Telefonica UK Limited Annual Report and Financial Statements

Year ended 31 December 2019

Registered Number: 1743099

Contents

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Strategic Report

Telefonica UK Limited ("The Company") is a wholly owned subsidiary within the Telefonica Group of Companies, trading under the O2 Brand ("O2"). The Company's immediate parent is O2 Holdings Limited, a private limited company that heads the UK Group ("UK Group"). The ultimate parent company is Telefonica S.A., a company incorporated in Spain and primarily listed on the Spanish stock exchange ("Group").

Our Purpose

Make every day better through personal experiences that count

Our Strategy

Customer Led Mobile First

Our Values

Bold, Open and Trusted

Our Priorities

Our key objective is to enhance and enrich the everyday lives of our customers by embracing new technology through our commitments to:

(1) **Our Customers:** We're focused on delivering a simple and personal customer experience, helping customers get the most out of mobile connectivity through our customer promise that every product, service and experience they have with us will help them to live better lives.

(2) **Our Propositions:** We offer mobile phones, tablets and wearable devices to our customers as well as a range of mobile services and products, including mobile voice, messaging and data services. We also provide Wi-Fi, cloud services, digital payment services, fixed-line services for businesses and some insurance products.

(3) **Our Sales and Service:** We provide our products and services through a multitude of channels and work in partnership with a portfolio of strong brands to support the delivery of putting our customers first.

(4) **Our People:** We have a diverse and inclusive workforce. Our ambition is to create an employee experience, centred on our values of Bold, Open and Trusted, that sets O2 apart in the eyes of our current and future talent.

(5) **Our Technology:** We continue to invest in our network infrastructure, the technology to innovate whilst making sure we operate in an efficient and cost-effective way.

(6) **Our corporate responsibility approach**: Our sustainability approach centres on doing the right thing for our customers, our people and society. As a responsible business, we'll continue helping to reduce our (and our customers') impact on the environment while increasing the positive social impact we deliver. We continue to work closely with all our regulatory authorities to ensure we influence on areas which matter to our customers and our business.

We believe our strategy will help us to drive clarity, ambition and pace whilst we continue to deliver a strong financial performance that will generate the cash flow required by our business model and provide a suitable return for our shareholders. **Each of our priorities are discussed further in the sections that follow.**

How we achieve our strategy

1. Our Customers

Our Customer Led strategy means that all our products and services are designed with the customer in mind. Our commitment is to put the customer at the heart of everything we do in order to achieve high levels of advocacy that will make us one of the leading customer experience organisations in the UK.

Our customer experience priorities are:

Creating a culture focused around customer experience – fostering an environment and mindset that encourages all our people to deliver the best experience for our customers

Customer led design capability – We embed our Customer Experience Principles (see below) throughout the organisation to create a consistent 'best in class' experience across all our products and services

Some examples of things we have implemented as a result of customer feedback in 2019:

- **Introduced a Premium Service checker** that helps prevent bill shock by enabling customers to understand which Premium Services they have contracted/subscribed to
- **Promoted Fair Deal**, as many of our customers did not realise that existing customers always get the same or better deals than new customers
- **Launched clear and concise communications** to keep customers up to speed during periods of network disruption
- **Introduced an improved welcome experience** to ensure that all our customers get a warm and helpful welcome to O2
- **Improving Advocacy through Net Promoter Score (NPS)** – we strive to continually improve our customer experience by listening to our customers and understanding how we can deliver the best possible experience to create true brand advocates. NPS measures the willingness of customers to recommend a company's products or services to others. We maintained our market leading position in overall NPS ending 2019 at 18.

Customer Experience Principles

In 2019 we continued our focus on the Customer Experience Principles and introduced the Net Promoter Score, Our focus was to embed NPS through our culture plan activities supported by our Customer Experience (CEX) Principles. Our Customer Experience Principles are:

We treat you like a friend

We offer a personalised touch as we care about what our customers are interested in. We take time to listen to our customers and treat them as an individual with their own needs through our Customer Promise.

We look out for you

We proactively look out for the best interests of the customer. For example, our approach to vulnerable customers and those with disabilities as set out in our Accessibility & Vulnerable Customers Policy Statement on our website. Our aim is to provide support to those customers who may be vulnerable when they interact with us and ensure that they receive a consistent approach which takes into account their circumstances, meets their particular needs and delivers a great experience.

We work on your terms

Whatever lies ahead we're right there with our customers. Adapting to what our customer needs, not the other way around. As demonstrated through the variety of offerings such as Custom Plans, O2 Extras, Family Tariff – which is the extension of family tariff into Pay as you go and Unlimited.

