BT GROUP PLC

Q2 2015/16 RESULTS CONFERENCE CALL TRANSCRIPT

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	Tony Chanmugam	Group Finance Director
	John Petter	CEO BT Consumer
	Graham Sutherland	CEO BT Business
	Luis Alvarez	CEO BT Global Services

Slide 1: Good day ladies and gentlemen, welcome to the BT results presentation.

Slide 2: Before we start we need to draw your attention to the usual disclaimer on forward-looking statements. Please see the slide and our latest annual report and Form 20F for examples of the factors that can cause actual results to differ from any forward-looking statements we may make.

Gavin Patterson

Slide 3: Good morning and welcome to the Q2 15/16 results. Today we're going to go through the highlights of the year then I'm going to hand over to Tony to go through the specifics and the P&L.

Slide 4: In terms of the overview first of all. We've had a good quarter, good set of financial results. Headline revenue's up 2% year on year, strong performance on cash flow as well.

Fibre continues to be a real driver of our success. There has been strong take-up across the market, we've now got over 5 million homes and businesses connected to the network. We have 24 million premises across the UK and importantly it's been taken up across the whole of the market, so over half of the adds within the quarter are other service providers apart from our own.

It's not just about the network itself, it's about the services and content that is covered, that we carry over the network and one of the highlights in the quarter was the launch of BT Sport Europe which is doing well. It's ahead of our expectations at this stage. The majority of our customers have taken the full complement of the sport channels on the back of it. So that's going well for us, audience figures are good as well and we'll go through that in more detail later.

So net/net we are on track to deliver the outlook that we have talked about for the full year and we will give you more detail on that in Tony's presentation.

Slide 5: A quick update on the CMA process and the acquisition of EE. You'll have seen yesterday that the CMA gave us provisional approval for the acquisition of EE without remedies, and this is because they don't expect a significant reduction in competition. Obviously we're very pleased about this, we think it's the right decision and it will allow us, we think, to create a network that would be good not just for BT but for the whole of the UK.

In terms of the timeline at this point, there's a further consultation that will be taking views from everybody across the market including us until 19th November. They've taken advantage of the potential to take a full 8 weeks [extension to the deadline] to review those, it might not take all that time, but they have chosen to at least flag that they may do, and if that's the case the final decision will be just after Christmas on the 18th January. That means we are on track to complete the deal by the end of March.

On that note, Tony.

Tony Chanmugam

Slide 6: Thanks Gavin, good morning everyone. As Gavin said this has been a good set of results, which reinforces our confidence in our expectations for the full year. Our revenue performance was strong and we continue to transform our cost base while investing in the growth of the business.

Slide 7: I'd like to start by looking at an overview of the Quarter 2 financials. Headline revenue was flat, but this reflects the £53m negative impact from foreign exchange movements and the £33m reduction in transit revenues. Our main revenue measure, which excludes FX and transit, was up 2%, it's a significant improvement on last quarter's performance and the best result for seven quarters.

Consumer delivered another good revenue performance driven by the launch of our Champions League coverage. Openreach also had a good quarter helped by fibre broadband, with steady performances from BT Business and Wholesale. Global Services was again impacted by a tough UK environment, which although better than last quarter, offset strong growth in our European businesses.

EBITDA was down 1%, this was mainly in BT Consumer, reflecting the costs relating to the launch of BT Sport Europe. EBITDA was also down in Global Services reflecting the public sector declines in the UK. Our other divisions grew their EBITDA helped by cost transformation and fibre growth within Openreach.

Below EBITDA we continue to see the benefit of our focus on debt reduction leading to lower interest charges, however this is partially offset by the fact that our share count is 4% higher, reflecting employee share schemes and the equity placing in February. This meant that our earnings per share were level with last year.

Normalised free cash flow was slightly above last year however this is despite a cash payment of around £90m for UEFA rights and reflects some tight working capital management, so a good performance here.

Finally our net debt was down £1.1bn year on year reflecting both the equity placing and the cash flow generated by the business. Net debt is up £100m from June with the payment of last year's final dividend offsetting cash generated in the business. So overall our Quarter 2 performance puts us on track to meet our full-year outlook.

Slide 8: Looking at operating costs, the chart shows the underlying operating costs excluding transit were up 3%, however as you may remember in a Quarter 4 results in May, we called out a number of headwinds that we face this year.

Firstly all leaver costs are now above the line. These were £20m in Quarter 2. Secondly we no longer benefit from the sale of redundant copper, which we net against our costs. And we flagged that our pension operating charge, which is a non-cash item would increase. This had an £8m impact in the quarter. In addition we have cost of our new BT Sport Europe channel. It is worth clarifying that we expense the UEFA rights evenly throughout the year and we have incurred 2 months of rights costs this quarter. The cash payment to UEFA are lump sums paid twice a year, hence the cash payment of £90m is larger than the circa £50m P&L cost of the right.

Excluding these factors, underlying costs excluding transit were down 1%. This is a smaller reduction than in recent quarters as it reflects the high cost of sales associated with our materially improved revenue performance. These are partly offset by a strong performance on a net labour costs, and excluding the headwinds I mentioned, these were down 4% on the quarter and 5% on the half year.

So we have had another good performance on labour costs and I would like to give you the big picture on how these have evolved over the last 6 years.

