



# Investor Day Part 2

Thursday, 13<sup>th</sup> May 2010

## **BT Wholesale**

Sally Davis

*CEO, BT Wholesale*

### **Introduction**

Thank you very much, Tony. Good afternoon, everybody. This afternoon I'm going to start-off by talking about the wholesale market in the UK. I'm going to start off by talking about how Steve and I both address many of the same customers, but with slightly different propositions and I'm just going to talk to you about how they are different. I'm going to talk about some of the market trends before I then turn to the way in which BT Wholesale really has transformed itself over the last three years. Not just through cost-cutting, although that was very important – especially in the early period – but critically, by deepening the relationships that we have with our key customers and creating stability in our business by developing long-term contracts with our customers – growing that from 10% to 40% over the period – and evolving our portfolio to be fit for an IP future.

### **International opportunity**

Now just before I do that, I want to pick-up on a couple of comments that we've had already today – on the international perspective in particular – because we will wholesale at any opportunity. We like to maximise all the opportunities we have in our business, and you heard Gavin this morning talk about what we do in Ireland. Jeff will also mention some of the things that we're doing in some of our countries in Europe as well. I just wanted to mention that we work as a team right across the business, sharing best practice, working globally with some of our big customers, as well as leveraging some of our portfolio. As I go through I'll talk about the bits from my portfolio that we are able to leverage globally.

### **UK market**

#### *Overview*

Let me start off talking about the UK though, because this session is very much about the UK, and about how we work with Openreach, starting in the best possible place which is of course, our customers. BT Wholesale has around 1,000 customers. I think that's a real testament to the extraordinarily diverse and competitive environment we have here in the UK as well as the number of business models that have evolved in this market. Openreach serve about half of those – a subset of those – with their very focused access products, that first mile into the customer, both the LLU product and also the Wholesale line rental product. You can regard the exchanges as almost the boundaries between our services. In Wholesale we take those Openreach services and then blend them into our own adding either functionality or distance by adding trunk network capability or some element of value-added services. I will just give you a couple of examples of these. In broadband we buy LLU SMPF from Steve, we add electronics, we include trunk capacity and we provide internet connections and then sell that as a broadband product both to customers who don't want to build any infrastructure – don't want to build the LLU footprint – and we also sell that to LLU operators outside of their LLU footprint. Another example would be Ethernet, where we take the products in an equivalent way from

Openreach and we package them, often adding trunk Ethernet capability and, for example for the mobile guys, we also add synchronisation capability as we link into their base station. So those are the kinds of things that we do and then our own managed service business sits on top of that, packaging the products from us, which of course package the products from Openreach. I just really wanted to provide you with that overview.

#### *Trends*

However, if we move into the trends in our market, I think there are two main things to say. First of all, there have been a number of trends that we have seen for a couple of years now. We absolutely see those continuing. We see continuing decline in some legacy products - analogue voice, analogue circuits, Transit. We also believe that consolidation is going to continue: with a thousand customers in the market it is inevitable. We also see that all of our customers are really wanting to deliver, and provide, converged products. We also see that the scarcity of capital in the markets is also going to continue, which means that some of our customers are not going to find it so easy to fund their self-build options and we believe will be coming to us increasingly for some of the managed network capabilities we are able to provide. However, critically – and I think this is a theme you have heard a lot today – we really see that we are going to be major beneficiaries of this accelerating demand for bandwidth driven by digital content. Over the next couple of years, most analysts are expecting something like 70% to 80% of internet content is going to be video based, and quite a sizable proportion of that will increasingly be HD video.

#### *Usage*

Already the usage per customer of our fixed networks, the broadband networks, has doubled over the last 18 months. We see that over the next couple of years, the fixed networks are going to quadruple in their demand for bandwidth. This is a slide that Ian showed earlier which talks about the mobile networks where they are going to be taking analogue based, voice, TDM networks – built for voice – into the IP world with something like a twentyfold increase in capacity. We are very well placed to help these customers cope with that and I'll talk a little more about that later. As a part of that, building our IP platform services – I think you might have seen one of the demonstrations at lunchtime – and again I will talk a little bit more about that, as well as our managed network services. We think these are really accelerating trends.

### **Wholesale's journey**

#### *Turning around*

Let me just talk now, for a couple of minutes, about the journey that we've been on in Wholesale. Wholesale has actually always been an important contributor to BT Group profits and in the last year we contributed just under £1.3 billion. But, there was a period of time when we really were going in the wrong direction, predominantly as a result of customers moving on to an LLU basis. Now, we have turned that round. We have stabilised that trajectory and we are now really feeling very positive about maintaining that. We have done it in a number of ways. First of all we have really focused on the needs of our customers and all of our customers: our mobile customers, our fixed customers, our service providers. As I said, we sell to LLU operators as well. Most recently we have been selling to broadcast and media companies which are going to become increasingly important in this content-rich world.

*Managed network services*

Fundamental to that business change has been our focus on managed network services. This last year we sold £1.8 billion of contracts, up from 1.2 the year before and that does not include the business that we recently won with Orange to manage their LLU network. That is in this financial year. I will say that all of these are pretty competitively hard-fought. We do have a lot of competitors out there so these are hard-won contracts of which we are very proud.

*Portfolio simplification*

We have been simplifying our portfolio. We have been extending it. We have been developing a portfolio fit for the IP future. But also, of course, we have been on a relentless cost reduction track and if I can just spend a couple of minutes on that. Net operating costs are down 19% over the three years, partially driven through the cost of sales reflecting the change in product mix over that period. But underlying all of that, we have made a 47% decrease in our direct operating costs. Now, what has really been at the root of that – and again, you have heard this from many people, we make no apologies for it – is that the Right First Time programme has been critical in that journey. It really has helped us to eliminate waste and reduce overlaps in functions and capabilities. It has some real business outcomes. We have doubled the life – extended the capability – in our data circuits. The reliability of those data circuits has doubled in that period of time. We have also eliminated something like two thirds of our broadband faults over that period of time. What is critical to that is the point that Gavin was making earlier: this intelligent diagnostic capability. We have more to do on that going forward and we are absolutely committed to putting as many tools in the hands of our customers as we possibly can because, by the way, that also helps to reduce our costs. Of course, we have also kept a very tight control over discretionary spend, but we cannot just cut ourselves out of the situation that we have been in so the growth and development of our business has also been very important. Here you can see how our portfolio has evolved over that period of time. Taking out Transit, which has its own trajectory, we have known that we were going to have a decline in our Transit revenues both as a result of the mobile termination rate reductions but also, some of customers have chosen to connect directly with each other and we do expect those trends to continue. Fundamentally we have changed the nature of our portfolio from one-off sales of point products to packaging our products into these managed network service capabilities. You can see that this has increased in a very major way across our entire product base over the last couple of years. The other thing I will mention is the start of the development of our IP platform services. Here we are now seeing the nuggets of products which we have grown from zero to about £20 million over a couple of years and which we think truly have the potential to go on to be £100-200 million product streams for the future.

*Product areas*

Just talking about each of those product areas, I am not going to go into this in a great deal of depth because Clive did a great job in talking about how all of this product base is absolutely anchored on the work that we have done on 21CN. In the broadband sphere, the fact that we are able to roll out our ADSL2+ capability to 75% of the population who will be able to access that by the end of this year. Most importantly, we are building a broadband platform which handles the mixed economy. For quite some time now we will be in an environment where some customers will be getting the 8MB product, some customers the 20MB product, increasingly the Fibre to the Cab (FTTC) product and the Fibre to the Premises (FTTP) product.

Our platform will handle all of those different access varieties and our CPs will be able to really then offer the customer the latest that is available in their particular area. Therefore, it is a competition ready platform handling these multiple access mechanisms. In fact, some of my customers were some of the first to work with Steve and his team on the FTTC trials and had some fantastic feedback from it.

#### *Ethernet*

In the Ethernet we have talked a lot about that. Particularly proud and particularly looking forward to the launch of our 10GB product – you stop talking in Megabytes and Gigabytes, it is Petabytes and Zanoabytes and all the rest of it. We are moving up in our bandwidth capability to handle this extraordinary explosion that we are going to see. Finally our Voice evolving into IP again – as I said, you saw some of that at lunchtime in one of our demos – IP Exchange though, I will just mention briefly. It won the innovation award at last year's ISPA Festival. This is a product that enables IP to IP minutes to be connected using many different flavours of the SIP protocol, or it can go IP to TDM and TDM to IP. It is both for fixed and for mobile operators. We now have a hundred operators on this platform. We doubled the minutes that it handles and we have great development plans to handle number portability, identity, presence and authentication – these kinds of value-added services. This is just one of the products that we truly will be taking globally and working with all of our Wholesale businesses across the company with that.

#### **Managed services**

##### *Infrastructure-free*

Let me now focus on what has been a really important element of our overall transformation story and that is the real focus that we have put on the development of managed network services. These really come in three flavours. Some customers want to be completely infrastructure-free. They want to offer converged services and new services to the market – to their customer bases – but they really do not want to invest in any of this infrastructure. Examples of this would be the Post Office or Scottish and Southern Energy – in fact I think just this week we announced that we have resigned with them for a further four years. This is where, as soon as you hit the portal to order the services – whether you are a customer of theirs or one of their customer service reps – as soon as you hit that portal, everything beyond that is supplied by Wholesale. Obviously the products themselves – broadband, calls, lines and other value-added capabilities – but also the billing and in many cases, the customer service as well. It provides a complete package of services. We have now got to about 4 or 4.5 million end customers on those platforms.

##### *Adding functionality*

The next area I would just mention is our managed services and this is where we take some of our existing products and then the way in which we package them together or add value through functionality makes them a managed service. I mentioned the Ethernet capability earlier for our mobile operators where we are adding synchronisation into the base stations. We are also managing capacity and upgrades on their networks. It is like a managed service; it is provided as a turnkey into some of those operators.

### *Outsourcing capabilities*

The final area relates to either partial or full outsourcing of capabilities. A couple of examples here would be where, for example, Virgin Media outsourced their entire Voice network to us a couple of years ago. We have since been building on that outsourcing relationship. We run the whole of their TDM infrastructure for them. Another one would be our relationship with Kingston Communications – something that we announced last June – which is much more of a full outsourcing and I will talk a little bit more about that in a minute.