We make your life easier

We make everything frictionless, quicker, simpler, better for our customers, so that our customers can focus on what's important to them. Such as access to bill providing a PDF bill for SMB customers for easy access and an improvement to the natural lance in the Integrated Voice Response (IVR) tuning cycle 3 to make it easier.

We do right by you

Fairness, respect, transparency, security - nothing matters more to us than doing right by our customers, through

- Our Fair Deal makes sure existing customers get as good or better deals than new customers.
- Closing the loop allows customers who have expressed dissatisfaction, issues and queries via surveys to book an appointment with us at a time of their convenience.
- Our Refresh and Custom Plan propositions means that Customers do not pay once their contract ends.
- The Premium service checker allow customers to see what their premium charges are for.

We delivered content and training to our people across the organisation to raise the profile and embed NPS. We held a number of customer closeness sessions with our customers and shared these throughout the year on Workplace (our internal social media platform) focusing on who Promoters, Passive and Detractors were and used these to focus on what we needed to do to improve our customers' experience. We used #gotheextrasmile as a mechanism to share customer's and our people's stories on Workplace. We also shared case studies from other companies who use NPS.

2. Our Propositions

Consumer

In 2019, we continued to offer mobile phones, tablets and wearables to our customers, as well as a range of mobile services and products, including mobile voice, messaging and data services. Custom Plans, our revolutionary pay monthly proposition, helps customers to benefit from flexibility and affordability when purchasing their mobile device direct from O2. During the year we introduced greater flexibility by moving the tenure from 36 months to 48 months on premium tablet devices which includes the Apple Watch.

Our fair deal promise underpins the Bold, Open and Trusted values we hold at O2, as we have continued to invest in our Value Management Programmes, offering our customer not just a simple but more meaningful and a much more personal experience. This ensures existing customers can always access the same deals (or better) as new customers and ultimately maintain our industry leading levels of churn which stood at1% for Q4 in 2019.

We also introduced unlimited data tariffs and launched O2 Extras. O2 Extras gives our customers the ability to pick an Extra provided by one of our partners such as Amazon Music and Melody VR to enjoy alongside all the usual benefits of their tariff. As an example, when we launched 5G, we offered our customers the opportunity to receive an Oculus Go & Melody VR subscription on selected 5G tariffs, bringing live music and gigs to life.

We consolidated and re-launched our prepay proposition, Pay & Glo, which offers a new introductory £5 entry point, aligning to the changing market behaviours we have seen within this segment. We also introduced eSIM for Smartphones and will continue to build on that capability in 2020.

We have a number of product and proposition areas that support our mobile services, namely accessories, mobile device insurance, O2 Drive (our car insurance product), offering competitively priced car insurance both to our customers and the market. We also have our O2 Recycle proposition which allows customers to trade-in their old devices in a sustainable way.

Our Priority reboot refreshed our reward proposition, providing a great opportunity for us to remind our customers how important they are. Through Priority we give our customers great offers from high street brands, tickets and experiences, as well as access to the best in entertainment.

Priority Tickets allows access to some of the best artists in the world. They are available through our 22 sponsored venues, including The O2. Awareness of Priority Tickets continues its steady incline – up a couple of points from 2018 - for both customers and prospects. Customers who use Priority Tickets have higher NPS and increased consideration of the brand awareness.

Small Medium Business (SMB)

Our SMB strategy is to help support UK businesses grow, making life as easy as possible for small and medium businesses so they can focus on the things that matter to them. Our Small and Medium Business segment (SMB) includes customers from one man bands to companies up to 500 employees. We have propositions to serve the variety of needs of the different size of business organisations that we serve. We offer communications solutions for our SMB customers, from our strong core mobile offerings to the use of digital advisors to help our customers select the right cloud applications for their business. Our strategy is to serve our SMB customers through their channels of choice whether is through our Retail stores, our online channels or through our dedicated sales and service teams. Our priority is to ensure our SMB customers can get the right level of service that works for them.

Enterprise

We have focused on building true partnerships with our Enterprise customers, through understanding the business outcomes they want to achieve and delivering in partnership with them. From new product development and innovation, to how we evolve our core offering, everything we do is built around our customers aligned to our strategy of being Customer Led, Mobile First. Enterprise has specific teams of advisors with Service Delivery Managers and Client Managers and we are committed to keeping our business customers connected, 24 hours a day, 7 days a week, 365 days a year.