Slide 9: Historically BT outsourced and off shored a number of activities including some aspects of front-line customer services. Strategically, we now want the key roles to be undertaken by BT staff with key customer services activity being undertaken in the UK and back-office activities centralised in both the UK and overseas. This strategy has allowed us to improve our customer services and reduce our unit costs.

We have insourced 13,000 roles into the UK in the last 6 years including around 2,000 roles last year. The insourced roles cover a number of areas including customer service, outbound sales, facilities, and engineering activities. The insourced roles remove the supplier's overheads and margins, reduce staff churn and improve the quality of the staff output.

We have created a central services organisation with around 6,000 roles providing more efficient and effective back office activities.

We have invested in over 1,000 new customer service roles which will support our commitment to have over 80% of BT Consumer calls answered by people in the UK by the end of 2016 and we plan to go further in the years to come.

We have invested in our engineering staff for both our fibre rollout and to improve service through quicker repairs and provisions. We have recruited around 3,000 Openreach engineers in the past 18 months of which more than 300 were apprentices. In total we have hired more than 800 graduates and apprentices across BT last year and we plan to hire around about 900 more this year.

As we have insourced more of our engineering work back into BT we have seen an increase in our capitalised labour. So we have seen a change in the mix between our various labour cost categories but the key point is we have been able to continue to reduce our net labour costs as you can see on the right-hand chart.

We are confident we can continue to do this in the future and in conjunction with the cost transformation activity we are still seeing more than £1 billion of gross cost saving opportunities. These savings allow us to invest in the business. I would like now like to touch on the investments we are actually making in our networks.

Slide 10: This quarter our capex was £629m, 18% higher than last year. This was driven by an increase in fibre roll out. Around £20m because of high volumes of Ethernet provision and a further £20m from connecting more new homes to our networks.

You will also remember our Quarter 3 results in January we explained our future network vision. At the heart of it is a single IP core network providing one common access platform to connect copper, fibre and mobile. We have been investing in this and we are on track to complete the refresh of our UK IP core.

On our current broadband rollout we have now £157m of grant funding deferred, based on our latest assumption of about 30% take-up in the BDUK (Broadband Delivery UK) areas. This reflects the strong demand that we are seeing. We expect the vast majority of this deferred funding to be reinvested to improve both the quality and the reach of the fibre network.

Looking at Group capex for the first half of the year, it is up 23% as illustrated by the chart on the right-hand side. Most of this reflects the deferral of grant funding. Excluding this, our capex is up about 10% but this largely reflects the phasing last year, normally our capex is fairly evenly weighted between H1 and H2 but last year it was more H2 weighted. This year we expect our Group capex for the full year to be broadly in line with the first half run rate, after allowing for the grant funding.

Looking specifically at Openreach, we do expect the capex for 15/16 as a whole to be higher than last year given the investment we are making in our network and service.

Slide 11: Moving onto a different topic now. I want to touch very briefly on the pension. The IAS19 deficit has slightly reduced from last quarter, to £5.6bn net of tax. As you can see on the chart, this reflects a reduction in the liabilities due to a lower future inflation expectation, largely offset by a decline in asset values due to market conditions.

<u>Slide 12:</u> Moving onto shareholder returns, I am pleased to announce an interim dividend of 4.4p, up 13%, growing in the middle of our full-year outlook range of a 10 to 15% increase.

In addition this quarter, we have spent a further £61m on our share buyback programme, bringing us to £250m so far this year. We still expect to spend around £300m for the year but we front-loaded it again this year as we had some employee share schemes vesting in August.

Overall our shareholder returns remain well covered by our cash flow and we remain committed to paying progressive dividends. Once we have acquired EE, we will talk more about our shareholder returns then.

<u>Slide 13:</u> Lastly, I would like you to remind you of our outlook, this is on a stand-alone BT basis. On underlying revenue excluding transit, this quarter's 2% growth is a significant improvement on the flat performance last quarter. It puts us in a good position to meet our guidance of growth for the full year. In the second half of the year we will see further benefit from our Champions League coverage but bear in mind we have a tough comparator in Quarter 4 from the ladder pricing revenue Wholesale received last year.

We continue to expect modest growth in EBITDA for the year and we expect normalised free cash flow to be around £2.8bn.

I'll now hand back to Gavin.

Gavin Patterson

<u>Slide 14:</u> Thank you Tony. So I'm going to take you through each of the lines of business, starting with Global Services.

<u>Slide 15:</u> In Global Services it was a better performance this quarter. Underlying revenue was down 2% and that was an improvement on previous quarters. In terms of the component parts, a strong performance in continental Europe, up 12%, driven by the delivery of a number of major contracts. We also did very well in Asia-Pacific but that was not enough to offset a poorer performance in the US and Latin America.

Closer to home in the UK, revenues were down 8% which was better than the 12% decline that we saw in Q1 but is clearly not exactly where we want it to be yet. In terms of what was driving that, fundamentally it was about the unwinding of the local government contracts that we've talked about in previous quarters, so we will see that continue going forwards for the next couple of quarters.

Underlying operating costs excluding transit, were down 2% which left EBITDA on an underlying basis excluding FX down 3%. You can see within that EBITDA number the move from build to maintenance phase, particularly in the health programmes, which we talked about in Q4.

We have also got leaver costs above the line as Tony mentioned. We see that continuing in the second half of the year but in spite of that, we see EBITDA growing in Global Services in the second half.

In terms of cash flow, it is up almost £80m year on year, so a better performance there, predominantly down to working capital.

