets closer to some homes. They are unlikely to be the large green things that you kind of have in your mind, they're going to be much smaller units. Some of them may be actually physically located in footway boxes, so underground; some may be located at the top of poles. The key breakthrough though is that we no longer believe that G.fast is only suitable to serve customers when located at all of the distribution points, the 4m that Gavin referred to, so that we can get away with the topology that leverages the 90,000 cabinets, and a modest number of distribution point locations.

Gavin Patterson

And I think your third question, Barry, was about whether or not there are innovations that we can learn from, in Deutsche Telecom.

Barry Zeitoune - Berenberg

I mean, it is one specific innovation, which is they've talked about using the macro mobile network to basically improve speed. So with vectoring they're talking about 200 to 300Mbps, using VDSL. And I was wondering whether that's something, assuming you own a macro network in the not-too-distant future, whether that's something that you would be able to use for your own network in the interim?

Gavin Patterson

I mean we are open to good ideas from any market and anywhere we can find them, so if there are good things that DT are doing, we'll look at them. I am aware of the one you're talking about. I think our base assumption though is that, provided these pilots that I've talked about in Gosforth and Huntingdon go well, that we would see the expansion of G.fast being our primary choice, and that we begin to really gear that up in fiscal '16/17.

James Britton - Nomura

Hi, good morning guys. A question on BT Sport please. Are you permitted to leverage the sports content over mobile devices, or do you need to own separate mobile rights? And if you can leverage the content over mobile, do you think this can actually help you to reduce the net costs, which are then taken into account in the VULA margin test? And then secondly can you just give us an update on enterprise mobile, how many mobile customers have you acquired in the first six months? Thanks.

Gavin Patterson

OK, on Sport, John do you want to answer that? And then I don't know whether Graham and maybe Luis, potentially, want to just add some comment afterwards on how mobile is going in their markets?

John Petter

Yes certainly. So the sports rights that have today, yes they can be used on a full range of mobile devices. That's distinct from the separate 'clip rights', so for example, [that] the Premier League [packages and sells] separately, that we don't own. And so the rights that we have today, yes we can, is the short answer to that. In terms of how the regulator could treat that, in the context of the margin squeeze test, that's not envisaged in the consultation document that they've published so far, so that's not clear. But clearly that can only be beneficial.

Gavin Patterson

Thanks John. Graham just a quick update on mobile for you, and then Luis.

Graham Sutherland

Okay, thanks Gavin. I mean we're encouraged by the early signs of mobile. We're obviously focussing largely on migration at the moment from the Voda MVNO over to EE, so putting a lot of activity into that. We've had a number of fairly substantial encouraging wins, which are in our work in progress at the moment. That will be delivered over the next quarter, so I think encouraging signs, but it's still quite early, obviously, in terms of some of the new services we're putting out there.

Gavin Patterson

Luis, anything from a corporate sector?

Luis Alvarez

I think that the very high demand on data is really driving most of the adoption in the new contracts that we are signing, and just in the last three months, as a number, we have signed more than 30,000 SIMs, provided services to a number of companies, so I think we are very, as Gavin said, we are very encouraged on the first results.

Gavin Patterson

Thanks Luis.

Andrew Lee – Goldman Sachs

Yes, good morning everyone. So the question was we've had lots of updates and deals announced in UK telco since we last spoke. So I was just wondering what your thoughts are on Talk and Sky's MVNO announcement, the

potential Hutch-O2 deal, and specifically what do you think this means in terms of the opportunity for growth in UK consumer telcos, and your positioning of the quad-play provider within that?

Gavin Patterson

Well it seems that the move, the exclusive negotiations we announced with EE has provoked some reaction in the marketplace. I think that's what you can conclude. We're very happy with the choice we made. EE has the best network, the best spectrum position, the market leader, the natural partner for us, given that we have arrangements around our MV&O, and everything we've seen to date in the due diligence process has really supported that. So hopefully in the next few weeks we'll be able to bring this to conclusion, but we are very much focussed on our vision for the future. And it's much more than quad-play, for us it's about the convergence of the networks, and quad-play is just one element of that. It's about creating this single network, with a single platform, that is able to meet the needs, particularly the data needs, of customers, wherever they are, inside or out. So I think we're extremely well positioned, and because we will have the network assets, both the best of fixed, and potentially, if the EE deal gets agreed, the best of the wireless asset, I think we're very, very well placed to take advantage of the trend.

Andrew Lee – Goldman Sachs

Thank you. Can I just -, just a brief follow up on the regulatory jurisdiction. Which regulator do you think will have jurisdiction over the two big deals, BT and EE, if it happens, and Hutch-O2? Do you have an insight into that?