### *The future*

For the future, we think there are further opportunities in the market here, and we are also working on packaging bids for next generation access which will see us putting fibre products alongside copper products – and potentially other value-added services – into some of these bids for the next generation access networks as well as focusing on our broadcast and media environment. The fundamental point I want to make about these bids is that many of them package some of our existing strong product set. We are not necessarily building entirely new things. They are based on existing capabilities which we then package. It is very low capital intensity. We put the capital into our products and we package those into these managed network services rather than building anything necessarily unique or bespoke for these customers.

### *Kingston contract*

Shall we just spend a couple of minutes now on the contract that we have with Kingston? At the time of signing, Bill Halbert was very positive about the potential of the transformation of their business. We now manage their entire national network. We don't manage the network in Hull, they still run that, but we do manage the entire national network. I have to say that in their last earnings announcement they were very positive about the transformation that they've already achieved and in fact, I think, it is going even better than they had hoped which is of course the way we like it to be. It has helped them to reduce their own capital intensity as well as giving them greater reaching capability. For us, it is good. It adds to our scale and in many respects this is absolutely a scale business.

### **Mobile sector**

Let me finally just talk a little bit about the role we play in the mobile sector because it is a very important sector to us and mobile customers are some of the largest customers that BT Group has, period. They are a very important sector to us and, as they themselves grow and face challenges in their own business models and the evolution of their own networks, we are keen that we can provide a set of services to help them deal with those challenges and evolve into an IP future. We talked a little bit about the Ethernet capability and big chunk to the 1 billion odd Ethernet orders that Clive was talking about do come from that mobile sector. It is not just about Ethernet, it is also about IP offload and certainly the wifi capability that we sell and the Openzone capability is an important element of that. But so is some of the consultancy. We have been running IP networks for a long time. We know how to really maximise those and the capability there. These are all really important areas, as are the contracts that we have won to help these customers expand their portfolio and sell the fixed services into their SME and consumers. Of course the contract that we recently announced with Orange, where we are taking over the operation of their current LLU network, and over time we will be migrating that

into our own broadband infrastructure. We think that these relationships do position us well for growth as they evolve into their future networks.

### **Summary**

Let me summarise. We have transformed our business. We have reached the position of stabilising our profit performance. We will, of course, continue to focus on cost reduction. There is always more to do and more opportunities. We are evolving our portfolio into two for an IP future and we particularly see us capitalising on our strength in managed services and also in the development of IP platform and content delivery services, which we mentioned earlier. Finally, we really want to be in the forefront of creating what we believe is a true next generation wholesaler but, as with all of these things, there is still a lot more to do. With that, I would like to hand over to Steve to talk about Openreach.

## **Openreach**

Steve Robertson

*CEO, Openreach*

### **Openreach overview**

#### *Infrastructure*

Thank you very much. Let us look at what we are going to cover this afternoon. We are going to talk about who we are, we are going to talk about our track record and we are going to talk about how we are implementing our strategy. Everywhere you go in the UK, every city, every town, every village and every street: Openreach has its infrastructure there. You can see, feel and touch it. The 4 million poles, the 88,000 green cabinets that I remember we used to gather around when I was a kid are still there. It is a highly visible, physical business and it is ubiquitous and that ubiquity is a critical part of its fundamental strength. It is something that is very easy to take for granted.

#### *People*

Alongside that physical ubiquity is a fantastic workforce. 32,000 people, average length of service over 20 years. These are people who are a huge source of expertise, skill, passion and commitment. Part of that £10 billion of assets is something that you cannot see. Something that has really been built in the last four years and it is one of the most important parts of our business. Openreach has a unique capability to manage the relationships across a service provider community that represents the whole of the UK market through a set of provision and repair systems that are some of the most scalable, smartest, most brilliant business to business systems in the whole world. Those systems allow us to form a seamless nervous system with all of our partners and when we talk about significant improvements in service delivery right across the industry, one of the foundation stones for that has been that amazing ecosystem that has grown up in the last four years around Openreach.

#### *Service*

That ubiquity of infrastructure, ubiquity of a really fabulous and skilled workforce, and a superb capability to deliver something like one million transactions per day – one million transactions per day – through this amazing nervous system for the whole of the industry along with the

fact that our customers reach every part of this market. It does not matter if we talk about the most exciting, multinational corporations or the simplest offering for my mum up in her flat in Edinburgh. Openreach's service providers reach all parts of that market and it's because of this that when we look at our financial results, they are phenomenally resilient. We can look at the EBITDA performance. Excellent levels of EBITDA, but most importantly maintained throughout the relatively short history of our business. If we look at cash flow this is a very, very clean cash flow number – it's basically EBITDA minus capex – we can see growing cash flow and the last year of that column is very important. That is the first year of our investment in superfast fibre product and yet we can see the strength of that cash flow. However, that has been achieved against a really challenging background. Over £400 million of price reduction have been delivered into the market. Right across our portfolio, whether it is LLU, Ethernet, WLR, connection charges – that is a huge amount of price reduction that has gone into the market. Also, alongside that price reduction we have seen some phenomenal churn. You have probably heard enough times now about the way growth in Ethernet is happening, but we should remember that is accompanied by a decline in some of our traditional products.

### **LLU growth**

Alongside that, of course, has been the phenomenal growth of LLU. When we created Openreach there were 300,000 unbundled lines. It was a product that had been in the marketplace for ten long years. There are now 6.7 million unbundled lines and we are trending above 45% of those as fully unbundled lines. When we created Openreach one of the great worries was if you get to full unbundling, somehow our business would get holed beneath the water line. That is absolutely not the case. One of the things that have happened as we have helped to generate the tremendously competitive broadband market in the UK is a huge growth in terms of the speed and requirements across that whole market.

In our external market we started off with round about 6% of our revenue. So, at the point of the birth of Openreach, our external service providers were an extremely small part of that revenue pot. What we have seen in the last four years is a growth where now they represent more than 20%, driven by that take-up of LLU. That take-up of LLU has acted as a crucible of innovation in the broadband marketplace and on the back of that – whether it is the stuff that has come along that Sally referred to in the mobile space, but perhaps more crucially in the fixed line market – we have seen a phenomenal growth in Ethernet products. Perhaps the most important bar in that chart is the growth in the greater than 1GB product set that we are just starting to see set on fire. It is a tremendous opportunity for us and what has been critical for Openreach is we have maintained our really strong position in the market throughout that migration into the Ethernet space. If we have huge growth in volume, if we have dramatic reductions in prices but we must maintain strong EBITDA and strong cash flow, the focus on delivering efficiency cannot be avoided. Inside Openreach, from the day of our inception, we have been focusing extremely strongly on a huge reservoir of efficiency potential. That is built around the resilience and reliability of our network and ensuring that the way that we operate that network minimises the number of engineering visits and minimises the breakage that you cause yourself when you are working in the network doing tens of millions of transactions. What you can see here in terms of total labour cost reduction is primarily a result in the improvement of reliability of that infrastructure. A 50% improvement within those four years: 48 months, 50% improvement in an infrastructure that reaches everywhere.

**The achievement**

How have we done that? We have had a huge focus on making sure that the network infrastructure itself became more resilient. Now, I have not got videos, I have not got any gismos like Gavin's got. We look up the value chain with great envy at all these wonderful things, but the difference is – if you want to take this away with you afterwards feel free – this is a miracle device. When Openreach was created, if you wanted to go into our network and if you imagine, when something breaks or you want to deliver a new service, you have to break the network open. These are flexibility points in the network and what you used to have to do was take a knife to them, open it up – there was a metal skin, a resin skin, there was insulation inside it. You would do your work and there was then a 27-step process to put it back together again with Bunsen burners and resin. Can you imagine the guys – you have a hole in the ground with the rain pouring down and guess what? When we created Openreach there were 800,000 what we call open joints – that is places in the network where when it rained and the water filled the manholes guess what happened? The network fell over. It was absolutely normal for BT to have 50-55,000 repair jobs in the work queue when we had bad weather.

Earlier on we had the question about engineering visits. I do not mind engineering visits by the way. If it is to provide a new service and get money through the door, that is fantastic. If it is to fix a fault, that is a bad visit at about £80 a time. Now this little darling here is different. It is a ski boot closure and you can see even a CEO can make it work. That is the litmus test. You close it with these little ski boot thingies and every time an engineer needs to go into it, they just simply open it up, do their work and close it again. Alongside the amazing systems and all the rest of the stuff we have done, we have closed 900,000 open joints in four years. 900,000. Today, if you look at an average week we have around 10,000 jobs in our work stack. That is about one day's work. You can see resilience of the network has paid huge dividends because that is literally millions and millions of engineering visits at £80 a time that we have saved. It hasn't stopped there. We have some amazing systems inside Openreach. We test every single one of our 28 million lines every three days week after week and month after month. We gather that information and in the last four years we have started to use it in all sorts of innovative ways.

We have something called Turtle. It is called Turtle because the guy who invented it is a guy who has been in BT for about 35 years and he wanted it to be his legacy. He knows that turtles live for a very long time, so we call it Turtle. What it does is take all of the line characteristics and data that we have ever gathered historically about that line and makes it available so that when we have a fault the accuracy of the diagnostics is absolutely spot on. This means we send the right engineer with the right skills to the right place to fix it. We hate repeat reports. They are bad for customers. If we get a repeat report within 28 days it is an awful thing for us, it is a rubbish thing for our customers and it drives massive incremental costs. In the 12 months we have reduced the number of repeat reports in our network by 30% – actually, I'm exaggerating – 27%, by using a great device like Turtle.

**Fault rates**

The other thing is that we look at fault rates right across our infrastructure. We measure fault rates right across our infrastructure. You can tell we are very enthusiastic about this stuff. Other people might think this is a little bit boring but for us it is fantastic: we can predict when a bit of our network is about to fall over. In the last year we have proactively gone to 200,000

places in our network and fixed it before it caused a major problem. So, instead of having a hundred, two hundred, a thousand customers out of service, we have had two or three and then we have gone and proactively fixed it. Again, it all saves money.