We also launched a number of new products in the quarter, particularly around our 'Cloud of Clouds' strategy. One particular one was BT One Cloud Voice which is a way of connecting to video conferencing, being able to schedule a video conference call and connect to it, regardless of which system you come from, be that Cisco, BT's own system or indeed something like Microsoft Lync. So it's another example of being able to use the network and particularly the Cloud of Clouds strategy to drive competitive advantage.

In terms of the order intake, up 36% within the quarter, strong performance across the year as a whole all in all an improving picture but we feel as though there is still some way to go in Global Services.

Slide 16: Moving on to BT Business and again a steady performance in BT Business within the quarter. The underlying revenues excluding transit were flat, which is an improvement on recent quarters, and you can see the trend improving over a number of quarters here on the slide.

In terms of what is behind that, BT Ireland had a very good quarter and data and networking was also up. Voice was down 1% but that is an improvement on recent quarters. IT services down 4%, that was because, and we talked about this in previous presentations, that we have focused on services in IT services rather than hardware per se.

It is worth talking about what is happening in IP lines. We launched, about a year ago, a new set of IP Voice products and they are really beginning to get some traction in the market. The number of IP lines grew just under 50% in the quarter, delivered by our BT Cloud Voice service and our BT Cloud phone service, both of which were up significantly. What we see is this is a trend that we think will begin to accelerate going forwards. Underlying lines are going down as customers are increasingly moving to IP-based delivery mechanisms. They are replacing some of the lines with IP lines but IP generally has fewer lines but higher ARPU. So if you look in the quarter, just this specific quarter, around a quarter of the PSTN lines loss were replaced with IP lines and we see that trend continuing and if anything the mix improving going forwards. So that is the key dynamic in the business market at the moment.

Costs were down 1%, which left EBITDA up marginally at 1% within the quarter. In terms of cash flow, that was down, that was largely down to a change in working capital that worked against us, a timing change. In terms of orders, decent performance in the quarter, up 16% on a 12-month rolling basis, up 1%. So continuing to see good, steady performance in BT Business.

Slide 16: Onto BT Consumer, and Consumer had another strong quarter, really defined by the launch of BT Sport Europe. On a revenue basis, revenue was up 7%, driven by a particularly strong performance on broadband and TV, up 17% within the quarter. ARPU was up a very reasonable 6% to over £427, that is a good performance and one that compares very favourably with many of our peers.

In terms of EBITDA, that was down 10% in the quarter and that reflects the investments we have been making on BT Sport Europe and AMC, offset but not completely offset, by continuing progress on cost transformation.

In terms of cash flow, that was down 50%, it was £53m in the quarter, this reflects the payments we have been making to UEFA around Champions League and that is what Tony referred to in his presentation.

Operationally, a very robust set of numbers from Consumer as well, starting with BT Mobile. We have now got over 200,000 customers on BT Mobile, taking increasingly the mid and top-tier packs, the mix is improving there. Great performance on line loss, second-best performance in the last 5 years, lines lost was only 52,000 within the quarter.

On broadband, 82,000 net adds within the quarter, that is just over 50% market share, 51% market share within the quarter specifically. Another very strong number on fibre and increasingly taking the top-tier fibre product as well, so 210,000 fibre net adds within our retail business. Just to give you some sense of the scale of it now, 44% of our overall broadband customer base is now on fibre.

Slide 17: If there is one number that isn't covered in that it's TV, so we should talk about that in a bit more detail. Best-ever quarter in terms of TV net adds. So we had 106,000 TV net adds within the quarter, which is really a very good number indeed. We've continued to invest in the offering, both on the TV side and the sports side. On the TV side we added AMC this quarter and a third of the available audience have already watched that channel and we see that increasing going forwards. We added the full suite of UKTV channels, we now have 182 channels across the service in totality.

In terms of sport, sport audience continues to grow, up 47% year on year. The Premier League audience grew year on year but also other sports such as MotoGP are doing very well for us where the audience is up 56% versus last year.

We are delighted we won the rights to the Australian home cricket between 2016 and 2021, which of course includes the next Ashes series, but the highlight of the quarter was probably the launch of BT Sport Europe on 1st August. This has made a really very good start for us. As we said, it's ahead of expectations in terms of what it is delivering financially for us, and the majority of our Consumer and Commercial customers are taking the full suite of channels. Indeed 75% of people are now paying in some way or other for BT Sport and that compares with around 40% before the launch of BT Sport Europe.

I'm also really pleased with the way we've used the technology to take full advantage of this content and a couple of things in particular are worth highlighting. We launched the first ultra HD sports channel in Europe in the quarter, BT Sport Ultra HD, which is absolutely spectacular if you get a chance to see that. But also we relaunched the BT Sport app and we have seen unique users go up 30% year-on-year behind that and this is a brilliant way that takes advantage of the fact you are showing 8 games simultaneously and how can you make that something that is an interactive experience for your customers, and I think we have done a tremendous job of this and rather than talk about it I'll show you....

Video plays: *"This season BT Sport brings you a whole new Champions League experience. Choose any live match and take control of your show and catch all the biggest moments of the game so far with our interactive timelines. Multi-cam lets you watch the highlights from different camera angles, and with goal alerts you're just one click away from the action as it happens. With all these features available on the BT Sport app and at BT Sport.com, you won't miss a thing. BT Sport and the UEFA Champions League, it's in your hands."*

Slide 20: So good performance on sport but also now a good performance on BT Wholesale. So underlying revenue on Wholesale was up 3% year on year, which is a decent number. It is again driven by IP so IP services up 22% year-on-year both in terms of the underlying IP minutes as well as the underlying Ethernet side of the business as well.