Gavin Patterson

Tell you what, let's wait to see whether the deal goes ahead, and perhaps we can ask that question, or answer that question at that point.

Simon Weeden - Citigroup

Thank you very much. My question really relates to your dividend guidance and, I guess indirectly, the leverage guidance. In the event that you go ahead and make the purchase of EE, your proposal includes expanding the share base, which will obviously affect the total amount of dividend you'd pay. To what extent does the agreement with the Trustee become a different one if the share base is expanded, and do you envisage retaining your guidance and your starting point for the dividend per share in the event that the EE deal does ahead?

Gavin Patterson

OK, Tony do you want to touch on that?

Tony Chanmugam

Yes sure. Look we've given guidance for next year, and that guidance says quite clearly 10 to 15%, we want to give a degree of certainty. That's in changes in relation to whatever may happen as far as EE is concerned. Our guidance only goes out until next year though.

John Karidis – Oriel Securities

Thank you, good morning. Can I come back to the fibre margin squeeze test please, and very, very specifically can you help me understand, what the scope is for it to stop you, or restrict you, from bidding for Premier League content? You see I don't know how much, to what extent you're clear of the margin that they have in mind, and the other thing I don't understand is, if you appeal, what happens to the enforcement of this test? Does it get postponed or not?

Gavin Patterson

Well if you look at what Ofcom announced, they announced that we would pass the test if it was executed today, including the investments we've made in Sport. So it does give you some indication that actually the margins that we're making have fallen and allow us to make the sort of investments in Sport that we've making to date. I don't want to speculate on either how we will respond, in terms of challenging it, nor do I want to speculate in terms of what impact it has on our ability to continue to invest in sport's rights, including the Premier League, going forwards. It's the wrong time to do that I'm afraid.

John Karidis – Oriel Securities

OK, so just a point of detail. You've told us you passed six hundred and thirty premises in the BDUK areas in the quarter, what's the aggregate number?

Gavin Patterson

Sorry that's a second question John.

John Karidis – Oriel Securities

Well I didn't get an answer to the first one, so I just wanted to ask another one. Just a number question basically. What's the aggregate BDUK premises? That's all.

Gavin Patterson

We passed 630 in the quarter, and it's around two million now I think.

James Ratzer – New Street

Just one question please on mobility please, nothing to do with the EE deal, but just on your existing plans please. Just be keen to get an update on where you are with regards to thoughts on femtocells either rolling them out into home hubs, or indeed in public spaces? Thank you.

Gavin Patterson

Well it's going very well. We've been impressed with the way the technology has developed, we've been testing it in live environments in somewhere called the Building Research Establishment, which is a sort of fake town I think you'd describe it as, a bit like a Hollywood movie set, to really assess whether when you create millions of femtos together are they able to organise themselves so that there isn't interference between them. That's gone very well. So we're now starting the process of building them into our roadmap going forward for our hubs. So, regardless of whether the EE transaction happens or not, we firmly believe that femtos will be very much part of our network architecture going forwards.

James Ratzer – New Street

Do have a time when those will start shipping in your home hubs for the first time please?

Gavin Patterson

It'll be probably in about a year to 18 months' time, something like that, nearer 18months.

Jerry Dellis - Jeffries

Yes, good morning. Just one question around the Premier League auction please. Obviously Virgin has applied for these interim measures to hopefully delay the process. I just wondered what your attitude to an auction delay might be, given that it might just open up the possibility of a greater number of games becoming available? Thank you.

Gavin Patterson

It's one for the Premier League I'm afraid Jerry. It won't be a big surprise that I think you're expecting us to have an interest and to be bidding when the auction takes place. Until somebody tells us differently, until somebody says that's not going to happen in the way that it's planned to at the moment, all I can say is we're committed to ensuring that we can get some high quality games at a good price for our customers.

Stephen Howard - HSBC

Yes, thanks very much. I just have a question on convergence services please. If we work on the presumption that fixed line regulation does continue to support the need for investment, and the current, I guess we might term, more for more pricing environment, could you perhaps talk a little bit about how you are thinking of positioning

yourself in the Quad play market, and doing so without reigniting a potentially very painful negative sum game kind of contest that would then surely adversely impact your fixed line broadband pricing? Thanks.