Inside the exchange – I don't know if any of you have been inside the exchange. If you imagine all these cables, all these 28 million lines being connected into about 5,500 exchanges and basically we have a thing called a cable chamber. The cable comes up through a hole in the ground into the exchange and we have an amazing piece of metal work called a main distribution frame. Every single one of those little copper pairs gets put back out into that main distribution frame, and when we connect all of our service operators and communications providers' equipment, then that is the place we connect it to. We take each pair and connect it to the right piece of equipment. We saw a trebling, a quadrupling, a quintupling – in many of our exchanges – of the work that happens on that main distribution frame. If any of you had actually seen one, you would probably be amazed how anybody could actually do a piece of work accurately. It is incredible. Some of them have got 100,000 individual circuits all laid out on this huge piece of ironwork.

Despite the fact that we quintupled, in many places, the amount of work that happened on that, we actually reduced the amount of faults that were self-induced by around 20%. The way that we did that was to make sure that nobody touched that equipment unless they were accredited, and every time somebody does a job they test that afterwards that was absolutely the right little bit of copper, connected to the right equipment. In the last four years we have gone through an incredible journey: network resilience, quality of workmanship and innovation in terms of our diagnostics.

### **Productivity**

In the last 12 months we have discovered a brand new reservoir of efficiency and that is something that has been a brand new journey for us. Maybe for you and for lots of other industries it is old hat, but for us productivity is a brand new journey. You can see fantastic news for us on the chart there – we have reduced the amount of time it takes for one of our engineers to do a job by around 22%. It's roughly the same whether it is a repair job or a provision job. The way we have done it is we have put tracker devices in all of their vans which means – instead of the three jobs at a time they used to get, with the mantra 'three jobs day, three jobs a day' – now each engineer gets a job one by one by one. The engineer goes to the next job that is nearest to them and each time they complete a job, they make sure that the service provider knows that the job has been completed. This means we save on travel time, we absolutely optimise the number of jobs that an engineer can do, and because we are creating a standard operating environment for them to work in, it means that we can apply standard task times. Every single one of our engineers, every single one of them, on every single job is measured on their quality of workmanship, if they generate a repeat report, if they generate an early live failure if it is a provision, how long they have taken for the job, and that data is made available to their manager every single day. This is a world where performance management, efficiency, productivity – but productivity with quality – is at the heart of our journey: the next steps that we will be taking to actually mine a whole new seam of efficiency.

**A resilient business**

Here we have a business that has proven itself resilient to massive price reductions, resilient to huge changes in our product portfolio, resilient to huge changes in our customer mix and in fact has made that a strength, and throughout that has also delivered really significant improvements in efficiency which has given us excellent cost reduction and not only that, a future where we can see more of that coming. When you add all of that together, that is why we have had the confidence to begin reinventing our infrastructure and investing in our superfast Fibre Access Network. What a brilliant day for everybody in Openreach. To hear that if we do this right, if we deliver the business case, we are going to extend to two thirds of the UK. I can tell you today that there are 32,000 people who are outside this room cheering because this is exactly the news that they wanted to hear.

The reason that is important is because we have got 32,000 extremely motivated people. Remember these are the people who put their hand up and volunteered to work on Saturdays for no overtime because they understood we had to drive efficiency. These are the people who put their hands up and volunteered to work into the evening or get flexed off early so that we could optimise the number of jobs that we could complete in any given day. What they were looking for was the chance to reinvent our infrastructure and have a future. This is not just an infrastructure business that has a sustained and long-term view of its finances. It is a business that is populated by people who have got a long-term commitment to Openreach and to the BT Group. So, we have a plan: 1.5 million premises passed in early summer. We are very confident that we are going to get to that plan. We are in the process of ramping up – by the end of the calendar year we will be at 4 million premises passed. 10 million by 2012. Then, by the time we actually start spending our next pot of money it is going to be another what? Two-thirds of the UK, probably another 5 million passed by 2015. We are looking at a programme that is extremely comprehensive and when we look at the external environment we believe that there is every opportunity that this infrastructure can be extended into many other places because we may have a new government, but one thing that has been consistent in the last year is that the need for the best possible infrastructure for UK PLC has been at the centre of many of these debates.

**Learning process**

When we started out we didn't know much about this. We went into Muswell Hill, we went into Whitchurch in Cardiff and we also went into Halfway in Glasgow – I think Ian insisted that we had a wee shot in Glasgow as well – and we started to learn. We started to learn what it was like to go in and deliver service. When we deliver service in this world we have to rewire houses and we have to integrate all sorts of equipment, for instance, a Wii. If you have got a managed install for this, it is perfectly normal for our engineers to go in and integrate your PC, your laptop, your Wii and your Xbox because that is what the customer promise is. It was a learning process for us. When we started out on this journey it was maybe taking six hours to do a pretty straightforward, FTTC installation. It is now taking around about two hours. This is a learning process for us. We are on a journey, but one of the great things about it is we are getting superb feedback from customers. The way that one of my own engineers – actually a recently qualified apprentice in Cardiff – described it was, 'it's fantastic, Steve, to go into someone's home and to blow out the candle and put on the floodlights.' That is the sort of difference that consumers are experiencing when this comes into town. Of course as part of

that, as we get to scale – we now have thousand of cabinets up and stood up – we are learning how to scale it.

### **Local councils**

There are issues around local councils. If you are in a conservation area and you want to go and put in several hundred cabinets, you actually lodge several hundred planning applications simultaneously. Believe me, local councils are not geared up to handle several hundred planning applications simultaneously. They are just not, because it normally does not happen. At first, we did not think about that. It is only through the experience of doing this – and of course, the preparation, working with local councils, and also some of that local pull – that what we have found is where we work closely with local councils and where there is an appetite – as there was in Cardiff – the process of deployment is so much easier. Working hand in glove and working cooperatively is critical. Working with the electricity companies is critical. Every single one of our NGA cabinets has to have power to it and it is a massive deployment. Therefore, working hand in glove with our supply chain and making sure they have early visibility of where we are going and when we are going to be there and what we need, is something that is allowing us to begin to scale.

### **An active service**

It is also a new journey for us in terms of our business. We are now in the game of an active service. That means managing the modems that actually deliver the Ethernet service. If you are going to have hundreds and thousands and tens of thousands and eventually millions of modems, you need to understand, for instance, that modems get upgraded. They get upgraded quite a lot actually and you need to be able to contact all of those modems within a very short period of time to make sure the latest firmware gets downloaded. That is the sort of lesson, and experience, that you have to get your hands dirty with to start to understand. Those are the lessons we have learnt, and we are very confident now, looking into the future that fibre is absolutely going to be a business as usual item for Openreach. You should not forget that it is part of our heritage as well. Clive talked about BT being the people who invented Blown Overhead Fibre. That means that you put a little plastic tube overhead, you have your compressor and you blow the fibre through that tube. This means that we can utilise the 60% of our network infrastructure that is made out of poles and overhead cables for this new world. It is not just about ducts.

This new world of fibre is somewhere we have been before. BT has already got 11 million kilometres of fibre in its infrastructure. I'm not saying this is going to be a big scale up, but it is something in terms of the physical apparatus if you like, that we are also pretty familiar with.

However, maybe the most critical success factor for us is if this is a product that people want, is this a product that works in the marketplace? As the CEO of Openreach, it is very interesting that I hear two stories. I have people interrogating me saying, 'There is no demand, is there? Nobody is going to use this bandwidth.' On the other hand there are people saying, 'You are only going to do 40MB? That is useless – it needs to be 100 or 200.'

### **Fibre to the cabinet**

#### *Benefits*

Let us look at what we can do with a straightforward FTTC product. You can be at home downloading high definition iPlayer. I do not know if any of you have had a shot at high

definition iPlayer; it is really, really cool. It downloads in seconds, it doesn't have any buffering, it is really fantastic. By the way, high definition iPlayer consumes about five times the bandwidth of the original iPlayer. Earlier on when you looked at the growth of Ethernet back haul, the reason that this is happening is because the usage of broadband is completely changing. It is moving right into the sweet spot of superfast fibre. The days of when your broadband was predominantly a chitter-chatter thing – when you download something and have a look at it for a while, maybe upload a little tiny something else – that is going. This is nailed-up, full on, torrential consumption of bandwidth because it is big downloads. It is online. It is IP television. It is a world where Sony's latest television has got broadband built in. Why has Sony's latest television got broadband built in? Because the days when we thought broadband was for propeller heads – or even people with PCs and laptops – is moving away. Why is broadband going through another growth spurt? Because the way it is being used is fundamentally changing and that is a movement straight into the sweet spot. You can have a high definition iPlayer going, a high definition Vision service, and also be playing Super Mario Kart. It is fantastic – you have to try it folks, you have to try it. Get your multiple high definitions and get on Super Mario Kart at the same time and you can do all of that stuff and simultaneously have very fast surfing of the net with this sort of service. The great thing about this is that there are certain things that these new types of applications that need symmetry. If you are video chatting, you need symmetry. If you are gaming, you need symmetry. 10MB up is just as important as 30 or 40MB down and this product does it. It is a product that we can deploy quickly, we know how to work and one that we believe the time is absolutely coming for. The reaction of Gavin's customers – and Gavin is obviously the first mover on this infrastructure – has been fantastic.

#### *Compared with cable*

Therefore, let us deal with the vexed issue of cable versus FTTC or FTTP. Actually I think our headline rate for FTTP is always going to be the fastest. We do tend to have an obsession with speed. Even if you can do all the things you can imagine you can do with 40MB, there is still this, 'what is the fastest?' However, if we look at our basic FTTC offering, it has certain attributes that are very important. You get what it says on the tin. Every single customer connection is a dedicated customer connection. The Openreach product is totally uncontended, so when one of our customers buys a superfast fibre connection from Openreach and sells it on to a consumer, we assure and promise the speed that they are going to get. Nothing that can happen to that line is going to compromise that speed.

#### *Power in the marketplace*

From an Openreach point of view, the second thing that is really important is the power in the marketplace. When we come into town, we bring a whole bunch of service providers with us. Not only do we offer a great service with an assured speed, we offer real consumer choice. That choice is about different business models, different commercial models, different pricing structures, different strengths and weaknesses which we can bring to the market. Perhaps the most important part is that as we are committing to go to two-thirds of the UK, it means that we can go to places where there is no other competing infrastructure. That is a huge motivating factor for us, to ensure that the business case stacks up, and of course that is in the hands of the people inside Openreach.