So on the volume side of things Ethernet orders had their second highest quarter, which is a great result. Exchange minutes were up 23% on the IPX side of things. Costs excluding transit were up 4% and that reflects the investments we've been making in IP services and that was partly offset by a reduction in SG&A of 15% within the quarter. Net-net, EBITDA up 2% year-on-year.

In terms of cash flow, that was up year on year modestly only £3m, but it is an improving picture. And order intake was very strong again and you can see the rolling 12 month average on the chart here but it was up 40% year on year within the quarter and up almost the same as much again on the 12 month basis.

There is one other thing I did want to highlight on BT Wholesale is its performance on fibre. So increasingly we are seeing the smaller CPs who tend to be customers of BT Wholesale really get behind fibre and really benefit from it and you can see that in the take-up of FTTC within the quarter itself, and I think it again demonstrates that this is an investment that works across the whole of the market whether you are a big customer or a small customer of BT.

Slide 21: So talking about fibre, fibre was also the driver of a good quarter in Openreach. Revenue up 2%, driven by 38% increase in fibre broadband revenues, partly offset by the drag from regulation around £30m in terms of that impact. Costs were flat within the quarter which means EBITDA was up 3%. Tony referred to capital in Openreach in his presentation but just to reiterate, it was up 41% because the capex within the quarter was driven by the investment for fibre broadband, new homes and new sites that we have been connecting and also the throughput on Ethernet.

In terms of operating cash flow that was £329m where the increasing capital was not completely offset by changes in working capital. In terms of the operating metrics themselves, the physical line base grew again, up 7,000 within the quarter itself which means over the last 12 months it is up over 188,000.

On fibre itself, as we said, we've passed the magical 5 million mark in terms of homes and premises connected. In terms of the coverage as a whole, we've given coverage to 24 million homes and properties across the UK as a whole. So 5 million connected, that's take-up of around 21% and increasingly it's being taken up across the market as a whole, so 50% of the adds within the quarter were other CPs, in other words not our own BT owned service providers. So fibre continues to be the key driver of our business.

<u>Slide 22:</u> So, before closing, I just want to touch on the DCR and the Ofcom Strategic Review. We talked about this in September, I know many of you came to the announcement we made around Digital Britain on the 22nd of September, but I thought it was worth reiterating a couple of points today.

We put in our submission with everybody else at the beginning of October and the things we tried to call out in this submission for Ofcom to consider really come down to three things.

First of all is certainty, it is the ability to get some clarity and certainty over the sort of investment period that is typical in this market which runs to many, many years rather than something that is continually being changed. So looking to align the timescale of that investment period, is really really important.

Secondly around clarity, simplify the framework as much as possible, remove duplication in regulation, really ensure that regulation can't be gained by any individual player trying to take advantage of differences in regulation between different providers.

And then fairness is the third area. Fairness in terms of getting a fair return for the investment anybody is making, not just BT but any provider in the market. Making sure they are able to make a fair return for the investment they are making but also fairness in terms of how regulation is applied across the market as a whole and you should recognise it is a single homogenous market now and the regulation that is used to control any of the players in the market should not be defined on where they've come from but recognise the fact that customers are increasingly buying bundled services. One area we think they should look at in particular, you won't be surprised to hear is Pay TV. At the top of the chart you can see how much regulation and indeed and how dynamic the market is in terms of broadband. We've got the lowest prices of the big 5 in Europe. Clearly the Pay TV market has not benefited from the same sort of competition where we've got the highest prices and that is one of the areas we think they should look at in more detail.

<u>Slide 23:</u> With the right regulatory framework, on 22nd September, we set out what we felt we could do not just for BT but more importantly what we could do for the country as a whole and it was around these four pledges.

Number one, we stand ready to deliver a minimum broadband speed of between 5Mbps and 10Mbps depending on where they land, of course. Provided that Ofcom and the government create the right regulatory framework to make this commercially viable.

Secondly, we are ready to expand the reach of our fibre network to help go beyond the government's target of 95% coverage across the whole of the UK.

Thirdly we are ready to take the UK from a superfast nation to an ultrafast nation, behind our investments in G.fast and increased investment on FTTP. So we set out the goal that we would achieve 10 million homes achieving 300 to 500 Mbps between now and 2020 and indeed we have actually been testing the next generation of technology which is XG-FAST in our labs over the last few weeks and we announced at the Broadband Forum that we are achieving speeds of 5.6Gbps on that. So I think it demonstrates how much we can do with the existing combination of copper and fibre, rather than just assuming everything needs to be fibre to the premise.

Finally, raising the bar on service. We need to recognise, not just as BT, but as an industry as a whole, that customers' expectations are increasing and in many ways going ahead of what any of us are able to deliver at the moment. So we all need to step up on service. We've talked about some of the things we're doing today. Indeed, on that day Joe set out the Openreach Charter, which makes a number of commitments around going beyond the current Ofcom agreed service levels and exceeding them, but it's not just what goes on in Openreach, of course, I think it's also true that all the service providers need to step up. We've launched a number of things over the last quarter I think that will help. The View My Engineer service within Openreach, which allows you to track where the engineer is when they come to your house or your business. And that's reduced, in one CP, in a pilot scheme, it reduced missed appointments by 25%. In the Consumer market we talked about handling calls in the UK in Tony's presentation but we also launched a new app called My BT, which gives customers much more control and flexibility around how they manage their own services and indeed they can change their appointments right on their smartphones. So I think those are a couple of good examples of what we are doing on service.

