



BT Payphone Business Model

Profitability Assessment

Version 1.0

02 October 2017

Prepared for:



Version History

Version	Date	Author	Changes	Distribution	Approval
1.0	02/10/2017	Cartesian	Final version for client	Vodafone	Cartesian

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Contents

Executive Summary.....	4
1. Introduction	5
1.1. Context	5
1.2. Objective and Scope	6
1.3. Report Structure	6
2. Methodology.....	7
2.1. Model Structure.....	7
2.2. Research methodology.....	8
2.3. Business Model Limitations.....	8
2.4. Main Cost and Revenue Components	9
2.4.1. Cost Components	9
2.4.2. Revenue Components	13
2.4.3. Volume Components.....	14
3. Key Findings	16
4. Final Considerations.....	18
Appendix A – Glossary of Terms	19
Appendix B: BT InLink Initiative	20

List of Figures

Figure 1. BT’s Payphone Evolution.....5
Figure 2. BT Payphone Overall Business Model Structure7
Figure 3. COGS Definition and Methodology9
Figure 4. SG&A Costs Definition and Methodology10
Figure 5. Capex Definition and Methodology12
Figure 6. Revenue Components Definition and Methodology13
Figure 7. Volume Components Definition and Methodology14
Figure 8. Overall BT Payphone Business Model Assessment Results (in £ units Per Annum) 17
Figure 9. BT’s InLink Kiosk Features20

Executive Summary

It is apparent that BT's payphone business has undergone significant change over the last 20 years. However, there is very little information in the public domain regarding its current financial performance.

Within the scope of this study, Cartesian developed a model to assess the costs and revenue components incurred in BT's payphone business.

Cartesian built the model based on publicly available information and has developed its own estimates to fill the gaps where information could not be found. The model aims to provide an indication of BT's payphone profitability.

The results and analysis presented in this report, and the supporting model, are based on an assessment of BT's payphone business as it stands today. We have not sought to forecast how this business may evolve over time.

The model provides some relevant insights into the possible P&L for BT's payphone business, the most significant findings are:

- BT's payphone business seems to be lucrative when all revenue sources are considered (i.e. telecom, advertising and ATM revenues);
- Advertising and ATM revenues are estimated to account for around 55% of total payphone revenue, making payphones a valuable estate for BT.
- Other than line rental, costs directly related to the provision of payphone telecom services are not significantly high; and,
- Given the wider breadth of income that BT receives from payphones, the revenues from the Payphone Access Charge (PAC) may no longer be proportionate – it is questionable whether these fairly reflect the incremental costs associated with originating free-to-caller services from payphones.¹

The model estimates total annual revenues from BT's payphone business to be £36M, comprising of retail calls, wholesale, advertising and ATM. Cost of Goods Sold (COGS) are estimated to be £3.5M, driven mostly by cash collection and treasury costs. Selling, General & Administrative (SG&A) costs are estimated to be £17.1M, and we estimate depreciation to be £940k based on the age of BT's payphone estate. After costs, we estimate BT's payphone business generates Earnings Before Income and Taxation (EBIT) of £14.5M at a margin of 40%.

These figures are based on BT's current estate of 47,217 on-street and off-street payphones. BT has recently announced plans to decommission 20,000 payphones over the next five years. As those payphones are likely to be less profitable than average, the overall margin of the payphone business can be expected to increase as a result.

It is important to note that the amount of publicly available data on BT's payphone business is limited and therefore the model and results are heavily reliant on Cartesian's estimates. If more data became available, it would be possible to update the model inputs to increase the accuracy of the outputs.

¹ In 2004, BT made a voluntary commitment that the PAC would continue to be "reasonably derived from cost".
https://www.ofcom.org.uk/data/assets/pdf_file/0025/49633/statement.pdf