**Key messages**

Finally, I think our key messages are pretty straightforward. We are a business that is extremely resilient. We have a track record of managing huge price reductions, massive variability in our products and massive variability in terms of our customers. We have a very clear strategy that is very straightforward and we are well down the path to delivering it. We are a business that has not only proven that we can deliver great service, but also that we can deliver true efficiency and we have got a whole new reservoir that we are only just beginning to explore. Yes, we do have a lot more to do, but as one of my Glaswegian engineers said to me – Ian, in words that would probably ring in your heart – with his hard hat on in the rain, ‘Steve, we have the means and the facilities to do this and we are the men to do it too.’ So, there you go. Thank you very much.

**Q&A**

**Ian Livingston:** Let us take some questions for five minutes.

**Jonathan Grocock (Investec):** TalkTalk commented that in their trials they had a significant minority who thought the copper was too poor quality to provide a decent FTTC product, i.e. superfast broadband. How are you going to address this? Would you have to replace the copper or would you go, ‘Oh well, we will not copper, we will just do FTTP because it’s cheaper’?

**Steve Robertson:** There are a number of circumstances where your FTTP is not only a better option in terms of the speed you can ultimately offer, but also it is cheaper. These include circumstances for instance where customers are directly served from the exchange, etc. We will absolutely be delivering a mixed economy – one of the key things about our roll out is that it is a mixed economy within an exchange area. Within a given exchange area, as we begin to learn how to deploy FTTP we will be making sure that we get the optimal mix and therefore be able to handle situations like that.

**Damien Maltarp (Credit Suisse):** I have a couple of questions for Sally. You mentioned that it is an EBITDA stable business, but given the magnitude of the contracts you have been signing, why shouldn’t we think about this as an EBITDA growth business? Perhaps secondarily, and related to that, how should we think about the EBITDA profile of a long-term contract that you sign, for example the Orange contract? Is that loss making in the first year and then grows? How should we think about that profile?

**Sally Davis:** I think our desire is of course to grow EBITDA. However I think that we have a number of countervailing forces, in particular some of the regulatory prices that are still downward pressures. We are still seeing some legacy decline and so we are seeing currently that our managed network services are a balance to that rather than really going ahead. In terms of the overall shape of the contracts that we are signing, what I am really trying to emphasise is that a lot of them do cement in a lot of our existing products. As a result, yes with some of them we do take a lower margin in the first year or so as we bed things in, but they do recover relatively quickly and they do cement in some of our existing products. However, at the moment our outlook is to say that we still have enough negative pressure coming through so our managed network services are not quite enough to take us forward.

**Ian Livingston:** Of course that is a big difference from where we came from in terms of LLU continuing to be around. However that is certainly a big step forward.

**Nick Lyle (UBS):** Steve, can I ask you about the issue of the costing of fibre? Is it possible to get a little more granularity on what you are finding? You of course mentioned mixed economy in different areas, but could you break down the fibre rollout, cabinet and other costs for us as you find it so far. I see Tony is shaking his head there actually, but he earlier mentioned unit costs coming down. Could you give us a scale of how much they may come down by? Is it a large factor, or percentage wise? Are you assuming a large reduction in unit costs as you go forward and scale up this rollout?

**Ian Livingston:** It may be helpful to talk a little bit about this as we saw and understood the KPN comparison, which I know a lot of people have asked about. That might be more helpful now that what we are seeing. Granted we are doing a lot of these, but it is still very early days. On costs overall, as Tony said, we have not seen anything that has frightened us so far, but maybe the KPN comparison to FTTC.

**Steve Robertson:** The KPN comparison was really interesting and quite a lot of noise has been made about it. The first thing to understand is that the KPN rollout is very, very different. The first thing is that in terms of the FTTP rollout, they are actually building a completely new infrastructure whereas we are reusing. When you look at the relative unit cost between FTTC and FTTP, in our case we are looking at probably FTTP may be a little more upfront, but in terms of the entire lifecycle costs, there are almost the same. That is why we can look at a mix of FTTP and FTTC within that budget envelope. I am not trying to avoid the question, but in a way it is not completely relevant to us. KPN is going to build many more handover points for its FTTP product, well over 1,000. We are well under 1,000. In KPN's situation, there are going to be dedicated headends for FTTC and dedicated headends for FTTP. In our case, we will have a mixed economy headend which can support both. If you look at the way KPN's costs are represented, they are very different. They have their own joint venture that is doing the fibre part, so it is actually very hard to make comparisons between the way we are looking at costs and deployment costs and the way KPN represents them. By the way, I am not saying that ours is a better or a worse way – different network topologies and different environments actually call on different types of optimal solutions. We believe that we have the optimal solution for our environment.

**Ian Livingston:** Steve will find you any more information on mixed headends that you need.

**Robert Grindle (Deutsche Bank):** Is the issue of bigger street-side cabinets an issue for the superfast rollout? I know I would not want one on my street, but maybe it is more room for the kids to play around. Is there really a barrier or do people have to like it or lump it? Also, on the Wholesale side, is the Orange/T-Mobile merger a headwind to growth this year or is it a non-issue? Thank you.

**Sally Davis:** Actually I think the Orange/T-Mobile merger is an opportunity. We are already working with MBNL, which is the T-Mobile and 3 joint venture on the Ethernet rollout and we will expect that Orange will work with that as well. I think there are some opportunities there, but I also think that on the contract that we have signed with Orange for the LLU piece – again T-Mobile do not offer fixed services at all yet, so there may well be some opportunities there. All of this takes some time to evolve.

**Steve Robertson:** The cabinets are not proving a major issue. Obviously some people object to having a big green cabinet outside their garden, and especially in some conservation areas you need to tread carefully. However, in general we are not finding that it is a major problem.

**John Karidis (MF Global):** Firstly for Sally, at what point do you think that mobile operators might have to consider building their own infrastructure or, for example, buying an unbundler? Could you give me the technical reasons why it does not make sense for them to do that, aside from price and availability? On Openreach, I am finding it hard to understand why the profits would be just stable going forward given that you can charge more for local loop bundling and you are charging more than five times for wholesale access to fibre over copper. Is it because of a heck of a lot of start-up costs which may melt away by year two or three?

**Ian Livingston:** To help you – I do not know if Steve will want to add anything, but I can talk about this. The important thing to understand on Openreach is that we still have a headwind of people moving to MPF, from partially unbundled to fully unbundled and that has an impact. We have seen big price reductions, particularly on Ethernet, and there is quite a lot of cost associated with the rollout of NGA that is not a capital cost and that is one of the things that we said. There are people who are just revenue, they are not capitalising. Therefore there are some start-up costs and we are not relying on some huge increase in pricing. It also costs us more to supply some of that stuff. However, we will be driving Openreach efficiency and I am delighted that the questions that are being asked now are, 'Why do you think the EBITDA will only stay flat?' I like these questions, and I think we are driving the business to continue to do better. However demand is critical to that happening and that is why we want to encourage demand by lowering pricing. This is why we have been aggressive with pricing, because if like us, you have a fixed infrastructure, demand is very important. I think that is the critical part added to the Openreach efficiency programmes that Steve talked about at some length. They are critical and as you can see we are still in the early days of the Openreach programmes, but these are the most important, particularly in terms of our customer service, but also for our cost base. Steve, anything else?

**Steve Robertson:** I totally agree, Ian.

**Sally Davis:** Clearly you have to ask the customers themselves, but I would remark that buying an unbundler is not going to help them with their number one challenge: bandwidth explosion. Unbundlers do not have circuits into their base stations, and that is the biggest issue that have. Unbundlers could possibly help them to reach the consumer market but I think, as we have seen from the Orange transaction, you do need to have scale. I think they would be addressing different issues and it really does not help them when one of their biggest challenges is how they cope with this big explosion of bandwidth for their mobile customers, which is still their core business.

**Ian Livingston:** Okay, thank you.

## BT Global Services

Jeff Kelly

*CEO, BT Global Services*

### Opening remarks

Thanks, Ian. Well, I don't come with one of these and I certainly don't come with one of those – but I can give a presentation on time! You can tell Steve doesn't get out very often but you have got to love the passion. Let's talk about Global Services. I am going to take you through 2009/10; I am going to try and get through that fairly quickly as Ian and Tony have already been through it, but I am just going to add a little colour. I want to open up the colours a little bit because I get a lot of questions about what is underneath Global Services; it has been a while since we have talked to you about that so I want to spend some time talking about the business model, the businesses we are in, and then we will spend the rest of our time talking about the future.

### Overview

#### *Initial impressions*

Since I am the newest and it has only been four months for me in BT, when I came in I had some initial impressions and I wanted to share those with you. It is nice to know that many of the ones I had, I still have. The first one is the impression of the current customer base; the portfolio of customers that we start with is just amazing – I will walk you through some of the high-quality logos shortly – it is a great place to start and the service orientation of the people and the culture in BT serves them well. If I can mix both those two I think we have a great starting point in BT for where we want to be in the future.

As I look back on 2009/10 it was really a year of stabilisation for Global Services; a lot of things went in – Risk Management, Solutioning Processes and the like – and it was really a year of stabilisation. If you ask me what I was disappointed with or what things I am going to spend my time on, I would say contract performance. Execution is key to our future; we need better and more skilled resources where we are delivering to our current customer base so that we get the performance there that we need. But there are opportunities for growth and, with challenges and opportunities to improve, those actually turn into opportunities for Global Services to improve going forward.

#### *Our commitments*

If I am talking up here 20 or 30 more minutes I would like you to leave with these messages, these are the headline messages that you should walk out the door with; we stabilised the business in 2009/10, we had better controls over our contracts that we are doing and we are improving our current performance on our existing contracts. Operating cash-flow will be positive in 2011/12 – we will need a substantial improvement in 2010/11 to get that done – and finally we will return to growth in 2012/13. I will talk about some areas of the business that we will invest in to make sure that happens.

#### *BT Global Services summary*

So, the mission for Global Services: as Ian said, you come in and you say, 'It's the same.' We want to be the global leader in managed networked IT services. Our primary markets are large multinational corporations and public sector organisations; we are in several domestic markets

today where we provide services to both the national and the MNC market. The way we are going to do that is to be a global organisation, because many of our customers in our target market are global. However, you also have to deliver locally because they are in a lot of different countries in the world. We are in a great position because today we operate in 170 countries around the world and, if you look at our customer base, many of them are already there. So, the mission of Global Services is unchanged.

