BT'S SECOND QUARTER RESULTS
KEEPING AHEAD OF THE GAME
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Ben Verwayen

Good morning everybody and thank you for coming. Before we go into the presentation I am delighted to introduce Sir Mike Rake our new Chairman. I would like to ask Mike to make some comments. So Mike.

Sir Michael Rake

Thank you Ben. Thanks very much Ben and welcome everyone, it really is a pleasure finally to be here after all these months of preparation. This to me is an absolutely fascinating, complex and competitive industry whose success, whose importance is critical to every individual, every sector of the economy and operates within incredibly fast changing landscape of technology, globalisation, regulation, sourcing and many other issues. So the six weeks, today actually that I have been here have really been stimulating, fascinating and interesting.

I have been fortunate in the last few months, since the announcement, to be able to spend sometime, particularly when I was travelling around the world with my previous firm to really visit some of the BT operations around the world. In Hong Kong, Tokyo, United States in Belgium and the BT Centre here, spending time with a lot of the executives and I can tell you that I have been hugely impressed with the quality, the enthusiasm of BT's people, their commitment to BT to its customers to their communities and this was actually very well illustrated when going to York for a regional meeting. Meeting some of the engineers from Openreach who were involved in the floods that we had and the kind of level of commitment when BT wants to get something done against all the odds, I thought kind of sums up the way I see BT in the short period that I have been here.

This business has quite clearly been transformed in the last five years, by Christopher, by Ben and by the management team. They have put together and I think leaves BT extremely well positioned in this highly competitive and fast moving environment to move forward as we continue to invest in customer service, in technology, in global capability whilst putting what to me I can see as an enormous commitment into complying with the UK regulartory regime, one by the way that has clearly made the UK the most competitive environment in the world. Lastly, before Ben goes on to deal with the results, I would just like to say that given this highly competitive environment that we have, the investments that we continue to make, I personally find the results for the quarter to be extremely encouraging. I am delighted to be here, I am extremely enthusiastic and optimistic about the future for BT, for its people, for its shareholders, for its customers, thank you for coming and I'd like to hand over to Ben.

Ben Verwayen

Thank you Mike. Right you have seen, this chart before as always, please read it at your leisure, very interesting reading. Maybe as interesting as this one, because this gives you a picture of the quarter. Now as you know, companies go always at great lengths to think about the headline that they need to use around the quarter and you will have people from different schools trying to position what the quarter is all about and some people, if you read what we have said, I believe solid or rock solid and people read a lot into that. The best way to judge a quarter of course is to look to the facts. See what is the composition of that one word the company is choosing and the thing that I'd like to say here is, the word is quality. Because if you look to the quality of our revenues, you will see a marked difference from where we were a long time ago.

You can see the journey that we had as a company. To go from hardware to software, from basic services to value added services, from a focus on the UK to a global focus, from a dependency on technology to a capability to develop has been enhanced tremendously. You can see that in the highlights of the quarter. By itself all of these elements do not tell the story but the composition of the elements do tell the story and do tell you why Mike was so encouraged when he saw this.

If you grow 19% out of the UK, 19% growth, that is a phenomenal number, if you have four years of drought in the consumer business and you grow again and you grow again in addition to enhancing your ARPU it tells a story. The customers that you have are of a higher quality, they are not here because they have no choice, they are here because they want to be with us. If you look to what the market share of Broadband is telling you, in a market where the free story is still alive and kicking. You can see that the net adds of BT Retail are double that of Carphone Warehouse. So you can see there is something happening there. Then people will say, but, EBITDA. EBITDA is 2.1% or so, it is in the same bandwidth as it was for the last couple of quarters and it's based on two things. It's the quality of revenue and the cost savings and we will come back to both of them.

EPS, in its 22^{nd} consecutive quarter of growth, is of course a story by itself and then 6% up for interim dividend is a clear sign of confidence that the Board has given. So you have seen this chart over and over and over again, this is about a transformation of the company and you see two things. A company that is much more capable of dealing with the decline in the traditional, this quarter it's actually down 0.7% and you can see that our new wave revenue keeps growing. Let's look to both.