1. Introduction

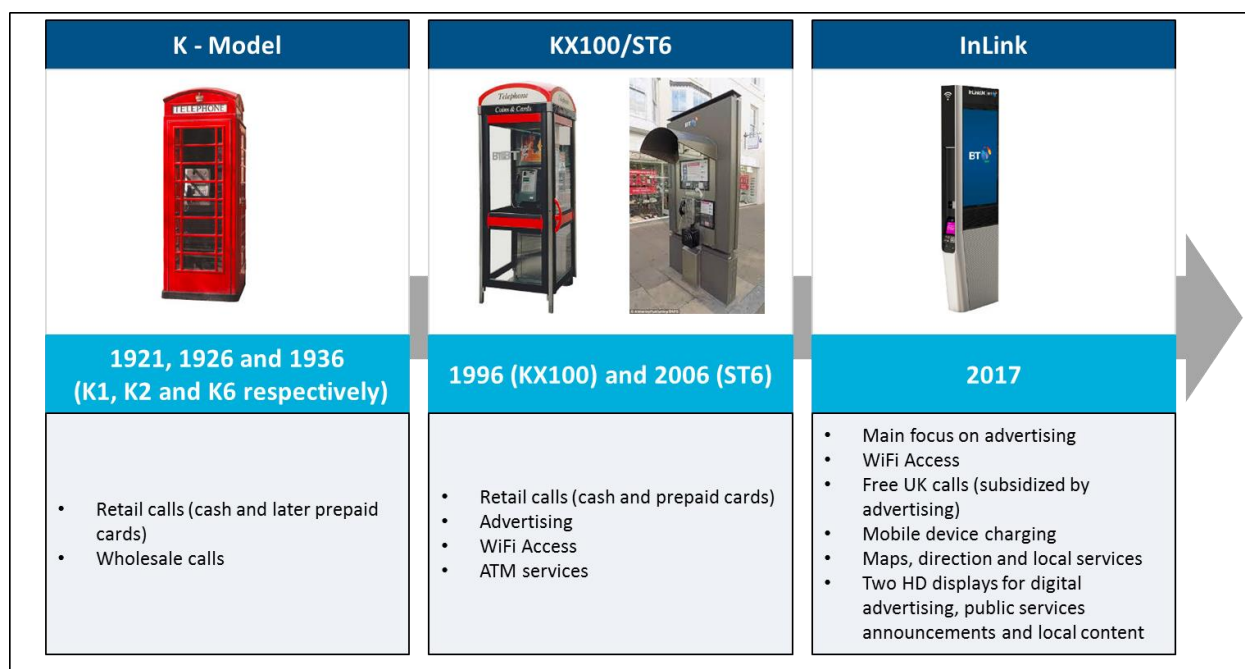
1.1. Context

The humble British Telecom (BT) payphone business has undergone a substantial makeover from its debut as the K1 model in 1921, followed by the traditional red K6 model in 1936, and later, to its transformation into the more widespread, and modern KX100 and ST kiosks. With each transformation, BT has evolved its payphone business model to fit changing cost structures and consumer demands (see Figure 1).

Up until the launch of KX100, payphone revenues were generated solely from calls. However, the design of the KX100 opened the potential for it to be used for outdoor advertising. Since then, BT has developed agreements with advertising companies such as ClearChannel and JC Decaux to explore its payphone estate.

BT has continued to evolve the payphone, and introduced digital display advertising in the ST6 model. BT is now trialling InLink models, which feature prime advertising displays, local services (e.g. maps, directions and local news), mobile phone charging and Wi-Fi access. The InLink business model is purely based on advertising. The kiosk will offer free services to the user (including free calls) which will be subsidized by advertising. The InLink initiative is structured as a separate business arm from the traditional payphone business (and as such has been excluded from our analysis).

Figure 1. BT's Payphone Evolution



Source: BT

In terms of payphone usage for telephony, the volume of calls has declined by 90% in the last decade. This is largely due to increasing mobile penetration. Consequently, BT has initiated a programme to decommissioning unprofitable payphones. The number of payphones in the UK reduced from a peak of

Cartesian: BT Payphone Business Model - Profitability Assessment

92,000 in 2002 to the 47,217 that remain in service today. In August 2017, BT announced plans to scrap a further 20,000 payphones over the next 5 years.²

It is apparent that the payphone business has undergone significant change over the last 20 years. However, there is very little information in the public domain regarding its current financial performance.

1.2. Objective and Scope

The objective of this study is to estimate the profitability of BT's payphone business.

The scope of the analysis includes direct and indirect costs to BT of operating the payphone business, and revenues received by BT for telephony and other relevant services.