## **2009/10 Performance**

### *Orders and revenue*

Let's talk a little bit about 2009. Our order intake was £6.6 billion and we are relatively pleased about that. I went back eight quarters here to show you that we are a seasonal business, so usually our fourth quarter is a little better. I would say that what we are seeing in the market are some delays in certain contracts, so you tend to pursue contracts – you either get them in the quarter or not – and it is important for where we are not to push that too hard, so we took the fourth quarter and I was relatively pleased with that. But we expected a better than average quarter last year; before that the run rate was £1.5 billion a quarter and you see we ended the quarter at £2.2 billion. There are some pricing pressures; we are seeing that specifically in the UK and I think we are holding our own. I don't think we are seeing anything other than other telcos that operate in the UK or globally.

Our revenue has declined by 1%, primarily driven by mobile termination rates that are in our European business where we team with Sally. Also our traditional products here in the UK, calls and lines, were boosted back up by our newer products like Ethernet and our core MPLS offerings that came back to about a 1% decline year on year.

### *Indicative revenue by sector*

I thought I would give you some colour – and I think earlier somebody asked the question, 'What exactly is your public sector business?' – so here I am just trying to break down that total revenue and give you some sense of the risk profile by geography or if there is any one particular part of the business that brings risk. Actually, we have a pretty balanced portfolio when you look at it; 26% of our business comes from the public sector, but you can see 47% of our business actually comes from domestic markets, many different verticals around the world, MNC customers and so forth. It is a nice balance in that you look at that and you can see we have a flexibility to respond to certain dynamics in the market that may happen over the next few years.

### *Major contracts: portfolio analysis*

If you took a look at our current contract profile, we are a business that is in the 'long-term business' business. We sign three to five-year deals typically that is the sweet-spot of what we sign but, here I break out on the left side of this chart, to give you a feel of our current portfolio, you can see 10% of our business actually does churn quite heavily. It is traditionally the calls and lines business that is more UK-centric and so forth, but you can see that we sign some very long-term contracts where we provide services to local authorities and the like. Also, if you look on the right side of the slide, I am trying to give you some sense of how often that turns over; you can see here in the last few years roughly 50% of our current portfolio has turned over. We had the opportunity to re-compete, so there is some risk to that – we do pretty well in the re-competes and I am pleased with how we are exiting those renewals – but

it also ensures you, as a trusted investor of us, that that new portfolio has been through the risk profile and all of the processes we have put in place over the last couple of years, it actually went in around 16 months ago.

#### *EBITDA and costs*

This is how we ended the year from an EBITDA perspective; again, earlier I said it was a year of consistency, promising on our commitments and delivering on them. You saw EBITDA expand through the year and roughly about 6% of costs came out of the business. So, how did it come out? There were really four major cost programmes that were implemented in 2009/10; roughly 6,000 people came out of the business in the operation. Some of that was brute force but was really about taking slack out of the business and just getting more focus on execution and delivering on the promise. Our quality actually went up to our customer base so it proves that we can take people out of the business without impacting quality negatively. Again, I said the business is too complex; there were quite a few acquisitions, we are a large organisation and there is always room for simplification so we have been focused on our product portfolio where we have obsolete products. We have just simplified that and taken them out of the portfolio. I think Clive took you through many of the systems activities where he is consolidating and rationalising systems, and we are taking advantage of that in Global Services. We eliminated 84 systems this year and we deliver services from BT sites from around the world in a lot of different sites to our customers and we actually closed 100 of those – I think you saw on Clive's chart where we have targets on what we will do on site consolidation and network rationalisation.

That leads me into the section here which is network rationalisation. We spend about £3.4 billion on networks; we spend inside, we buy local access from our supply chain and we took about £80 million run-rate out of the business on an annualised basis. That is getting better focus with the top 40 in the supplier management programme, primarily focused on local access that we are buying, but we are closing networks. A great example of that is we closed our ATM frame network this year and we are going to take advantage of that network closure over the next two to three years.

Finally, we spend a lot on non-telco spend – about £2 billion – and we took about £100 million out of there; again, that was the top 40 suppliers as well as taking a look at the Global Services-specific supply chain and then added our activities to it as well.

#### *Cash flow*

Now, those will continue through this year and next because they are working; they delivered on the promise this year, there is no reason to change that and we will keep them through 2010/11. The net result of that is cash flow has improved; as Tony said, we halved cash flow year over year and it is a great improvement. We are not satisfied with that but we are making good progress. I will talk you through the four cost-reduction programmes, primarily focusing on supplier agreements – we took money out of the new equipment that we are spending in our capital plan – and we also saw capital improvements in the deal structures. When we do new deals with clients we are using leasing mechanisms and third-party financing to make sure that the capital load of bringing in new customers and acquiring them is also less to us, and then we refocused the portfolio on core portfolio items and things that will be important to our customers and target markets over time.

So, 2009/10, a year of stabilisation; I would like 2010/11 to be where we substantially got after the turnaround of Global Services. There is still work to do in that area and, as Ian reminds me, there is always a lot to do. Prior to getting into 2010/11 though, I thought it would be good to just open up the covers and talk a little bit about Global Services and the business models.

## **Business review**

### *Structure*

Last year when we talked about Global Services we talked about three go-to-market areas. Those are unchanged; our multinational customers (which I refer to as MNCs), we have our enterprise business – which really when you look at it is a set of domestic markets and we have a lot of professional services people in this part of our business – and finally the UK which in some aspects is just another domestic market. It is a big domestic market because we just happen to have a lot of strength and power in that market but I am going to talk about the UK specifically because it is an important part of the business. They are roughly a third, a third, a third; they are large and they have scale in their own right.

### *Multinational customers*

Let's talk about multinational customers. The addressable market there was roughly £100 billion last year and the three-year forecast on that for our portfolio is about 6.5%. We have about 400 customers in this part of our business; they are large, multinational clients and they are solving large complex problems. They are usually buying for one of several reasons; they want to take a fixed cost and turn it into a variable cost, they are trying to enter new markets or emerging markets where they are trying to get access to consumers, they want a proposal that will deliver value to them over time so they want to see a cost profile where they get price efficiency when they make the commitment, and they want to team up with a corporation that is going to make investments in new technologies to get them through some of the transitions they may not be able to do themselves, taking out them of legacy products, for example, and maybe making the transition to IP-based products. That is why these guys buy our services.

Now, we have some names on the top right of the slide and you can see logos that we announced through the year; there are a lot of nice names up there and this is a substantial part of our business. However, I think it is important to note that there are three key sectors that I want to focus on going forward that I think will be important to Global Services. One of the ones I wanted to take you through was our Financial Services sector; I picked this one primarily because many of you live and operate in this sector so I think you will get some of the value propositions I am talking about and it will help you understand what Global Services does in your industry. Roll the tape please.

BT's network connects over 14,000 financial sites around the world. The world's largest banks, largest brokers and largest exchanges rely on BT's infrastructure. The world's top exchanges, the world's top investment managers, the world's top broker-dealers and the world's top hedge funds rely on BT's large scale infrastructure.

(Wim Claess, Executive Director, Euroclear) "The BT solution demonstrated their client focus and their willingness to support Euroclear in realising a worldwide deployment of the new communication infrastructure for the single platform."

(Ignace R. Combes, Deputy Chief Executive Officer, Euroclear) "The work we do with BT is very important to support us in making sure that the client can properly access our service so that the clients always get the service that they need to have."

(Wim Claess, Executive Director, Euroclear) "The BT project team shows rigour and discipline combined with, when needed, the right level of flexibility."

BT manages the secure data networks for 90% of the UK's major financial institutions, carrying 80% of all credit card transactions in the UK, transforming retail banking across the globe.

(Craig Simpson, Head of Channel Systems and Change Management, National Australia Group, UK) "From a BT point of view we have seen significant change over the last two to three years. There is a real consistent knowledge of NAG now as opposed to BT, it is very much a partnership that has evolved and that is one that operates on various levels with NAG and BT."

One in three traders worldwide uses a BT turret, that is more than 6,000 traders in over 800 trading firms across 51 countries.

(Yann L'Huillier, Chief Technology Officer, Turquoise) "I think that due to the involvement of BT into the financial community in the UK but also abroad and in all of Europe, it is big part of the reason why today we have picked BT as a partner."

Winning global recognition in financial services, year after year.

### *MNC sector strategy*

So what does that mean? Well, I think industry-led solutions matter in our business. When we come to you in Financial Services we are not coming just as a network provider, we are coming with somebody who is delivering content that helps you run your business. You saw it in that short film but also I have seen it in my four months here. Outside the UK, I was on one of the exchanges walking the floor just trying to get an assessment of our technology and our depth. I am pleased to say when I was there on the floor looking at the legacy environment that the traders were using and you look over and see the new BT turrets going in, I have to say the customer there was very pleased with the execution. It was flawless, no interruptions, on time and on budget, and you could tell in those customer environments that we are actually a partner in getting the job done. We have got 33% of this market globally; if you walk into Europe we are underneath Visa Europe, we do three billion transactions a year whether they are credit card or debit transactions, so while we are business to business firm we touch consumers every day and we do that in a secure way. I think this is an example where we spent a lot of time and money developing a vertical strategy that is very successful; if the definition in the mission is to be a global leader in managed IT network services, this is an example of getting it done. We are part of the business and the way this industry runs. I think we can do that in other industries and that is why the MNC segment is so important to us.

### *Enterprises*

The second part of the business that I want to talk about is Enterprises and I will talk about this in the context of being in domestic markets that matter. So, we get a lot of questions: what

about Enterprises? What do you think about it? What is the strategic importance of enterprises? The fact is, depending on what domestic market you are in, 20-33% of the business that we run out of those markets is MNC business, so we are supporting the multinational. So, when I say, 'How do you deliver? Do you deliver globally? Or you are global but you deliver local?' well, part of the value proposition is being there. There is power in the value of the proposition to talk to a CIO in the US or in Europe and say, 'In the 8-10 countries around the world where most of your operations are, we are going to put you on BT assets and support you with BT people on the ground. I don't have to rely on deep supply chains and partnerships because it is our people supporting you day in and day out in those environments; they are drinking coffee with you, they are part of your environment, we are a logical extension of you.' So, the number one reason we are in this market is because the domestic markets are important to support our primary mission which is the multinational corporation.