Look to the defence of the traditional and as we said when we were here (points to chart) we talked about defending the traditional and look to the trajectory of where it's going. If you look to the minus number now, its made up of lines and calls of £30-£35 million. It is made up of transit which is very low margin as you know, same amount and on the up with the MPLS that is really growing, 31-32%. So you can see from the numbers what we are dealing with is a factor lower than where we were a couple of years ago. You can also see if you look to this traditional business, that it is becoming an embedded part of what we really sell to our customers. This is telling you that traditional/new wave is much more capabilities that we sell and you can see that if you look to this slide. If you look to this chart it tells you that we are growing our business substantially, its now 38% of what we do in the definition that we use. 38% is new wave, 12% growth on ICT network services, 12% growth in broadband, these are phenomenal numbers and it keeps growing. Why?, well because what we sell as a capability to the market is in high demand.

So let's look to the high demand, BT Global Services order intake, £1.6 billion for the summer quarter is a very good number. 128 new names added to the list of corporations from around the globe. Hanif is always keen to say 60% of the orders were outside the UK, and he's right that's true. But even more important than that, I think, is the quality of the orders that we get. Look to here, you see DHL which is in Italy 180 offices, look to ArcelorMittal, it is 700 points of presence in 40 countries around the world, so look to what we do here with Novartis, an existing customer of Infonet, extention to a $500 million contract. A Logica contract for seven years and why is it, why is it that we have such a great position? Well there are two things.

The first is the capability that we talk about and the second is reach. Now in the quarter we have expanded our reach, we have made acquisitions and you have seen them. Comsat International in Latin America gives us for example all of a sudden a seat at the table with the Brazilian government to talk about internet in the Amazon region. i2i in India which gives us a very strong position in a growing Indian market and gives us a footprint that we didn't have before. We make a deal with Golden Telecom in Russia to get access to their backbone network and guess what, our customers want to be present in that market and we have now a capability, cost effective capability to go and reach them. So its reach and its capability and you can see it, 12 months rolling, going to 9.2 billion and still we are struggling to tell you the story. Because, how do you put it into context?

Well maybe we get help from Datamonitor. What Datamonitor is doing, is they take contracts in Europe that have a network element to it and they exclude the wholesale network because that is traditional telcos together. And they said, how many orders were there and there you see it and who won the orders and what's the value of the orders. And there are two things here that are important. First of all, look to the list of competitors, this is a conversed world, interesting enough, number two and number three are suppliers to us. Classical suppliers to BT turning out to be number two and number three on the competitors list. So welcome to the world of friends and enemies, they don't exist anymore. This is a world where you are working together where it makes sense and compete on other sites and be perfectly comfortable with that. And if you want to see on the list, which is equally important, those classical competitors of ours, you would have to go lower down the list. Look to the numbers of orders, this is Europe, we have more orders than the number two and three combined, and if you know that the order for Siemens was for one order in Germany, even with that in mind, we are almost double the size of that of the number two.

And why is that important, it is important when we are going to talk a bit later about the available market and pipeline and to see what is available to us. If we translate this into a capability that is very closely positioned with our customers. We can take a global sourcing cost model into this order portfolio.

Next broadband, this is the story that everybody has seen coming, and few of you have doubted that our growth would continue. This is almost 500,000, 479,000 to be correct growth in the ADSL market. LLU stands now at 3.2 million lines and will grow further and you see the squeeze in the light blue in the middle. This is a growing market and you know what, as long as it is growing on ADSL its great news for BT. And the difference between us and cable over the last 12 months is a ratio of 7 to 1, 7 to 1, so the comparison with any other market in the world, put that number in the back of your mind.

BT Retail I think have done a terrific job, they did absolutely a terrific job, they positioned themselves as a value player and look to this, there are two numbers here that I stress every time and I'll do it again. First of all, look to the gross number, the gross number is important because those are new people coming to the market, picking up a phone and saying "I want Broadband", 450,000 of them scanned the market, looked to everybody who was available and went for BT Retail. 60% said "I want value in Option 2 and Option 3" and of that 60%, three quarters went to Option 3. Which means in normal language, over half of the people who buy from BT Retail, buy Option 3. The recognition of what we deliver is not just measured by the numbers, its also measured what people say after they bought stuff from us. So we do care about the fact that Computer Shopper says that 86% overall rating for Plusnet is a differentiator in the market. We do care what we get, for BT Total Broadband the recognition from the Mac users. Because it tells you that there is stickiness to what we offer. It is not just the time that you take to make a decision to buy, it is something that really has value for us.