The analysis considers all the 47,217 payphones (street and off-street) currently located in UK. The report includes the segmentation between traditional red payphone boxes (i.e. K model) and the most modern ones such as the KX100 and ST models.

As mentioned above, the InLink payphone model launched in 2016 has been excluded from the analysis as its deployment is at an early stage and the impact on the overall business is unclear. Further details of the InLink initiative are provided in the appendix.

1.3. Report Structure

This report is structure in four sections:

Section 1 introduces this report covering context, scope and objectives.

Section 2 explains the methodology applied to assess the payphone business model, including the description of main revenue and cost components as well the details of the key assumptions considered.

Section 3 provides the key findings from the assessment.

Section 4 brings the final considerations based on the key findings from the assessment and proposes relevant areas for further investigation and discussion.

Appendix includes the glossary of terms and provides an overview of BT's InLink initiative.

² <http://www.bbc.co.uk/news/business-40934210>

2. Methodology

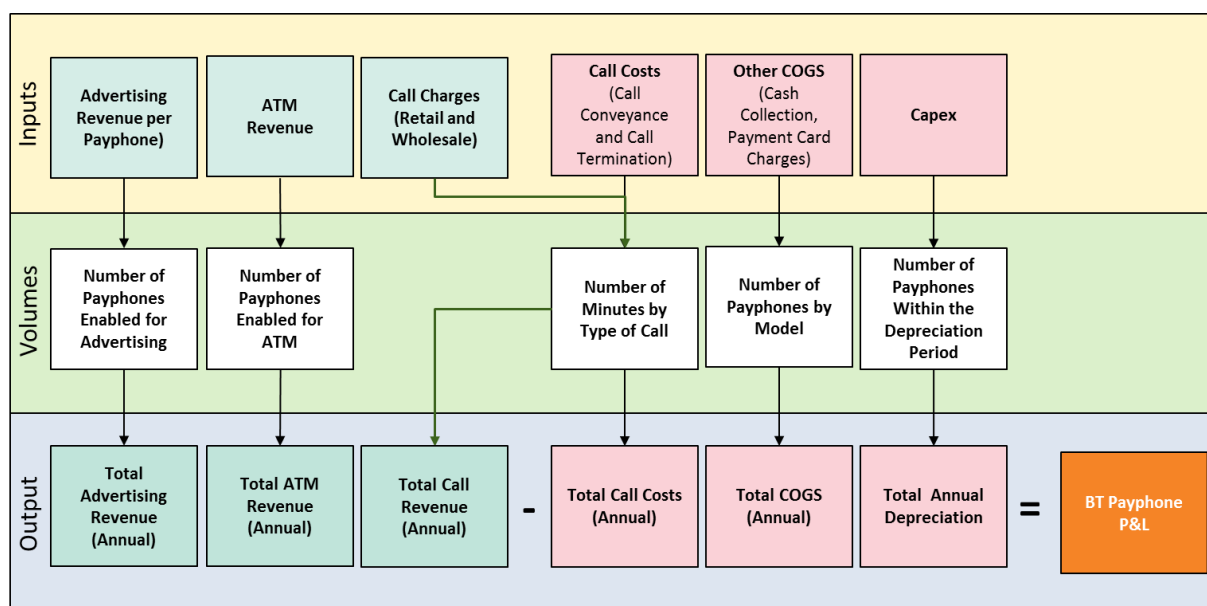
2.1. Model Structure

To assess the overall business model for BT payphone business, we developed a model to estimate the annual income statement for the business. The income statement subtracts BT’s payphone costs from the revenues to determine the profit. Capital costs on the income statement are reflected as a depreciation charge, using straight-line depreciation and historical cost accounting.

The model structure has three main areas (see Figure 2):

- **Inputs** include the main costs and revenues. Costs include call costs, Costs of Goods and Services (COGS), Sales, General and Admin (SG&A) and Capex. Revenues consist of call charges (retail and wholesale), ATM and advertising revenues.
- **Volumes** include the number of total payphones in UK segmented by model, number of minutes by type of call (mobile and fixed, geographic and non-geographic, on-net and off-net) and number of payphones within the depreciation period.
- **Outputs** consolidate the calculations between inputs and volume and they provide the results for the overall profit assessment.