Slide 24: So in summing up, this was a good financial performance within the quarter. We saw a better revenue trend across the business and with our ongoing focus around cost, this has largely allowed us to control and swallow the investments we've been making on Champions League within the quarter.

The operational trends have shown the strategy is working. We've seen growth in TV, good performance on broadband, BT Sport is delivering what we expected it to. Mobile has started very strongly but we are also seeing the benefit of IP services that we launched within the business market really having an effect on our business helping us drive orders going forwards.

As I have made the point on many occasions service is a key priority for us and this is a multi-year programme but we are making progress and we will continue to invest in that.

And fibre continues to go from strength to strength, not just for our own business but increasingly across the market as a whole. We've set out a vision to Ofcom and indeed the market as a whole, that we are prepared to continue to invest going forward and take us to the next generation of technology not just for the benefit of BT but of course for the nation as a whole and it will, if we are allowed to do that, create a great platform for growth.

Q&A

Q1: Paul Sidney – Credit Suisse
Just a question on EE. Just I wondering if you can discuss the size of the financial opportunity to up sell your content, maybe particularly - sports content to EE's 20 odd million subscriber base and if you could just confirm that you've got the rights to offer your existing TV content on mobile devices?

Gavin Patterson
The EE transaction I think offers synergies both at a cost basis and a revenue basis, and we set out some goals around both numbers and we are feeling confident that we'll be able to deliver those. In many ways I think the revenue synergies are the ones that are, I think, are even more exciting than the cost ones because I think creating new products and services that can benefit from the combination of fixed and wireless is, I think, we are getting right at the key part of the market. So I think it will come in the form of bundling in many cases but it will also, I think, allow us to create new services that are just converged across both, so customers hopefully won't see the seam between them.

I think it's worth recognising that a lot of focus is around the consumer market on this but in many ways the business market could be an area of really significant growth. So if you look at BT's brand, its coverage, its fixed product set, its IP capabilities and you combine that with EE's strength and mobility, and the fact that neither has much of market share in business at the moment, I think there is a sense of opportunity there that is quite significant.

On the Consumer side we do have the opportunity to provide our BT Sport services to EE customers. I think it's one of the areas that I think will be very interesting but I think there are many others and obviously the closer we get to completing the transaction the more we will see those things firm up. Is there anything you want to add Tony?

Tony Chanmugam
It's just the size of revenue opportunity, £1.6bn of NPV and in the business space in particular, it's a real opportunity because EE is the 3rd brand behind Voda and behind O2 and it's an opportunity with owner economics to make penetration in this space.

Q2: Nick Lyall – Societe Generale
Can I ask on the Consumer business please Gavin. Can you talk about how you protect customer data in the Consumer business please and are preparing for churn or any churn to come from other operators, how are you doing that?

Gavin Patterson
Well, security is a key priority for us. You won't be surprised it has been towards the top of our risk register for a number of years. We've got a lot of expertise in this area so I'm sure we've told you before, but for those of you who haven't heard it, we did all the security for the Olympics in 2012 for example and to give you the scale of the number of attacks, there were over 200m attempts to bring down our network during the Olympics and none got through. So we've been able to build on that experience and provide services, security, and cyber services in the business market and to governments as well as looking at it as a way of protecting our own customers. So we take it very seriously.

Situations like what TalkTalk have been through in the last week, they are not good for TalkTalk, they are not good for the market as a whole because they undermine trust. Our reaction is, the first thing we did was to offer help to TalkTalk but then look at our own systems and just check again that we've got the best possible combination of security measures in place to protect our customers' data. So we have been spending the weekend and the last few days ensuring we are as tight as we can possibly be and we remain very vigilant in this area.

Q3: Steve Malcolm - Arete
I'll stick on Consumer if I can and one question for John. You said the experience was above your expectations in Q2, around the BT Sport Europe launch. Can you just give us a bit more colour on what those expectations were? What were you expecting in terms of churn as you went in to the quarter, as you started charging people? What was your expectation on opt-out from the charging, what actually happened? How do you see the Sport Ultra [HD] offer take off? One connected question just on the Virgin Lightning impact, your physical line number looks pretty robust, have you seen any impact from their network expansion in the last quarter as they accelerate their rollout?

Gavin Patterson
First of all on Lightning, there has been a minimal impact to date. Clearly we are making sure that we're anticipating where they are going as much as possible and making sure we are proactively working with our customers to minimise the impact there, you would expect that. But it's early doors Steve, I think it is a few hundred thousand they've rolled out to date, but it's been a relatively small impact.

Within terms of BT Sport Europe I will let John give you the colour on this. The headline is in terms of what we were expecting financially, we've beaten the business plan. Now you can always say "you never told us what the business plan was", but recognising that we do have one and we do expect to generate a return out of this, we are ahead of where we expected to be at this point.

In terms of the dynamics they are not quite what we expected originally, but there's been less spin down than we expected. John, do you want to give any more specifics?