Now, this is an interesting picture, I'll just add to this because there are two things that I'd like to say about this. First of all these are the six largest players, and amongst themselves have more than 100% of the net adds in the quarter. Which tells you that the other 300 players or so are losing, there is concentration at the top. And you can also see that the concentration at the top is such where Virgin was for a long time the leader in this market. If we had given you this chart based on historic basis, for many, many years they would have been up in number one. We have overtaken them and we are growing very, very fast, going forward, based on the value concept.

And this is the value concept. Whether it's working or not will be determined by customers and I'll just give you numbers so you can get a feel for it. Security and storage, we talk about it all the time, Digital Vault, 300,000 customers. The homework of your kids, the photos on your computer, you want to have them safe, they are safe on the net and you don't have to worry about it, adds to value. The VoIP that six months ago we talked about being at 1 million registered VoIP users early, I can announce today 2 million, and really soaring very, very fast. And let's look to two others that are truly important and I think will capture the imagination of our customers. The first ones BT Vision. Now we have set targets for ourselves, the problem with targets always, the targets become the story, so before I go onto say something about how we are doing on the targets, let me tell you something about the story itself.

BT Vision is an enhancement of the Broadband platform, that's what it is. It's a capability that gives people an enormous amount of extras over and above their broadband access line. And it fits in that picture. We have targets, we have numbers. So let's talk a little bit about them. 70,000 installed, which is great and I think fits the bill perfectly but 100,000 sold and that's even better. But even better than that 75% is now self-installed. On average households on BT Vision, in September, paid for 11 views and by the way if you look to the movies, 60% of the moves are new releases. That tells you that 40% is library and that tells you that there is a wide variety of news services that you can think of that can be based on BT Vision. So there is an enormous amount of data that is now gained by using real customers and their experiences and how they use it and when they use it. The capabilities will go to enhance further our capability around Vision and the number of 100,000 is pretty good.

Now another pretty good one, is this one. FON was a brand name in the industry for a long time, clearly a leader in innovation and guess what they have done something spectacular. They have thought about something that is really helpful, and if you add to that the BT capability it is creating the world's largest WiFi community. Why does that matter. Well it matters because it's an enhancement that you can really use. You get, all of a sudden, hundreds of thousands of extra potential spots, where you can use your WiFi phones. Where you can be out and about and use your capabilities. By the way when we launched this, we gave it some publicity, no marketing yet, in the first four weeks, 23,000 people signed up for it. So this is really a thing people recognise as value and they want to create it and they want to have it.

And all of that is that broad smile and every single quarter the smile gets broader. It's the ARPU, and in essence that is the story. The story is that we get customers who want to stick with us for reasons, it's not just that we are giving them an access capability. It's the value that they create and they are willing to spend more and more with us. This customer ARPU picture is telling the story in the consumer market.

Now as exciting is this picture. Four years, no growth for all the logical reasons and you know it was fine. It was incorporated in our planning, we understand it, we saw it coming and it was perfectly okay in the development that we were on. But, I can't hide my smile when I see this one, because this is really a terrific performance from our consumer group. They really have now, in my view, made it clear to the market that we know how to compete.

We know where to complete. We know where to put our emphasis and this is a great illustration of that.

Equally important is the business market, the SME market. Now, I'll give you some numbers to get a feel. In the UK in the SME market, communications and infrastructure is £7 billion and that was the market in which we played. A very respectable market. If you expand that market because your capabilities expand and you look to hardware and you look to IT services you add a whopping £10 billion to the market available to you. And if you then add to that applications and hosting, you add another £2 billion to it. So instead of playing in a 7 billion market, you're playing in a £19 billion market and that's the story about BT business.