Figure 2. BT Payphone Overall Business Model Structure



Source: Cartesian

We provide more details about the assumptions used and method applied for calculating each cost and revenue component in the later part of this section.

2.2. Research methodology

We conducted both primary and secondary research with the objective to collect either direct inputs to the business model or data which would inform our estimates.

For the secondary research, we searched for information in press releases, Ofcom publications and the BT price list among other sources. For primary research, we contacted local authorities and commercial landlords to obtain information on payphone site rental. We also contacted advertising companies to obtain a better understanding of street furniture advertising business model.

2.3. Business Model Limitations

We built a model which simulates the business case for BT payphone services. The aim of our model is to provide a reference in terms of all cost and revenue components involved in the provision of payphone services by BT in UK. There is no intention to assert that the model intends to provide a complete accurate representation of BT's costs and revenues.

The main limitations that have constrained the assessment are detailed below.

Available Information	There is relatively little public information regarding the finances of BT's payphone business. BT has no regulatory obligation to publish a financial statement for its payphone business.
Input Assumptions	We have based our model on a series of assumptions to overcome the challenge of finding specific data points in the public domain (including estimates for new revenues sources such as advertising and ATM). Whilst we believe our assumptions are reasonable, the accuracy of model can be improved if better data becomes available.
Payphone InLink Model	We did not include in this report the recently launched InLink payphone model by BT. The new InLink Kiosks were just launched in October 2016 and it is still premature to assess the impact they will have on the overall payphone business model.

2.4. Main Cost and Revenue Components

2.4.1. Cost Components

We segmented the costs associated with the provisioning of payphone kiosks and services into three main categories: COGS, SG&A and Capex.

COGS includes costs related to retail activities such as cash collection and credit card commission and wholesale costs including call termination and call conveyance. All cost categories, their values and methodology applied are detailed in Figure 3.

Figure 3. COGS Definition and Methodology

Cost Type	Cost	Definition	Methodology	Value	Source
Retail	Cash Collection and Treasury Costs	Costs related to cash collection from a payphone booth, cash transport and accounting	Assumption based on 1 collection per week over 35 weeks per year at a rate of £2 per collection	£70 per payphone per annum	Cartesian Assumption
	Credit Card Commission	Percentage paid by BT to the company managing credit card transactions	Since the call price using a credit/debit card are significantly more expensive than cash call price, and there is a partner managing the whole payment platform, we assumed a higher percentage than the usual 2-3% commission	20% of credit/debit card calls revenue	Cartesian Assumption
Wholesale	Fixed Call Termination	Costs associated with BT terminating a fixed-line call in another service provider network	Blended tariff calculated from BT price list applying an assumption in terms of traffic per time of day (i.e. daytime, evenings and weekends represents 60%, 20% and 20% of the overall traffic respectively)	£0.132 ppm	Ofcom
	Mobile Call Termination	Costs associated with BT terminating a mobile call in another service provider network	Regulated price publicly available	£0.5 ppm	Ofcom

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Cost Type	Cost	Definition	Methodology	Value	Source
	Call Originating	Costs related to originating a call on BT Payphones	Cost available at Ofcom's website. Costs related to helpline calls are excluded since BT recovers these costs by charging Wholesale Origination Charges	0.2 ppm	Ofcom
	Transit	Transit calls incurred from calls originated on BT payphones	Costs estimated based on BT Price List Costs related to helpline calls are excluded since BT recovers these costs by charging Wholesale Origination Charges	0.07 ppm	Cartesian Assumption

Source: Cartesian

For credit card commission, we assumed 20% charge over the total revenues from calls generated by using a credit or debit card. Although we understand that retail credit/debit card commissions are usually on the 2-3% ranges, we understand that the BT payphone business outsources the entire card platform to Creditcall Telecom Limited. Moreover, the call rates when using a credit/debit card are significantly more expensive than a call using cash. Consequently, we assume that BT is paying a commission higher than the average retail fees.

In terms of SG&A costs, all cost components, their value and methodology are described in Figure 4.