Now, when I said, 'Why do they buy?' they buy because of those four reasons, but when you actually get into these markets they have large national institutions and governments and they are buying for the same reasons; they have the same technology issues that they have to get through, they have to make the convergence play, they are looking for long-term price performance and scale. They have the same issues and BT can help them get through that same process. It is really a combination of helping national and government markets in these domestic firms through that same problem, but also supporting our multinationals. Rather than take you through the details of the countries, you can see some of the taglines there. I think some of you might even be surprised that we are the number one challenger in many of these domestic markets, but we have commercial business and government business. I think probably the one I would mention here is in the fourth quarter we were successful in winning the Spanish Ministry; it is 260 different locations around the world, voice, data, bringing them together, plus all the Spanish sites within the country. We were successful against the incumbent, so this proves we can win in the markets and serve large institutions within these domestic markets that we operate in.

We also sell, with the help of Sally and her team, some international carrier business because they see value in the domestic markets we are in, so we do actually resell some of our network assets to give them scale in the region as well. In some markets where our networks go deep enough, we take advantage of that and it is also a scale business so we go down the market and we actually sell to small/medium-size businesses in those markets; primarily Italy and Spain would be the two markets where we are doing that.

#### *UK*

We are the leader in networked IT services in the UK; there is no doubt about that. We are number one because we have large public sector business – you know the names, whether it is the NHS or the MoD. The DWP is one I think I would like to talk about because it was actually my first customer visit here; I give Ian a hard time because when I was coming over he said that it doesn't snow here very much – I came in January and there was snow everywhere. Bad weather has its impact and if you are not inside the tent sometimes you don't understand how technology matters in making life better. This is a great example; Clive is very proud of the work at DWP because it actually represents one of the largest VoIP implementations in the world with over 100,000 phones. However, underneath that there is a set of call centres; 25,000 people that contact constituents that get services from the Department of Work and

Pensions every day and there are two million calls a day. So, what happens when bad weather comes along? They want to know if their benefits are going to continue and whether the cheques are showing up, so the calls may spike and maybe you will get three million calls a day. I was proud to sit there and see that those calls flexed across the facilities and it happened without incidents to their constituents. The reason is because we can combine the power of the technology and the men and women of BT making a difference for that department. That is the scale and the complexity; there are very few companies in my experience that can come in and solve problems at that scale and size for corporations and governments that need it.

We also have a local government business here and this is typically where we actually look more like a BPO firm; we bring our networks, we bring our process methodologies but we also serve local authorities along the lines of HR and benefits and revenue management and those kinds of disciplines. They are typically long-term contracts and I think they are good for those markets because we serve them well and they are good for the shareholder. If you look at the UK, we are talking about a third of the business here and the rest is actually spread across any industry that you want to name; we have reach and depth in any industry in the UK so our commercial brands cut across many different industries.

Finally, there is a volume business that is also important to us because we deal with that volume; it is primarily in lines and calls, and the way we get to the market is we go through desk-based accounting processes where we actually have calls and people who call out to get that volume and make sure we churn. That is typically churned at a higher rate and shorter contract links and that is how we get down the market. That is the UK. I won't take you through all the customer testimonies; they are up here and you can look at them. I will say this, though, I bet that most of you sitting out in the audience have a perception of BT today and it is primarily 80% on something that somebody else told you. Why? Because I don't have the boots and the stuff you can hand out – it is hard to touch my product, I am a service. It is a reference business; testimonies and reference clients are a big deal for this business and when I look at this I see value for money, I see a pair of safe hands that can deliver the value with a great work ethic and I see complexity being solved. That is a big deal; it is bringing value and it is one of the few things that I think BT can bring that there are very few select companies around the world in our business that can do the same thing.

#### *Global infrastructure*

Now, Ian thought he was going to get through this whole thing without having a network chart but I slipped one in because, in this business, Global Services, global matters. Reach is important; if we are going to have a commitment to a customer then reach is important. If you look at this chart you don't have to squint to see it; just look at the green colour because that is our core MPLS coverage. That says we are pretty decent from a standpoint of reach in this business; so, for us to deliver on the promise, having that investment and making sure that we can get access to the markets that our customers are going into is a big deal.

#### *Strengthened and focused portfolio*

That is part of the asset; we are a physical asset company so reach, scale and volume is important. Now, put on top of that 5,000+ professional services people. What do they know? They know mobility, they know unified communications, they know legacy technologies and

they know how to get from one legacy technology to the other. That is what those people know. They know security. So we basically combine the two assets which are our people and our intellectual capital with our physical access to go to market. How do we go to market? We go to market through eight basic capabilities. The network is at the centre of each one of those capabilities; it is not off-centre, it pulls our network through, it leverages what we do and it helps customers get through the transition. As I said, some customers are trying to get through the legacy transition and transformation within firms, and they are trying to get to IP-based technologies; so think of 5,000 people around the world that are aimed at those eight capabilities to help them do that. When I said we took our capital plan and we refocused it on our core systems and our core capabilities, these are those eight. The plan going forward is to primarily focus on those eight because we think it supports the mission to be global network IT leader around what we serve.

## **Future plans**

### *Our commitments*

Let's talk about the future. I am going to hit you again with the tagline: we are going to grow in 2012/13 and we have target investments primarily in the portfolio in Asia – in fact I was going to tagline based on earlier questions that this is actually the Asia presentation. My primary mission is to get this business to cash flow positive; in order to do that we are going to have to make substantial improvements this year to commit to you that the following year in 2011/12 we will be cash flow positive as a business. Finally, we have the roadmap; it is a question of execution. We see it, we know what we have to do, and it is just a plain execution issue.

### *Revenue*

I am going to touch on about five areas here and I am going to hit a couple of them just so you get a sense for over the next two years what we are all about. So, how are we going to grow? Customers are at the centre of that and the first thing you would look at is, what about the existing customers. If you took those 400 customers in MNC and you took the eight capabilities that I just took you through, the portfolio that we are investing in, on average we sell two of those capabilities to those 400 customers.

Let me repeat that: out of the eight we currently sell two of those capabilities. The number one plan is why wouldn't we go to our existing customer base? There would be lower sales and acquisition costs for us and as long as we are driving quality in the right way and we have their best interests in mind, we think this is one way where we can grow the business. Therefore, we will have sales teams focused on our existing customers primarily targeting those eight capabilities that I showed you in our portfolio.

Secondly, taking you back to the vertical offerings, the way we will go to market in our MNC business: three verticals. Why, because I think industry solutions matter and when you come you have to have content that solves the basic fundamental business issues that you are trying to do. It will have network at its centre. We are almost complete with the globalisation of our financial vertical. We have to sweep in our European operation and then Andy, the guy who is responsible for that today, will have a global integrated model around financial services. I want to do that for two other verticals. Specifically, I want to do that for our CPG (consumer products and goods) customers, and we have a very good portfolio in our pharmaceuticals

business. We will continue to look at those verticals and new content we can bring there to get in a similar position that we are in our financial services business.

#### *Capabilities*

The second is capabilities. We look at our profile of growth and what we are seeing is our core offerings are growing. Customers need higher bandwidths and they are putting more over their networks, so you will see us continue to invest in core MPLS; Steve took you through what is happening with Ethernet here in the UK and we think that is very fundamental; unified communications, security, CRM, and mobility – it is those eight that I showed you.

You will see us also launch some global offerings. We have launched those in the UK. Clive took you through the transformation that we are going through in our own data centres. The externalisation of that will be VDC, which is our virtual data centre offering, which is more like providing infrastructure as a service to the markets we serve. You will see us do some things around virtual private networks as well as hosted IP telephony in a global way.

We are going to have to invest in some skill upgrades. This is primarily our account management function, our relationship management function. We are going to reskill some, we are going to bring in some new talent, because I think we can get after our contract performance in a more effective way and we can make a difference there, not only in providing better returns for you as a shareholder, but I believe we can also uplift the skill sets and our customers will see the difference.

#### *Investment in key geographies*

Finally, Asia. When we talked about Asia internally I said, 'Let's not think about Asia as a geography. Think about Asia as an augment to the strategy of making our MNC successful.' If I see an MNC customer coming out of Europe or the Americas, you can pretty much guarantee if that is a global source that 20% of it is going to be in Asia, so there is Asian content because they are global sourcing. Therefore, you have to be in a position to make sure that you can receive it and deliver on a promise in Asia.

It is an £8 billion market for us. It is growing at 6% and that is basically taking the portfolio of eight things we do and saying if we just globalised our portfolio, we are not going into a specific country, we are just saying that you cannot buy today those eight services consistently everywhere. Therefore, all we are doing is we are making a portfolio investment in those core eight offerings to say which one of those should we invest in and provide to our MNC customers and the emerging MNCs that are in country. If you backed away from the strategy, it would be we do when well. Thus, number one is it is an investment in our MNC business. It is an investment in basically globalising our existing portfolio and going in behind our MNCs, so we do not have to take a risk on a specific country strategy because our MNCs are already going there. If you looked at our customer base, 80% of them are moving there and what they expect is we are already there. Therefore, we are investing in that to make sure that when they go into those regions we are there with offerings.

Now, we are also going to put some people on the ground and I want to talk about that because I think it is important from a solutioning and a risk management point of view. We have a common solutions process in Global Services today. We do it out of a BRC (bid response centre). That is a cross-functional set of team members that come together. There will be engineers in there, solution professionals, financial people who are doing financial

models, there will be people assessing risk, people doing integration. Therefore, think of it as a cross-functional set of team members that is the A team and you are going to push all your big deals into that centre. Why, because you want consistency, you want to be able to leverage your proposal management. If you have local access as part of those deals you want to have teams in there that keep currency to your local access prices around the world and you will connect that up to your supply chain. Part of that is 300 people we are going to put into Asia, because you do not want to go into Asia without globalising your solution, so at the end of the year we will have one in Dallas, one in London and one in Asia.

We will also complement that with our account start-up team. We have a very robust process now around account start up. I want to plug that in, in Asia so that as we begin to see the growth there we will have the SWAT team and the experts who understand how to start accounts up and can assist our client partners and delivery executives in starting those accounts.

Fundamentally, those are the two things that are going on in Asia. We are going to do some partnering for local access, so we do have some NNIs in the plan that Clive and his team are working on, primarily China and India, but we will continue to assess over the next two to three years what we have to implement as far as a partner strategy is concerned for that region.