Now in order to play you usually need a licence to sell. And that licence to sell is your credibility, to go and play there. So what have you seen, you have seen three things. The first thing you have seen is us making acquisitions to gain that credibility. Basilica in this quarter, £61 million spent on that. The second thing you see is brand recognition. It is important, therefore you don't need to do marketing and our Gordon Ramsey campaign has worked tremendously. The recognition of BT as a supplier of IT Service in the business market went up from 51% in March to 71% today.   That is remarkable. And the third element you need to have, are targeted products and services and we do have them now. If you take for example Tradespace, is a community platform that allows business to interact together and now there is a link to Paypal also to make transactions on the same platform. 20,000 SME market users. That's important. And, why is it important? Well, if you take the numbers of this particular market, just think about it, the SME employs 10 million people in the UK. That is almost 50% of the total private workforce in the UK and 24% of the UK workforce, works from home. And if you look to the start-ups, 60% are started from home. So what does it tell you? It tells you this is a fantastic market that's emerging. And what do they want? They don't' want hassle but they want to live in the 21st Century, so they want to have the capability to communicate, to delegate, to go out in the world and find supplies, find customers and do that in a way that they concentrate on what they do best.

So what do you see in the numbers. You see our mobility going up 35%. It's an impressive number, you see ICT Services going up 24%, you see our capability to sell "One Plan", 18,000 of them, where you bring everything together in a call plan. You see the hassle going out of this and the services coming into this. And therefore it's not a surprise to see BT growing and the market potential is even bigger.

Now under this you also have Enterprise. Well, this is a kind of "did you know". Did you know that BT had the largest, no the fastest growing conference business in the world? And we signed up Lloyds and Yahoo in the quarter, 11% EBITDA growth. Did you know dabs.com is now growing 10%? Did you know and you can see it on the chart, how we are doing in Ireland. So the capability in the small business world and our enterprise focus is a great engine for growth going forward.

BT Wholesale has three elements, giving rise to the red bar you see here. All but one were known about. The first one is LLU … therefore lower prices for the broadband part, that's one-third of it. The second one is transit business, I've said it before, transit business is basically, a spot market, you have it or you don't. It's very difficult to predict, very, very low margin but still it contributes. And the third one is TV, Wholesale got hit by the premium rate business because of the ban on TV. So if you look to this story, and its okay, we knew it would be coming, it's no surprise. What are we going to do about it? What's our story here? And the story is Managed Services. Because of the new market environment, we are very well placed to run a managed services wholesales activity. And you will see a few examples here.

Take the Post Office, 400,000 PSTN lines are transferred now onto our platform and the capabilities that we have to help them go and sell broadband in their 13,000 post offices is done in a very, very short period of time. So a capability that I think will give us future positive input in our Wholesale business.

Our Openreach business had a fantastic quarter. Mike talked about the floods, we almost forgot about that last quarter. And still Openreach had its best repair stats in 10 years. The whole focus of management in Openreach is working. It is even working to the extent that the OTA Report, this time, had some positive words in it and everybody who was following the TSR knows that that's a first, very welcome though. And I think 100% justified by the facts. Openreach is doing a fantastic job, not just on delivering service better and faster than before, they also have to cope with a massive increase in activities. The LLU world with 3.2 million lines means that you have a 50% increase in frame activity. You need to absorb that and in the old days, let's be perfectly honest about it, in the old days we would have paid through our nose for it. It would have been translated in worst performance, it would have been translated into cost. Now today you can see that a focused management and their capabilities are really delivering and I'm very pleased with what Openreach is doing, it is a world-class performance.

Now all of these things together, as you know, will only be balanced in a pattern of sustainable growth in our results, if we manage our costs correctly. And here's the message, a very simple message, £600m a year, £275 million in half one, so you get £325 million coming in half two. That's the message and we will delver that. And then if you look to the foundation of our costs saving, you can see it has names, rank and serial numbers behind it. We know exactly where it is and exactly how to execute it, the £325 is what we are going to do in the second half of this year.

Now, I thought this was interesting, lets give a view of where we will be in half two. There are four things on revenues that I just want to reiterate. First of all our ARPU is growing and will grow, because people buy more value added services from us, that will translate in ARPU and our portfolio is coming through. The second thing is we have talked about the expansion of the reach for BT business and enterprise in SME market, because the SME market capabilities for us are going up. There is more to hunt for, so to say. The third element is Global Services corporate contracts, our pipeline of prospect has increased over the last three/four months by 25% to a level now of £29 billion. And fourth, Carrier Services, Ethernet is a winning product and we can see a huge demand for Ethernet. So from a revenue prospective, from where we are that we understand where the business will go.