Figure 4. SG&A Costs Definition and Methodology

Cost Type	Cost	Definition	Methodology	Value	Source
SG&A	Site Rental	Costs related to renting the land space occupied by a payphone booth (applied only for payphones located in privately owned spaces)	Based on the Valuation Office Agency Rating Manual (section 1035)	£100 per payphone per annum	Valuation Office Agency Rating Manual (section 1035)
	Line Rental	Costs associated to connect and maintain a telephone line at a payphone booth	Reference from Openreach Wholesale Line Rental (WLR) Premium	£114 per payphone per annum	Openreach
	Electricity	Costs related to electricity provisioning at payphone Kiosks	Assumes 60W standard bulb in each kiosk, on for 12 hours per day. 1 bulb	£18 per payphone per annum	Cartesian Assumption

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Cost Type	Cost	Definition	Methodology	Value	Source
			consumes 0.06kWh. Based on a typical unit price of 8p per kWh, the lights will cost .5p per hour to run		
	Cleaning	Costs related to cleaning payphone kiosks	Assumption based on 1 cleaning per week over 35 weeks per year at a rate of £2 per cleaning	£70 per payphone per annum	Cartesian Assumption
	Maintenance	Costs related to general maintenance and repairs/replacement due to vandalism	£6M annual maintenance costs including vandalism/theft assumption	£127 per payphone per annum	Press Releases
	Overheads	Management costs incurred in overseeing the operations of the BT Group. Costs within General Overheads include central corporate costs	Assumption based on the Cost Allocation Review Report published by Ofcom	5% over the total service cost	Cartesian Assumption
	Advertising Replacement & Maintenance	Costs related to fixing and changing advertising material at the payphone kiosk (including advertising maintenance)	Assumption that all advertising related costs are covered by the company exploring BT estate for advertising	N/A	Cartesian Assumption

Source: Cartesian

We calculated site rental values using assumptions based on the Valuation Office Agency Rating Manual. The value refers to payphones located in private lands (e.g. airports, shopping malls) which make revenues up to £2,500 per annum. Based on our research, we assumed that BT does not pay rental for payphone kiosks located on public streets.

In terms of Capex, we consider depreciation as the main Capex element. The depreciation is calculated over an assumed number of payphones which are still within their depreciation period.

To calculate the depreciation, we estimated the average cost for the equipment (£2,200 per payphone) and we capitalized the cost of installing and connecting the payphone, as shown in Figure 5.

Figure 5. Capex Definition and Methodology

Cost Type	Cost	Definition	Methodology	Value	Source
Capex	Equipment	Cost related to build payphone shelf, telephone equipment and panels	Assumption based on anecdotal evidence found via primary and secondary research for KX100 model: <ul style="list-style-type: none"> • £800 (shell) • £1,000 (telephone) • £400 (Panels) 	£2,200 per payphone	Cartesian Assumption
	Installation	Cost related to man/days used to install the payphone shell and telephone. The costs are capitalized.	Assumption based on a £300 per day rate, two engineers and one day to install	£600 per payphone	Cartesian Assumption
	Connection Cost	Cost related to connect a telephone line to the payphone kiosk	Openreach WLR connection charge	£45 per payphone	Openreach
	Depreciation	Costs related to an asset within the duration of its useful live	10-year depreciation	10%	Cartesian Assumption

Source: Cartesian

Cartesian: BT Payphone Business Model - Profitability Assessment

2.4.2. Revenue Components

We considered two main revenues segments for BT payphone business: telecom and other. In telecom, we included all revenues generated from retail calls and wholesale call charges.

We assumed that BT's wholesale revenue is generated mainly from the PAC charged over non-geographic calls. The PAC refers to the Pay Phone Access wholesale tariff charged by BT for originating calls to free to caller services from payphones. It is charged to the Communications Provider who terminates the call, with the call remaining free to caller for the consumer. In April 2015, BT waived the PAC from calls to voluntary organizations helpline numbers. We assumed that the calls to helpline numbers included in the BT's PAC waiver represent around 20% of total non-geographic calls volume.

Although we understand that a significant number of calls to free non-geographic numbers will terminate within BT network, we assumed that there will be an internal wholesale charge within BT Group. Therefore, the wholesale revenues presented in this report are from the total estimated calls to free non-geographic numbers (including BT's numbers).