#### *Profitability*

I do not want to comment here other than what we did in 2009/10 we are going to continue to do from a standpoint of network and suppliers. In our 2009/10 strategy we focused a lot on our non-telcos in the UK, so all we are doing now is going outside the UK in 2010/11, running the same strategy and trying to get our performance better on how we buy non-telco services outside the UK.

We have too many networks. Clive talked to you about the efficiencies we can gain by network closures and legacy rationalisation, but with every network there is a system tied to it and there are people tied to supporting it. We think that is a big deal, not necessarily a big idea. As Tony says, it is not rocket science, it is just execution and getting through those migrations.

Simplifying the business will come with network rationalisation and some of the other things we do, but we spent a lot of time in 2009/10 creating a shared service model and a common system for inventory management and asset management, so we have one solution. We moved a lot of our UK base to that one solution to make sure that we were getting returns on that, and we are, and that is the SDK stack that Clive mentioned. We will be taking our existing contracts to this platform, but behind that the people are in a shared service model, so we will do our change controls, asset tracking and so forth under a shared service model and will continue to move our base to that new model. Anything that is solution new that is what we are going to solution. It comes with the SDK solution and the shared service model underneath it.

Finally, contract performance, the account start-up teams. As part of that strategy we are fairly selective these days as far as matching the opportunity with how we deliver and how we want to work. That is what Tony said when he mentioned we are more selective in how we are going at the market. Commercial terms matter, payment terms and risk profiling also matter in there. We do have improved bid management and governance. What I want to do over the next year is make sure we have that applied globally, i.e. what we are doing in Asia.

*Operating cash flow*

Those five things come together and you will see substantial improvement. The number one agenda item is to get the business cash flow positive. There will be substantial improvement in 2010/11 with us returning to cash flow positive in 2011/12.

**Key messages**

To summarise, the mission is unchanged: a global leader in networked IT services. We operate globally with the capacity to deliver locally. The business has stabilised in 2009/10 and we worked hard to get that done. You saw us meet our commitments there. We are a much better business, but there is more to do and we see the roadmap, it is a question of execution. Cash flow positive in 2011/12 and return to growth in 2012/13.

Thank you very much.

**Q&A**

**Will Draper (Execution):** To what extent is the investment in Asia likely to delay your return to operating cash flow generation? Is it pushing it back a year to 2011/12, for example, and can you help us quantify what that investment might be in absolute terms?

**Ian Livingston:** Obviously, all investment in a particular year means the cash flow is less than it otherwise would be, but we think 2011/12 is a good return and given where we have come from, it is a good step forward. What we are not going to do, however, is in order to hit a short-term cash flow number, we are not going to undermine the long-term sustainability and deliverability of Global Services. The great news is we will be able to do both of these things. We are investing and whether it be in Asia, whether it be in rolling out a global Ethernet portfolio, whether it be in new bid response centres, whether it be in just renewing contracts sometimes where you might have a small cash outflow at the beginning, we will carry on investing in that. I hope you have seen for all of BT in all the discussion we have had that it is not about what we can do next year or what we have done this year. It is about what we do next year, what we do the year after, what we do the year after that. Tony used the phrase 'long-term sustainable' and that is what we want, a sustainable business and so we are not sacrificing short-term, but at the same time we are delivering I think what people want to see in the financials.

**Jeff Kelly:** With regard to what we are spending it on, it is a blend of people and investing in portfolio, so we are asking Clive to do some work on the extension of our portfolio. There will be some capital deployments, NNIs, and the rest are basically people, the 300 people I talked about with specific efficiency or functional backgrounds to build out the ASU and the BRC.

To complement what Ian said on the return to growth in 2012/13, you almost have to back up a little bit and say if we are going to go into Asia and extend our portfolio you are going to build out our solutions capability and that will take some time. Then you are going to have to add some sales people. They are going to have to generate some pipeline and then you are going to have to close them. It is a good 12-18-month process that you are working on, so if you delay that too often all you are doing is pushing back the profile of where you can grow.

**Ian Livingston:** The thing to understand also about Asia is we already have a business that is multi-hundreds of millions of pounds and we already have 5,000-6,000 people. We have quite an impressive Asian business that is present in all the major Asian countries and is already doing some very interesting things. For instance, we manage a lot of the software infrastructure that supports the Port of Singapore. So there is quite a lot already we have out there that we do and this is really building on it to help the MNCs, because one of the things we hear from the MNCs is as they are expanding they want us to go with them. That is important and that is what we are going to do.

**Maurice Patrick (Barclays Capital):** You have talked a lot about it being a scale business. Clearly, you are investing in scale in Asia and you have it in the UK. Are there other parts of BT Global Services which do not have scale which you would consider closing down or selling off and what are you going to do with those areas?

**Ian Livingston:** We are among the largest if not the largest provider of global networked IT services. We have very strong positions particularly in Europe, in South America, in parts of Asia-Pacific, as we talked about earlier. Scale is often a misused word as well. Buying a 30% share of a systems integrator in France, for instance, is not going to give us scale or whatever. There are a few businesses that are, frankly, non-core that we have been selling off and that we will continue to do. What is important is servicing our MNC customers and the support behind there. I do not think you should expect any major sell-offs or, frankly, any major acquisitions, because I think already you can see from the chart that had all the green in it that we are pretty well serviced for our customers and what we have to concentrate on doing is producing more products and services.

**Jeff Kelly:** I think the definition of scale is the question. When you step from Asia, you say well, the scale you are going for is we do when well. It is not that we are going in to invest like we have in Europe per se, because there are specific challenges with that. Therefore, the question is at what point are you saying you want scale?

As far as what things line up to Global Services, we are taking a look at that, but at this point, four months in, I will probably take some coaching from the guy on the right here and we will do what we think is right.

**Andrew Lee (Citi):** You mentioned at the start of the presentation that it wasn't the strategy of Global Services that was wrong, it was the execution. Presumably, pivotal to that was the contract structure, so I wondered if you could talk about how the average contract structure has changed or stands today versus how it was three years ago. In particular, if you could talk about the economic model that you use to look at whether a contract is viable when making the decision to go for a contract and also maybe the incentivisation of your sales people, whether that is on sales or margin or what.

**Ian Livingston:** I am in danger of forgetting the first part of the question. I think you started off a little bit with the wrong premise. There are some things structurally that were wrong in the contracts. I think particularly they were too capital-intensive. One of the problems was the infamous 15% EBITDA target: would you take a contract with high capital intensity giving 15% EBITDA over one giving 10% EBITDA with no capital intensity? Obviously, you should take the latter. Perhaps the whole way the incentivisation might have worked internally and externally was to cause us to do the wrong thing. We are being far clearer about the use of our capital for

where we get return. I know, as Tony would like to say, it is not rocket science, but we are getting better at it.

However, the bigger problem was not so much that, although there were elements – you can always criticise certain Ts & Cs and things like that. It was the execution involved and Jeff should talk more about the process of what happens when we win a contract. Usually, if a contract is going to go wrong, it starts going wrong pretty quickly and we didn't have the processes necessary to get going at pace with it. This meant that usually there would be a crisis, quite often 100, 150 days into the contract and we would usually get it right eventually and we were not particularly worse than our competitors, but you had to throw a lot of resource at it. It also meant that you did not have the relationship with the customer where you can manage the contract in the right way and we did not manage the contract in the right way and you can see time after time after time the difference between a well managed, well run contract. It a) delivers big cost reductions over the life of the contract; b) good profitability; and c) a lot more revenue, because you can sell a lot more and you should be looking to sell a lot more into a contract. It goes back time and time again to the execution.

**Jeff Kelly:** I guess I would answer that in a couple of ways. As far as inside with the governance process, I think we have a more mature process on governance depending on the size and complexity of the transaction. In those discussions we have a lot of eyes on those at this point and it is really trying to look at what is the risk profile and the value proposition. For example, recently one came in where there were a lot of TUPE requirements. We had to guarantee employment for a long period of time. We could not move to our core network, so we did not get any leverage, so when you look at it you say how are you planning to make money, what is the core value proposition? We have that process in the governance process, but we also underpin that with a risk assessment tool where we look at hurdle rates based on a risk profile. There are probably 50 different items on there, such as, have we done this before, how many countries do we have to do it in, have we done it in that specific country, those kinds of things, the profile of the Ts & Cs themselves. That gives us some feel for risk in general and then whether you apply a hurdle rate to that has been done in several ways. We look at that should have a higher margin profile because we are taking a greater risk and delivering higher value.

**Mark James (Liberum):** Just sticking with contract recognition can you talk a little bit more in terms of the £100 million you brought forward? Was it one contract, was it lots, does it automatically mean a shortfall in FY 2011? Can you just talk about the mechanics of that process of revenue recognition?

**Ian Livingston:** The mechanic is we actually completed a milestone early, so we did not really have a choice. Frankly, I would prefer to have recognised it in Q1; that would have made things a lot simpler. It is just we have to recognise it when we earn it and that is what happened. It came with the costs associated because you recognise the costs at the same time. It is unusual to have such big milestones. It is unusual, but in this particular contract it did happen. Otherwise I guess, yes, we would have had more revenue in Q1 and that is why we have tried to highlight and subtract it off. I hope you see as we talk to you, we spend a lot more time highlighting the reasons why things are not quite as good as they might appear, as opposed to spending time on why they are better than they might appear and that is the way I would like it to be so you understand this quarter. In the next quarter, Group-wide revenue will

be weaker than it otherwise would be and probably it will be the worst quarter of the year. We will see, but it is possible it will be as a result of that.

**Mark James:** I understand about Q1, but I wondered if they are multi-year contracts and they are running ahead of schedule if you get the ability to hit further milestones in Q4 of this year on this.

**Ian Livingston:** It is a build and supply-type contract where that happens. It is unusual in structure. You get much smaller milestones in most contracts. This was unusual, but it happened and we just wanted to point it out so you know what it is. It has not had an effect on EBIT, but it does have an effect on revenue of £100 million and it was something we just wanted to pull out.

**Steve Malcolm (Evolution):** I have two questions, please. Firstly, I guess we get a reasonably good read on the revenue growth from the order book, but the revenue performance is better than the order book performance and so I guess there is an issue on contract life. Can you tell us what is the average life of contracts being booked at the moment compared with what it has been and how that maps into revenue growth going forward?