So now the question of course of margin. I have already talked about the costs, I've already talked about the fact that we see a widening of the BT Global Services margin based on two things. First of all there is a milestone plan with accounts. We understand those milestones and we understand where we are and we will meet them. And second, we understand how we can manage with our costs. So half two will see a widening of our margin in Global Services. And last but not least, we did reorganise our business, you may have heard about it and we organised in BT Operate and BT Design. And the synergies are coming through. I have to say what it is, if you looked at 21C and what progress we are making now on 21C, to take all those assets and put them into a logical order. Instead of simply executing what we had before, saying, how can we translate that in faster new services. How can we translate that in to more benefits upfront, so that we can get the 21C development translated earlier into benefits for customers. It is a clear signal to me that the new organisation lines up between the different units and it's really working.

So you know this one, you know the numbers here. I will not bore you to death but its too good not to miss. You know, 15 quarters, it's a great number, seven of EBITDA, 22 on EPS and I think a very healthy interim dividend. Hanif.

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

Good morning, from Ben's presentation it's clear that the positive trends continue, so if we look at the highlights of the quarter, revenue at £5.1 billion was 3% higher than last year. Whilst EBITDA and EPS before specific items and leaver costs both rose by 2%. Free cash flow is down year on year and this is primarily driven by the specific item and it relates to the restructuring programme that we announced last quarter. The interim dividend which we have said taking into account business performance will be 5.4p an increase of 6% and reflects our commitment to continue to reward our shareholders.

Let's look at the profit and loss statement in a little bit more detail. Revenue grew by £154 million with the £24 million decline in traditional revenue, significantly outweighed by £178 million in new wave revenues. EBITDA pre leavers grew for the seventh consecutive quarter and at £1.4 billion is £30 million higher than last year.

Operating profit rose £40 million to £755 million. And the operating margin improved by 30 basis points to 14.8%. That's the third consecutive quarter of year on year improvement.

Net finance costs of £92 million reflect an increased average net dept higher interest rates as well as movements in fair value of hedges that do not qualify for hedge accounting under IAS39.

And, of course, the higher interest rates have also improved our IS19 position on pensions and coupled with good performance in the equity markets, means that our pension position is now over £2 billion in surplus, an improvement since last year of £5 billion pounds.

Earnings per share, pre-specific items, pre-leaver costs of 6.1 pence was up year on year for the 22nd consecutive quarter and this quarter specific items amounted to £182 million pre-tax, the majority of which relates to the restructuring programme. And despite the ongoing investment in 21CN, capital expenditure in the quarter was £799 million, £13 million lower that the prior year. And by the end of the financial year, we expect capex to outturn at £3.2 billion, a similar level to last year.

Let's look at free cash flow.

Free cash flow in the quarter amounted to £171 million. This was £167 million lower than the prior year primarily due to the cash costs relating to the specific item.

And as you can see from this slide, our free cash flow profile has become more seasonal in recent years, given the new relationships that we have with corporates and large communication providers.

The Wholesale billing cycle results in skewed working capital inflows. This is primarily due to the relationship between the 30 day bill to cash cycle and the number of days in each calendar month.

The success in Global Services in winning new contracts means that we should see stronger working capital inflows from Global during the fourth quarter, as milestones on contracts are achieved.

Taking all of these factors into account, underlying Group free cash flow will again be strong in the fourth quarter. It will also grow more strongly in the coming years as Global Services working capital outflows become inflows as the contracts mature in the second half of their lifecycle.

Let's move onto the performance for each line of business.

Firstly Global Services.   Revenue of £2.3 billion rose 6% the highest rate of grow in six quarters.

New wave revenue has grown by 10%, more than offsetting the 8% decline in UK traditional revenue.   And revenue outside the UK grew by 19%.

Gross profit of £651 million is 2% higher than the prior year, despite the need to invest in delivering global reach required by our customers.

With SG&A figures broadly flat, despite acquisitions, EBITDA rose 5% to £240 million.

Depreciation is 11% higher primarily due to acquisitions resulting in a £7 million reduction in operating profit, which was £65 million this quarter.