John Petter
Yes, it's worth saying the expectations were premised on confidence going into this because the market research was quite clear, that most people see this as attractive content, just as Gavin said, that it informed the mechanic for customers to choose to get the Champions League, because customers could choose not to get it effectively. Although we were very confident that they would want it, I think it was very important to give people a very clear choice that was extremely transparent, and the take-up has been better than we expected.

I think it's important to say a couple of further points, one is that this is true not just of the consumer market but for pubs and clubs as well. So there was a substantial increase in unit prices for pubs and clubs, that reflects the massive extra value for them and for having 3 extra days in the week for consumers to come into their pubs, and that's gone better than we thought it would as well.

Then finally the bigger picture on this is that there are several revenue sources, and there is the consumer side in terms of the TV subscribers and sports subscribers. There's the advertising revenue from the viewing figures, the viewing figures have been good so far actually, not just on the TV channel but the viewing online has been very strong too, that's a third up, so quite a few revenue sources and finally wholesale too. The wholesale terms that we have through with Virgin Media, they represent a good deal for both parties we believe.

Gavin Patterson
So the headline number in Consumer is a good number up 7% within the quarter, ARPU's up as well, 6% and that's not shabby, and we are not ignorant to the competitive response that one or two others have been putting into the market, there is some very, very deep discounts, 12, 18 months free fibre for example, above the line. Free TVs, free smartphones, free tablets, these sorts of things, so it's been a very competitive quarter but I think the investments in Sport are proving good. But we've got to see the rest of the year and I find myself through gritted teeth supporting Chelsea, Manchester United and Arsenal and hoping they go through to the next round!

Q4: Simon Weeden - Citi
Just going to your thoughts re: the Ofcom review and in particular the Universal Service Obligation on broadband, where you say you could envisage providing something between 5Mbps and 10Mbps universally. The question really is, how much would that cost and what would Ofcom or the government's options be to allow you to recover that cost? Is it for example already effectively covered by the subsidies that are already in place or how would you envisage the various different ways in which that might be approached?

Gavin Patterson
I think this is a sort of moving picture in many ways, so in the spring the government set out a vision for 5Mbps, Ofcom believe it should be 10Mbps. Clearly with the rollout of fibre, that is the best way of doing this. If we deliver on the target which I'm confident we will, or help the government deliver on their target would be a better way of putting it, we'll get to 95% of the UK. If they choose to reinvest the success dividend from the first stage of BDUK, we believe that could add another point of coverage and potentially more as take-up goes beyond that. Other technologies are going to be very important as well, so we will be relaunching the satellite service to help people particularly in the last 1%. And there will be a mixture of other technologies, perhaps some wireless, some 4G, perhaps some longreach VDSL, that will help fill the gap between the two.

But it isn't easy and it isn't going to be cheap. There are no subsidies for broadband USO at the moment. In terms of how they may look at this, they have talked about a levy across the industry as a whole. I'm not overly keen on that, that again portrays us in a way that would not be ideal. They can use the regulatory framework to allow for the costs to be recovered. I think there are a number of ways of looking at it. What we've said is, and we've already started this, is working both with the government and Ofcom to find a way forward on this, and recognise that we're going to need some make some investment on it but we can't cover the cost as a whole, it is too much.

Q5: Paul Marsh - Berenberg
Two questions, I want to come back to opt-outs and maybe the question of refunds. Do you think customers moved pretty quickly in the quarter to opt out or do you think there could still be a hangover into Q3?

Gavin Patterson
Are you talking specifically around BT Sport here?

Paul Marsh - Berenberg
Yes and then on momentum for BT Sport just generally, do you think it peaked towards the end of the quarter given the timing of the season, or do you think that should still continue to build into the current quarter?

Gavin Patterson
I think the bulk of the opt out has happened if it's going to happen. We've been through one billing cycle, we've seen customers seem to appreciate the content and how we're programming the content, so I think we are over the peak there. In terms of the take-up, I see that continuing to grow through the year as a whole. If you look at traditionally what happens in Champions League, once you get into the knockout stage, and I am very confident that we will have representation there for the avoidance of doubt, that you do get audience levels kicking up again. So we should see take-up continue to build across the year as a whole.

Q6: Jerry Dellis - Jefferies
I've got a question on Global Services piece, you seem fairly confident about the cost outlook for Global Services but I wonder whether you are still committed to stabilising UK GS revenues this year? And more generally, there seems to be a trend of fairly volatile quarterly performance across the different country entities within GS, is there a structure that you can put in place to improve visibility, reduce quarterly volatility in general in GS?

Tony Chanmugam
I think it's important just to look at this in a number of different factors. So the levels of revenue decline in GS totally has gone down. So if you look at the underlying basis last year it was 4 points, Q1 3 points, Q2 2 points, so that's an improving trend. In terms of the EBITDA position, we are down compared to last year, in terms of the quarter we were down circa underlying about £10m year on year, but half of that was due to an accounting classification of pushing leaver costs up [above the line into EBITDA]. So effectively the levels of decline have reduced and as Gavin said earlier, Global Services will grow EBITDA in the second half of the year and fundamentally that's an important point.

In terms of visibility and volatility, I think you've got to remember in the UK we are in a situation, we are anniversary-ing out on some big local government contracts. The levels of decline are reducing, it's still material but it is reducing. And it has to be offset with the performances particularly in terms of Spain and Italy where these are strong profitable performances, and overall in Europe we are in a better position. The fact that we don't particularly split out country results and give it to you, doesn't mean that we don't have visibility of country performance.