Secondly, to touch on a point earlier, I guess we are a little wary of global managed data network businesses. Can you just tell us how you manage the relationships between country managers and account managers and whether Asia-Pacific has to be profitable in its own right, whether it has to be there to secure existing business, whether the account manager runs the profit centre, how we think about that?

**Jeff Kelly:** First of all, I gave you the profile of the contracts that are in the structure today and the sweet spot is really 3-5 years. You can do the maths on 50% in the last two years of the contract base, so 25% four-year deals, you can look at that and say we are doing on average four-year deals.

**Steve Malcolm:** Is that shortening?

**Jeff Kelly:** It is shortening, but I would say the 3-5 is steady; if anything, the 7-10 is coming back at us a little bit. There is a lot of churn business that we do on top of our existing accounts and then we have traditional lines and calls, which are typically a year long and I do not see that moving because it is already pretty short. It is really what will be the movement in the 5-7-year deals. We will probably do smaller deals, at least that is what we are seeing, and we will do them closer to 3-5 instead of the 7-10.

With regard to your second question, if we use financial services as an example, if that was a global vertical, my idea of a good time there is there would be a head of banking, a head of insurance, a chief engineer and a COO for that segment so that when we walked into any large bank or financial institution, Andy and his team comes in with 'This person is responsible globally for wherever your operation should take you'. So you have global account management and you map the resources to that, whether they are leveraged, because we will have leverage models under here and those will differ. If we are selling voice services it will probably be a thin layer because it is a highly leveraged service. MPLS is highly leveraged, so you might run a thin account model, 10%/90%. If we are talking one of our more customer environments, you might run a model that is more 70/30 or 40/60.

When it hits a geo you basically say 'within the geo I am going to point it both ways, so I am going to incentivise them both ways.' For instance, if we were in Italy the country manager is going to get the target but he does not run the account. The global vertical runs the account. However, from a workforce planning, works council viewpoint you have to do it by country and HR-wise people tend to think their careers are in those countries and so if it needs help or resourcing or if you are running a bank in the US and you need a sales team in Italy you want the Italian team motivated to get it done.

Think of it as a global account that runs this way. When it intersects with a geography you give the domestic guy a shadow target, if you will, so he is interested in helping you sell and deliver.

**Steve Malcolm:** Is the rest of the target aggregated at a country level?

**Jeff Kelly:** Yes. In essence, you are giving them the statutory P&L, if you will, because it has been my experience that if you do not incentivise them one way they do not necessarily come to help and you have to do that. On the other side, if you put it too local then you will get the comment, 'When I did this transaction I thought I bought the bigger BT and what I am seeing is more of a local BT', so there is some magic in how you do it and you have to get the right leadership to make that work.

**Ian Livingston:** We lost a lot of global scale advantages because I think we became too localised and servicing MNCs local by local by local makes it very difficult to have a single solution. I think it is absolutely different if you are servicing SMEs in individual countries and I think the new structure very much gives a better balance and it is why we are splitting between enterprises, which are going to be far more country by country, and MNCs, which are across the piece.

**Jeff Kelly:** I do not want you to ask me enough questions that I go beyond Steve's time, okay? I will never live that down.

**Steve Robertson:** You already are, Jeff.

**Carl Murdock-Smith (JPMorgan Cazenove):** I will just ask one then, but Steve might want to chip in. Just going back to the slide where you cut it into the silos of the three divisions, I guess I am slightly surprised that the profitability of all three seems quite similar on the EBITDA margins. I would have expected, given what you have been saying about the strength in the home market and scale, that the UK would be better. Is that due to some mix in there, due to some very low EBITDA margin contracts in there and am I being sensible, I would expect the EBITDA margin in the UK to be better than the others over time?

**Jeff Kelly:** What we tried to do is give you as accurate a picture as we could today, so there are some contract provisions in some of those numbers that would have impacts as you are looking across each of those segments.

**Ian Livingston:** I think the other thing to remember is the UK relies on someone else's network mostly – this is where Steve and Sally come in – so it is less capital intensive than the other places. Therefore, when we measure EBITDA, if you looked at return on capital you would probably get different numbers, but a lot of other parts where you get some of the profitability, for instance, Enterprises has run its own network at the EBITDA level but more capital. However, they are intentionally rounded numbers displayed because there is quite a lot of allocation. That is contribution and there is still quite a lot of allocation in there. Over time,

I think the important thing is the totality goes in the right direction and that is what we will be focusing on.

**Nick Delfas (Morgan Stanley):** On that subject of margin, is the NHS contract still cash-losing and is there any chance of being able to get rid of that one now?

**Ian Livingston:** We are not seeking to get rid of that one. Bear in mind we have a number of NHS contracts. N3, which is providing networks for the NHS, is doing absolutely fine. It is a very standard network contract, looking at renewing and extending. You have the Spine which is up and running and working pretty well. The Local Service Provider is the one people tend to focus on and that does tend to be lumpier, but we are providing that a lot better. You have just seen Kingston Hospital went live a number of months ago and we had St George's that went live recently, the big acutes are going live and we are also doing a lot of the community trusts and mental health trusts and they are being very successful, so that is rolling out. I suspect that whole programme may change a little bit in shape, but most of it is there and running nicely. The LSP is probably slightly different and we will continue to work with the customer. We signed a new contract called CCN3 to renew it. The other people who are doing this, CSC, did not, because I think they are less progressed. Hopefully, that provides a little bit more certainty, but we have been honest it has been a problematical contract that one.

**Jeff Kelly:** I will not comment specifically on any contract, but I would say it this way. When you take a write down it does not necessarily follow the cash, so if we are in a position where a contract is losing cash then the strategy will be to work with the customer to get the opportunity to match our revenue with our cash flow. They are long-term contracts, it is a journey. I think the nice thing about our government business is we are delivering. On that particular one there are a lot of people who are not delivering. We are delivering. I think you get the opportunities in situations over that long period of time. We continue to negotiate and work together to get your cash profile where you need it.

**Andrew Beale (Arete):** I want to come back to the question about contract profile. One of the charts you presented showed 40% of contracts in 2006/07 or before and you also showed the distribution of length of contracts and obviously those comments earlier. I guess that means you have a fair number of re-signs coming up over the next year or two and obviously your order book is 6.6 against a revenue of 8.5, so I am just trying to get an understanding of the magnitude of trough before you get back to growth in 2012/13.

**Jeff Kelly:** Remember we did cut the sales capacity, so when I look at yield and I do not want to get into win rates specifically, but if you just do the maths on the profile of those contracts you can assume about 25% of our book of business comes up for renewal. When you are doing 3-5-year deals that is how it is going to work, so we have to deal with that over the next two or three years. If you are going to grow, you better have a pretty decent renewal win rate. I would say today we are at market or better, so that is not going to be a big issue. The question is how much price performance you have to get to win the renewal. You guys can put your numbers on it; we have an opinion on that. I think our quality of service is good enough to get the renewals we need, then it is a question of what do we invest in to get the sales. I think we have, personally, a great opportunity with our MNC customers. I was very surprised to find that of those eight capabilities we are only, on average, driving two of them in there. That is part of getting the right people on the ground with the customer with the right value

proposition and driving the portfolio in there. Therefore, our existing customers will be a key part of the plan.

**Ian Livingston:** Bear in mind do not associate the £6.5 billion contract wins with the revenue, because there is also revenue that is not under contract, so you have to add to that in order to get to the right sort of number. In addition, it is not just about renewing existing contracts; it is also about winning new and, as Jeff says, selling to the existing better. As a Group, we said that we are going to have improving revenue trends from 2010/11 onwards and I do not think we can do that if Global Services were having a big trough. That is a bit of guidance for you, as it were.

**Participant:** The other divisional CEOs talked enthusiastically about the operating cost savings they were getting on 21CN, but Global Services does not seem to have had those. Is that because it is just taking time to work its way through and will it be your turn this year, next year? Perhaps you could just comment on that. I know the model is a bit different on your buy and the build model is a bit different, but at some point there should be some benefits in the whole centralisation programme.

**Jeff Kelly:** Yes, I do think we will see the benefits of that in Global Services. We are seeing it now, whether it is in our rates from our core leveraged solution. I did not necessarily put it out there, just because I think the primary driver for us is the number of sites that we deliver service from – I am talking globally – and the number of networks we have in the structure that have systems tied to them and then employees tied to them. From now until the time we are cash flow positive there is a lot more leverage in there for me if I can just get through that execution. The driver there will be there are customers involved in some of those migrations and closures, so you have to bring them along and make sure that you have the right quality assurance and so forth, but those are the big drivers in the next two years.

**Ian Livingston:** Thank you very much. Thank you, Jeff.

## Concluding Remarks

Ian Livingston

*CEO, BT Group*

### Acknowledgements

We are almost finished, but I have a couple of announcements before we do. First of all, thank you to all of you for staying through the day and the questions. Your interest is very much appreciated. For those whose questions we did not manage to answer, apologies, I am sure the IR team can help and even maybe put you in touch to have discussions with some of the lines of business teams if there is something substantial to talk about.

Thank you to all the conference team, the AV team that has done all the work, and also to all the people involved in preparing everything. As you can imagine, there is a fair amount of work in this and much as I would like them all to be getting back to doing their day job I just want to say thank you to IR, the Strategy team and all the lines of business that helped in this.

Finally, before I sum up, there is a little goodie bag for when you leave. Do not worry, there is nothing in it that your compliance department will worry about; it is not that level of value. Please pick one up, there are some vouchers and things like that.

**Key messages**

I just want to sum up the key messages. We are making progress, I hope that is clear. We have tried to set some clear objectives. We have tried to set them financially and operationally for you and I hope you have seen that. We have investment plans. We are not going wild; these are targeted investment plans and the numbers we are giving you are after paying for them. We are not asking you to make a choice, a choice that says we either invest or we deliver profits and dividends. We want to do both of them and that is coming from our operational improvements. We are going to deliver, therefore, growth in revenue in 2012/13, growth in revenue in the periods running up to 2012/13, growth in cash flow and growth in dividends. That is what we mean by growth, because growth at the top line if it does not come through is worth less than nothing.

**Summary**

In summary, the often quoted words: progress made, not only is there a lot to do, but the really good news is there is a lot more that can be done. Thanks for your time. Thank you.