In terms of other revenues, we considered advertising and ATM as prominent new revenue sources. We developed assumptions for these revenue streams to calculate the overall revenue per payphone per annum (see Figure 6).

Figure 6. Revenue Components Definition and Methodology

Type	Revenue	Definition	Methodology	Value	Source
Retail	Retail Call Revenue	Revenues generated from geographic and mobile calls generated from a payphone (cash and credit card)	Connection tariff plus tariff per minute multiplied by the total of minutes per annum.	Cash: 60 p + 10p per minute Credit Card: £2 + £0.27 (fixed-line) or £1.50 (mobile) 2.5 minutes for calls to geographic and mobile numbers 3.5 minutes for calls to non-geographic numbers	BT
Wholesale	Wholesale Call Charges	Revenue generated from wholesale charges generated from non-geographic numbers via Public Access Charge (PAC)	BT published price The PAC is not applied over helpline calls	£0.70 per minute	BT

Cartesian: BT Payphone Business Model - Profitability Assessment

Type	Revenue	Definition	Methodology	Value	Source
Other	Advertising	Revenue generated from allowing advertising companies to explore space on BT's payphone Kiosks	Assumption based of Advertising cost revenue share between BT and the advertising company considering 80% occupancy throughout the year	£1,011 per annum (BT's revenue share of 30% over £162 per payphone for a two-weeks period over 21 weeks, which represents 80% occupancy of total 26 weeks per annum)	Cartesian Assumption
	ATM	Revenue generated from renting the payphone booth to a bank to install an ATM	Revenue assumed to be £250 per ATM payphone per annum	£250 per ATM payphone per year	Cartesian Assumption

Source: Cartesian

2.4.3. Volume Components

In terms of volumes, we used several assumptions to estimate the total number of calls and minutes. We obtained the total number of payphones directly from a BT press release which states the current number of payphones in UK (see Figure 7).

Figure 7. Volume Components Definition and Methodology

Type	Revenue	Definition	Methodology	Value	Source
Payphones	Total number of Payphones	Total number of payphones in UK, segmented by model and location (public or private)	BT Published numbers	47,217 payphones	BT
Calls	Total number of calls	Total number of calls generated by all payphones per year segmented by on-net and off-net; mobile and fixed; geographic, non-geographic	Total of 33,000 calls per day Calls to non-geographic numbers represent 50% of total calls Helpline calls: 20% of total non-chargeable calls	Total 18.5M calls per annum	Press releases

Cartesian: BT Payphone Business Model - Profitability Assessment

Type	Revenue	Definition	Methodology	Value	Source
Traffic	Total traffic in minutes	Total number of minutes generated by all payphones per year segmented by on-net and off-net; mobile and fixed; geographic, non-geographic	2.5 minutes per call to geographic and mobile numbers 3.5 minutes per call to non-geographic numbers	Total 55.5M minutes per year	Assumption
ATM Payphone	Total number of ATM enabled payphone locations	Total number of payphones used as an ATM location	1,000 ATM payphones assumed in the model	1,000 ATM payphones	Assumption

Source: Cartesian

3. Key Findings

We estimate that BT's payphone business is generating revenues of more than £36M per annum. Revenue from telecom services (i.e. retail and wholesale) represents around 45% of total revenue (see Figure 8). We expect that BT is making approximately £19.8M in revenue from other activities, including advertising and use of sites as ATMs. Overall, we estimate an average revenue per site of £768 per annum.

Since there is limited information available regarding BT's advertising revenues, we have been deliberately conservative on our assumptions to calculate these revenues. Specifically, the 30% revenue share retained by BT may be low given the value of the payphone estate to advertisers and the maturity of advertising contract negotiation within BT. Therefore, it is possible that our model understates the revenues BT collects from advertising.

In terms of costs, we estimate a total of £3.5M Cost of Goods Sold (COGS) per annum, resulting in a Gross Margin of 90%. Costs that relate to originating and terminating calls are less significant in the overall COGS total. The volume of calls originating on payphones has reduced significantly over the last decade. We estimated a total of 254 calls per payphone per annum and out of those, 50% are calls for non-geographic numbers. Therefore, the amount of termination and call conveyance costs are relatively low.