Q7: Robert Grindle - Deutsche Bank
I wouldn't pin your hopes too much on Chelsea this season unfortunately! My question is on G.fast, is seems like you are getting a whole lot more out of the residual copper. Does this help you, could the mix in capex going forward be more equipment rather than labour? I'd be interested on your views on that. And on the G.fast spend, you talked about regulatory certainty from a BT perspective, the regulator might also be looking to get a bit more certainty about your investment as well. Could you negotiate on G.fast and the speed on which you might deploy it as part of the process to avoid a more difficult regulatory outcome in the New Year?

Gavin Patterson
I'll ask Tony to comment on the capex mix in a minute. In terms of what we're getting out of G.fast, if I look at what has changed in the last 12 months there's been a dramatic increase in the capabilities and outlook from what we can get out of the technology, absolutely right. We used to think it had to be deployed at telegraph poles which would take a lifetime to deploy it across the UK. We are now getting the sort of performance that we want from deploying it at a cabinet level. We are in test market with 8 CPs, in Cambridge and Gosforth in the North East, we are going to be doing some more testing in Swansea, and it is performing very well, so we are pleased with that. Because we've spent a lot of time building support in the broader community behind G.fast, we're

finding the vendors are really stepping up because they can see it is going to be important technology, not just for BT, but for other service providers as well. We're seeing the standards beginning to harden to take the speed even faster. So there's a lot that's happening and the price point if you like, the investment profile, is getting better all the time. So even over the last 3 months the economics have become more attractive to us.

It's clearly something both the government and Ofcom are keen for us to do. It'll be something that we will undoubtedly talk about as we get to the period of trying to come to an accommodation which no doubt will be probably in the New Year at this point. We know it's something our customers really want and we need to get on with it, but we need to recognise that these investments, and you guys more than anybody else will acknowledge this, we haven't reached pay back on the first investment yet. We can't keep investing without seeing a return. Now we're confident that the business cases are good, we're confident that we will make a return on this but it isn't a licence to print money, no question.

Tony Chanmugam
Couple of points. The first point is if you look at the split of what we are going to spend our money on in G.fast, ultimately it comes down to a number of items. So it will be the equipment, which is primarily heading downwards. It will be the labour cost associated with work that we currently undertake, things like planning. And then there will be the dig costs of getting to new points of presence. Now there will be a change in the mix because we will do more of that third category of work ourselves, simply because it will reduce unit costs, give us better control of what we need to do.

If I look at the overall profile in relation to the business case, as Gavin said, that's an improving position. The business case looks better now than it did 6 months ago and with things that are moving in terms of from the technological side, from a supplier viewpoint, I would expect the case to get better as we go ahead.

Q8: Nick Delfas - Redburn
I'd like to ask John Petter a multiple-choice question if I could. I'm trying to update my market model and one of your competitors doesn't release retail numbers and I just wondered if you thought TalkTalk has 3.4, 3.6 or 3.8 million paying retail customers? This is pre the cyber attack.

Gavin Patterson
It's not right for us to comment in that sort of detail Nick, as much as I would like to, those questions are questions for TalkTalk I think.

Nick Delfas – Redburn
I'm sure you know but you're not willing to share. Could I have a different question then, a question on Business, I think in euros Ireland saw a 25% increase in revenue in the quarter year on year, was that just organic or was there a special item in there?

Graham Sutherland
The 14% increase in the quarter year-on-year, in euros, yes there was 8% in sterling terms. We had a number of fairly large one-off deals with a large customer but underlying the performance was still strong in Ireland and still positive.

Q9: Sunil Patel - Bank of America Merrill Lynch
A question for John on the TV strategy, TV adds were a record in the quarter and strongly up year on year. Going forward how much do you expect in terms of investment and pushing the TV platform? Should we expect more 4K content, any more exclusive deals? Clearly you signed the Ashes. But how much do you think that's a driver of future Consumer strategy?

John Petter
These TV figures are the best that we've ever had, 106,000 net adds which compares to Sky's 43,000 and we're very pleased with that number. This was a particularly strong number and the launch of the Champions League clearly drove it. I wouldn't expect us to replicate it every single quarter in the future. So I'm not necessarily

signing on for that target Tony!

But in terms of the investment strategy, you will continue to see us be disciplined in the investments we make because the focus is in terms of top and bottom line growth. If there are opportunities that come along to give our customers better content at affordable prices then that's something that we'll absolutely do and investments we have made this quarter certainly reflect that. The cricket investment that we've made in the next season for the Ashes is a good deal for us, that gets us into a new sport. The launch of AMC is very disciplined, first play on the entertainment side, some exclusive rights. So if those opportunities come up they'll go through the normal financial discipline that we apply and some of them we'll definitely pursue.

Q10: James Britton - Nomura
A question on the Business segment, you called out this acceleration of IP migration. I just wanted to explore the financial implications if that does continue to accelerate. How much does the corporate customer generally save in this transition, or can you make it up entirely through additional services? And are you losing voice market share in the SIP market?

Graham Sutherland
The economics are reasonably strong on our new propositions. What we're also seeing as well is from the growth that we're experiencing a third is coming from new customers which is a positive. The overall PSTN line decline has been very steady over a number of years, around the 7% or 8% mark both at market level and for BT Business, so we're not losing voice share. So we will look to positively accelerate the new services because I think over the lifetime, they are fairly strong economics relative to our existing economics.