Gavin Patterson

In broad terms I think we see market changes and customers' needs changing, and the appetite for data, wherever you are, be that in the home or outside the home, is increasing and not showing any signs of diminishing. So we need to design our network, and design our propositions, for customers, with that in mind. In order to supply it the most cost-effective way of doing that is to combine the sheer power of the fixed network, where it's clear you can deliver high quality, high bandwidth, most effectively, and combine that with the convenience that comes with mobility. But even with the roll-out of 4G you can see the key to 4G is getting more and more points of presence throughout the UK, and, at those points of presence, getting it onto the fixed network. So for us this is about creating a really cost-effective high quality network, and then ensuring that actually we can meet the needs of customers, but ensure that margins remain strong as part of it.

Stephen Howard - HSBC

But is that a premium product? It sounds like it.

Gavin Patterson

We consider ourselves a premium product today, and I don't think I particularly want to move away from that.

Guy Peddy - Macquarie

Yes, good morning all. Just a very quick question, and probably it's more for Tony. On the regulated asset base within Openreach, if we look forward on your capex plans, especially with your G.fast plans, would you expect to continually see an increase in the asset base of Openreach, or is it just going to sustain the asset base? Thank you.

Tony Chanmugam

Without giving forward guidance, what I'd say is the indication is that we're going to continue to invest in superfast Broadband with the first step, G.fast is the second step. A large percentage of our capital spend goes on Openreach, and we need to keep investing in superfast broadband, upgrading the network, as well as maintaining the existing network. Consequently I can't see any fundamental shifts, material shifts.

Aamod Mishra – Nevsky Capital

Hi good morning. Could I just ask what the attach rate is doing as you roll-out your fibre broadband to more premises?

Gavin Patterson

The take-up rate?

Aamod Mishra – Nevsky Capital

Yes that's right.

Gavin Patterson

It's been increasing quarter after quarter, we're now 17% take-up against homes passed. It's been ticking up a points, typically, a quarter for the last couple of years I would say. So, as you can see in the results, this is overall a record quarter for Fibre for us, across the Openreach customer base, and it is a positive thing to say that 44% of the adds are with other CPs. So we designed the business case based on this being taken up across the whole of the market, not just on BT's service providers, and what we're seeing now is that's really happening, it's doing what we designed it to do in the first place. If you wanted to look at the long-term trend, we've gone up about eight, just under eight points of take up over the last two years. So that's it if you want to characterise it over a longer period.

Maurice Patrick - Barclays

Yes hi guys. Just on the fibre points. In the past you've talked about as the fibre penetration's been picking up it's been both in the legacy regions, but also the new regions picking up as well. Are we still seeing that trend where penetration is still increasing, even in the areas where you rolled-out two or three years ago?

Gavin Patterson

Yes, we're seeing that, if you look at the cohorts since launch, that those early cohorts are still growing, so Northern Ireland, for example, which is one of the first parts of the country that really we deployed into, and the government invested into. That is continuing to grow now, I think it's probably six years since we started there. Take up is 24% in Northern Ireland and going up. Cornwall, which was another very early one, is at 29% take up. And, if you look across the rest of the UK, there are now six hundred and twenty-one exchanges, in the commercial part of the programme, which are up with take-up of over 20%. So I think you can see there's a real strong demand and things aren't flattening off yet.

Mandeep Singh - Redburn

The question was, just coming back to Everything Everywhere, do you think it's normal for a due diligence process to take so long? I think the market was expecting a deal by now. Given that the deal's not yet been confirmed, and the facts on the ground have changed significantly, in terms of O2 and Hutchison, the market going four to three, should we be more nervous in terms of your ability to complete that deal?

Gavin Patterson

A number of statements there I would think, certainly I disagree with. It hasn't been that long. Let's remember we announced we were entering exclusive negotiations the week before Christmas. Clearly Christmas came, I know it

comes at the same time every year, but in terms of doing this deal it was rather inconvenient for us. We've been back for a matter of weeks since then, and we are very close to the end of the due diligence process. We always said the exclusivity period around until mid-February, so I know you say the markets are anxious to get it done, but we are not late, and I'm sure you want to make sure we do a really thorough job on the due diligence, and that's what we're doing. As you say other people have made moves subsequently. They are different types of transactions. The Three and O2 transaction is not the same, it's a four-to-three mobile merger, and I think -, from my judgement I think that will be a more a more challenging one to justify. But net-net, we'll finish the due diligence, and subject to that we'll be able to make an announcement shortly.

Mandeep Singh - Redburn

Can I just very briefly follow-up if that's okay.

Gavin Patterson

Very briefly please.

Mandeep Singh - Redburn

So I mean is the price that you've agreed a firm price, or is that subject to negotiations still, because clearly in a four-to-three environment EE may be worth more?

Gavin Patterson

We've said what we're going to say about it at this point, and we'll update you shortly.

Well thanks for joining today and look forward to speaking to you hopefully in the next couple of weeks on one thing or another.