Cash collection and treasury costs represent the largest share of COGS, since this relies on physical collection, transport and accounting of cash. We assumed a total of 35 collections per annum per payphone. However, it is possible that many payphones (those located in less dense areas) will have less frequent collection. Therefore, it is possible that cash collection and treasury costs may be lower than the ones presented in this report.

We took a similar approach to cleaning costs. We assume that the same person collecting cash will perform the cleaning. Therefore, it is possible that cleaning does not occur as frequently in all payphones as we assumed, which would also reduce costs versus our estimates.

We estimate a total of £143k for credit card payment charges, which is based on a small portion of calls (only 5% of total chargeable calls). However, we assume credit card charge to be a significant percentage of the revenues generated by this type of call (20%). This assumption may be higher than BT's actual cost, which again would improve the estimated margins.

We estimate SG&A to account for more than £17M per annum. Maintenance and line rental are the two major SG&A cost component accounting for 35% and 31% of total SG&A costs respectively. If we deduct SG&A from Gross Margins, we obtain a total EBITDA of more than £15M (or 43% EBITDA margin).

Figure 8. Overall BT Payphone Business Model Assessment Results (in £ units Per Annum)

Revenues		36,306,073
Retail telecom	4,687,806	
Wholesale Telecom	11,804,100	
Other	19,814,167	
COGS		3,575,473
Cash collection and Treasury Costs	3,305,190	
Credit card Payment Charges	143,396	
Call Origination	65,043	
Transit	22,765	
Fixed Call Termination	18,602	
Mobile Call termination fees	20,477	
GM		32,730,600
GM %		90%
SG&A		17,139,858
Site rental	696,100	
Line Rental	5,382,738	
Electricity	724,608	
Maintenance	6,000,000	
Cleaning	3,305,190	
Overheads	1,031,222	
EBITDA		15,590,742
EBITDA %		43%
Depreciation		940,327
Payphone kiosks	940,327	
EBIT		14,650,416
EBIT %		40%

Source: Cartesian

Depreciation accounts for £940k. Depreciation represents only a small share of costs (4% of total) since we assume that most payphones are already fully depreciated.³ We also considered that around 2% of total payphones had to be replaced due to significant damage (e.g. vehicle collision).

After depreciation costs, we estimate BT's payphone business to have an EBIT of more than £14.6M (40% EBIT margin).

³ Note that the new InLink payphone models are not included in the scope of this report.

Cartesian: BT Payphone Business Model - Profitability Assessment

In July 2017, BT announced it will remove 20,000 of unprofitable payphones over the next five years. We assume that those payphones carrying advertising are among the profitable ones and that they are deemed to remain active. By reducing the number of payphones, BT will reduce its SG&A costs significantly without losing revenues from both telecom and other services. In such scenario, BT could potentially increase EBIT margin from 40% to 50%.

4. Final Considerations

Payphones are an interesting asset for BT, since many units are found in areas with large footfall. Our model suggests that BT now receives more income from advertising than it does from telecom services. Arguably, revenues from advertising have the potential for further growth, contrary to payphone telecoms revenues which have decreased due to the large adoption of mobile phones.

Given the wider breadth of income that BT receives from payphones, the revenues from the Payphone Access Charge (PAC) may no longer be proportionate – it is questionable whether these fairly reflect the incremental costs associated with originating free-to-caller services from payphones.⁴

Based on the model outputs, the PAC accounts for 32% of total payphone revenue, equivalent to 55% of total costs (COGS, SG&A and depreciation). As the advertising and ATM revenue use the same payphone sites, we would expect cost apportionment to reflect this.

Finally, and as previously stated, the amount of publicly available data on BT's payphone business is limited. The model and results are therefore heavily reliant on Cartesian's estimates. Where inputs are uncertain, we have taken a conservative approach. However, if more data became available, it would be possible to update the model inputs to increase the accuracy of the outputs.