Q11: James Britton - Nomura
As a follow up, can you give us a sense of how much mobile revenue you have got from business customers now?

Graham Sutherland
We don't disclose that, as you are aware. I have answered this question about 4 times over the last 6 quarters. The one thing I would say is that over the last 6 months we've actually migrated our whole customer base off our Vodafone MVNO onto the EE MVNO, so we have been through that process over the last 6 months and as part of that process we have obviously re-contracted a substantial element of our base, so it gives us a strong position to move forward from now.

Q11: Michael Bishop - RBC
Two quick questions. Firstly on the £1bn gross cost cutting savings, I was wondering if you've got any more colour on timing? Secondly any more colour around the potential areas of redeployment for growth and obviously trying to get to potentially a net figure on that. Then secondly just following up on BT's Sport Europe and the pubs and clubs point. Are you seeing just a high penetration into the existing 30k pubs and clubs or are you actually seeing the Champions League drive the BT Sport Europe proposition into new premises?

Tony Chanmugam
In terms of the £1bn, we've never said it is going to be over 3 years, 5 years or 1 year. What I would say is the rate of gross transformation savings we are making is not slowing down. So when I look at the absolute levels of savings we are going to deliver this year compared to last year, it will be broadly similar. What distorts the numbers is the fact, when you got 2% revenue growth as to opposed to a flat revenue stream, you have got a large level of cost of sales coming through.

If I look at the cost transformation programme generically, we have got 60 odd live programmes running at this point in time that will deliver this year, which will have an annualised impact next year, and some of these programmes will also deliver incremental next year. So if you look at it in terms of that window, we know what we are doing, we know there is going to be deliveries and when it comes to this time next year, we will have another set of programmes because the opportunities are there. I didn't quite get the point about redeployment for growth?

Michael Bishop - RBC
This is more around division by division so you are saving in Global Services or you are redeploying in Global Services or was there any cross allocation of the cost saving.

Tony Chanmugam
No, we have a leaver's package going whereby people who are surplus to requirements who want to leave the company will go. We spent £20m on our leavers this quarter, £16m last year. We have given a guidance that is going to be roundabout £100m for the full year and that is how we will remove surplus resource but given that we are insourcing activity, that is a way of utilising the people we have in terms of spare and utilising them productively.

John Petter
The last published number for pubs and clubs was somewhere around 25,000. I can confirm that the number is higher than that and grew in the quarter, first of all. There was a clear choice for the pubs in this quarter so they could choose to take the full package that was an increase in their unit prices of over 80%, although for perspective the average price for a pub on BT Sport is £394, which is about £600 cheaper than the equivalent price for Sky or there was an alternative for pubs to pay 7% less and not take BT Sport Europe and to get the balance of the package. The overwhelming majority of people and it is a massive skew, have chosen to take the full package, so this is a good business for us.

Q13: Guy Peddy - Macquarie
You suggested that this year's capex is likely to be a little bit higher than last year. Am I right in hearing that correct?

Tony Chanmugam
I think you have got to take into account two things. The first is the capex this year includes the BDUK grant funding and £128m of that number relates effectively to last year in a catch up. So you have got to subtract that from your overall capital number.

Secondly when you look at the headline number for the first half of this year compared to last year, the anomaly is last year because 45% of our capital spend last year came in the first half, 55% came in the second half. So effectively what it looks like is, there is a material increase in spend because of those two components parts but if you run through our total spend across the year, this year is going to be broadly even. It is going to very much come in terms of the first half compared to second half, so effectively you get an overall position where the capital spend will come very close to your consensus but it will be more evenly distributed.

Guy Peddy - Macquarie
Given the way FX movements have gone, to hit the number flat year on year would suggest you probably are spending more in the UK than you were and is that because it is a good thing, you are growing your revenues better and therefore you are having to invest further behind it, is that something we can expect more of going forward?

Tony Chanmugam
I wouldn't take too much into account in relation to FX fluctuations in relation to capital spend, the percentage variation on that would be very, very small. What we have got though is a re-profiling of our capital spend, the level of expenditure we have got on Openreach is increasing where the level in the rest of the group is falling but you should all, when you look at the absolute numbers, because with the productivity improvements we are getting, we are actually buying more for that same amount of spend.

Q14: Adam Fox-Rumley - HSBC
In the release in the Global Services section you mentioned a customer insourcing effort. I was just wondering if that was a risk? I would have thought that the trend would have been to contract more in Global Services to BT ?

Gavin Patterson
We won't tell you who it is, it is a specific customer. Could you talk about the overall trend you see amongst multinationals?

Luis Alvarez
I think when you look to the way we are doing in the market I think there are two basic trends. One is an increase in the penetration we have in customers and a wider range of services which includes the conferencing services, the Cloud contact services, services that customers are buying more from us than before and we consolidated the network.

The second thing is that most of those customers are saying, “you take over all the services that we have internally and you run everything for me”, and this is what is happening, that movement of people. That is better for us because it gives us more sustainability of the business and less volatility, as in the first question we got. We are winning this kind of customers in different geographies as we have shown, both in the UK, we have won the Walgreens Boots Alliance which is a very major deal, we have been able to secure Alstom Transport in France, Orica in EMEA and Caixa in Brazil. So I think this is the shape of the things we are winning. This is our broader portfolio in those customers, securing the sustainability of the business.

Gavin Patterson
Thank you.