Recent actions in Global Services will contribute to the uplift in EBITDA margin during the second half of the year.

We are winning an increasing number of contracts with higher elements of value added services, such as resilience or firewalls, resilience of wide area networks and these services come with a much higher margin.

We will continue to gain operational and competitive advantages from the benefits of scale, particularly in the Americas and in France following our recent acquisitions.

Global sourcing activity has increased. In the first half of the year 1,800 roles were globally sourced, and in the last few weeks of September, 500 managers left Global Services, giving rise to a pay saving of around £30 million annually.

More contracts are entering the second half of their lives. Approximately two-thirds of our hundred major long term contracts will have done so by the end of this financial year. Therefore the degree of certainty about the profitability of these contracts increases and allows us to recognise more profit on those contracts going forward.

Let's move on the BT Retail. Revenue of £2.1 billion is £59 million better than last year, with new wave revenue growing 18% primarily driven by Broadband and networked IT services. A strong defence of our traditional revenue reduced the year on year decline to just 2%.

Gross profit of £631 million improved by 7% or £39 million as a result of revenue growth, better product mix and costs efficiencies. This boosted our gross margin by a full 1 percentage point to 29.5% In addition we have made further investment in customer service and also in marketing Vision and this has increased SG&A cost by 5%.

EBITDA before leaver costs of £257 million has grown for the ninth consecutive quarter, rising 9% year on year. With depreciation broadly flat, operating profit in the quarter was 11% stronger at £217m.

Lets move onto BT Wholesale. As expected, Wholesale external revenue declined. About one-third of that 9% decline was broadband related. The remainder resulted from lower transit, from lower premium rate service traffic, both of which are low margin products. On the other hand, internal revenue grew by 2% on the back of Retail's continued success in the broadband marketplace.

In the quarter total revenue was 4% lower at £1.8 billion, whilst gross variable profit decreased by 1% to £910 million.

Network and SG&A costs increased by 1% as 21CN costs were partially offset by costs efficiencies. As a result EBITDA before leaver cost decreased 4% to £466 million.

However, that decline was more than offset by a 14% year on year reduction in depreciation, mostly related to legacy assets. Therefore, operating profit before leaver costs was 12% higher year on year at £216 million.

Finally Openreach. Revenue in the second quarter increased by 2% to £1.3 billion, driven particularly by LLU and Ethernet services and this boosted our external revenue by 28%.

Operating costs increased by 2% to £836 million corresponding to ongoing investment in service and increased activity volumes. EBITDA of £468 million represents an 8% improvement over the last year and is the first quarter of growth since Openreach began reporting. In the quarter operating profit increased by £16 million to £298 million as depreciation at £170 million decreased by 8 million.

This is yet another quarter which contributes to the positive EBITDA trend and establishes an encouraging growth record quarter after quarter during our ongoing transformation.

EBITDA in the quarter of £1,448 million delivered the seventh consecutive quarter of growth.

Another firmly established record is growth in earnings per share. Our ability to balance investment and risk right across the business, coupled with financial discipline has delivered us our 22nd consecutive quarter of year on year growth on EPS.

Given the strength of our business performance and our confidence in the future, I am pleased to announce an interim dividend of 5.4 pence. This is an increase of 6% which will be paid to shareholders on 11th February 2008.

And during the quarter we brought back 115 million shares for a total consideration of £362 million. Our distribution policy is unchanged; paying dividends after taking into consideration our business performance and we will also continue with our £2.5 billion share buy back programme which is expected to complete by March 2009.

Our transformation to a service provider is delivering benefits to customers and shareholders.

In recent quarters we have firmly established a record of delivery which continues to underpin our confidence in performance and we will grow in revenue, EBITDA, EPS dividends again this year.

Thank you.

CEO – Ben Verwaayen

Thank you Hanif. Before we go to questions, I would like to introduce Sally Davies who is running our Wholesale division and Sally, if you could maybe wave to the audience and so you can ask her questions. And I ask for some consideration, Françoise has caught a cold and has lost half of his voice, maybe three-quarters of his voice, so if he whispers, its not because its not a strong conviction, its just the throat. Right, questions, we go over there.