⁴ In 2004, BT made a voluntary commitment that the PAC would continue to be "reasonably derived from cost".
https://www.ofcom.org.uk/data/assets/pdf_file/0025/49633/statement.pdf

Appendix A – Glossary of Terms

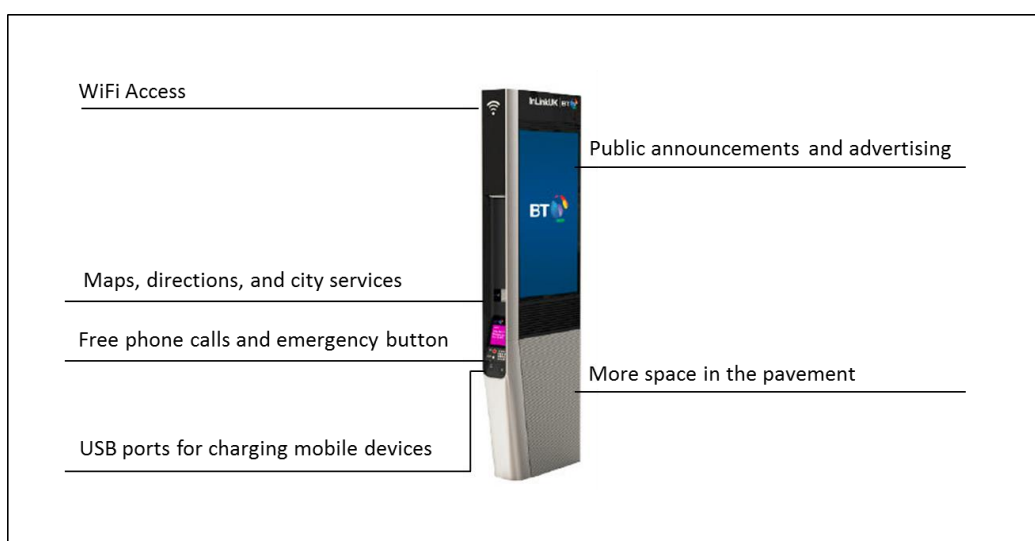
ATM	Auto Teller Machine
BT	British Telecommunications plc
COGS	Cost of Goods and Services
Cost of Capital	The opportunity cost associated with an asset investment. Cartesian has used an indicative 10% WACC as a reference in the study to calculate the cost of capital based on the MCE.
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortization
GM	Gross Margin
Market	Market is a collection of similar market services (by connectivity type), e.g. LLU and WLR are grouped in the Fixed Access market.
MCT	Mobile Call Termination
NTS	Number Translation Service
P&L	Profit and Lost
PAC	Payphone Access Charge incurs over Number Translation Services (NTS) for non-geographic numbers to business and public sectors in UK
SG&A	Cost of Sales, General and Administration
WACC	Weighted Average Cost of Capital
Wholesale Residual	An unregulated market capturing all the costs incurred on assets and activities in BT's network due to BT's business operations
WLR	Wholesale Line Rental is a BT market service within the Fixed Access market

Appendix B: BT InLink Initiative

BT has recently announced a partnership with Intersection and Primesight to deploy a new concept of street payphone kiosks in UK. The initiative aims to mirror the success Intersection had in New York where the payphone kiosks were introduced earlier in 2016.

The new InLink model was designed to provide a range of features including access to ultra-fast Wi-Fi capable of 1 gigabit per second, free UK landline and mobile phone calls, mobile device charging, as well as access to maps, directions and local services (see Figure 9).

Figure 9. BT's InLink Kiosk Features



Source: BT

Services provided at InLink kiosks are completely free to users, and rely solely on revenue generated from adverts displayed on two 55" HD displays on both sides of the unit. The initiative aims to install at least 750 InLink units across London and other major UK cities over the next few years; three have already been installed in Camden.

InLink kiosks represent a significant evolution in of BT's payphone advertising proposition. The model opens chances to explore more opportunities with advertisers by offering a new set of features and a HD display which can co-locate several adds in the same location (different to the static display which would only have one advert per time). Consequently, it is likely that BT's advertising revenue will grow in the coming years as the payphone becomes more of an advertising play than a telecommunication services kiosk.

As mentioned previously in this report, we did not include the InLink kiosks in this model for two main reasons:

- The InLink model is new in UK and it is challenging to predict its impact on the overall BT's payphone business case.
- BT has structured InLink as a separate organization from the traditional payphone business. As such, it is likely that the P&L for InLink kiosks will differ from that of the traditional payphone business.

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