Our Enterprise customers need to optimise and transform their Information and Communications Technology (ICT) assets, migrate to cloud services and digitise their employee and customer experiences, all within a secure environment. Our unique connectivity propositions delivered via our Gateway platform allow Enterprise customers to connect their business and their customers across secure WAN, Wifi and mobile services via any device.

Customers are demanding a new approach to products and asking us to support their transformation strategies. They are looking to work more effectively and provide greater engagement with their own customers. O2 aims to be a strategic transformational partner to these organisations and connectivity is the foundation of this relationship. This gives us permission to grow our offerings and explore future opportunities.

The propositions are made up of two product areas - ‘Core Offerings’, and ‘Non-Core Offerings’. The areas focus on creating, maintaining and improving existing products, as well as building a long-term product roadmap aligned to our strategy that our sales team can offer our customers.

Our Enterprise strategy is built on 3 key pillars:

Grow our mobile share, continuing to make significant mobile network investment.

Focus on high ICT growth areas such as secure connectivity, collaboration, digital workplace and cyber security.

Create future growth platforms across IoT, 5G, Commerce and Data and insights

As part of our expansive and growing relationship with Capita we have signed a new agreement with Capita Public Sector to extend our mobility offering into its client estate on a supported resale basis. This aligns to Capita's digital transformation strategy for Local Government sector. The agreement is based on a framework which, over an initial 3 year term, allows us the opportunity to bid which could generate up to 25,000 new connections. We launched 5G for Business and became a mobile service provider with managed digital workplace application for one of the hospitals in London.

As part of a wider drive into the Enterprise security market in 2019, we launched our own SOC (Security Operations Centre) providing the capability to offer managed security services to our customers. We have progressed the delivery of critical communications services to Saint-Gobain Limited in the UK, including the extension of the Fixed telephony services until 2023, the provision of Hosted Telephony services to 1,059 sites as well as 2,101 Managed Mobile Data Terminals now being live for Saint-Gobain's Transport team.

We took a collaborative innovation approach to discuss with customers and leadership of FTSE 100 in order to gain insight and identify how 5G could transform the way things are done. In collaboration with Ericsson and Northumbrian Water we conducted a series of initial 5G trials to harness the power of 5G connectivity to revolutionise the way the Durham-based company operates, as it supplies 1.1 billion litres of water a day to customers. We have entered into an agreement to provide 5G connectivity for the testing of connected and autonomous vehicles (CAVs) in the world's most advanced urban testbed, the Smart Mobility Living Lab (SMLL) in London. In addition, we delivered our cloud platform and first of our Smart Cities products.

We commenced a trial for connectivity for a new "Smart Ambulance" that has the potential to revolutionise patient diagnosis, transport and treatment. The project will involve equipping a standard ambulance with state-of-the-art devices and connectivity to create a "Smart Ambulance" that will simulate 5G connectivity, transforming the vehicle into a unique remote consultation room.

We won the following awards in 2019 which is testament to the partnerships we have built with both suppliers and customers:

MIA MOBILE INDUSTRY AWARDS 2019

Best Business Network at the Mobile Industry Awards

Transport for London

Supplier of the Year at Transport for London's Annual Awards,

Gamma

SIP Reseller of the Year and Deal of the Year at the Gamma Annual Awards

Commercial partnerships

Commercial Partnerships are fundamental to how we deliver the best products, propositions, communications and experiences to our customers. Through our relationships with product manufacturing partners such as Apple and Samsung we can secure great products for our customers, as well as insights into best practice from across the globe.

As we build relationships with new partners like Amazon, Netflix, Calm, Cafeyn, Melody VR and Oculus we can bring new and exciting offers to our customers. We are also able to learn from them to constantly improve the customer experience, such as the way customers can redeem their subscription, through to reminders not to forget their O2 Extra is waiting for them.

Sponsorship

For over a decade our sponsorship portfolio has focused on four longstanding deals. AEG (The O2), Live Nation (Priority Tickets), Academy Music Group (O2 Academy venues) and the RFU (England Rugby Men's and Women's Teams). This focus has allowed us to develop strong, integrated partnerships and given us the tools to build relevant, ongoing communications with customers outside of our core business.

We support live music at every level to inspire and engage fans and create a deeper connection to live music for O2. Being more meaningful and more relevant in people's lives enables O2 to appeal to fans, our customers and our people beyond traditional benefits-built loyalty. It also allows us to be the stand-out brand in an increasingly saturated music industry. Importantly it demonstrates clear customer benefits and the flexibility to talk to targeted audiences whilst remaining authentic and feeling inherently O2.

Wear the Rose Live

To celebrate the announcement of the official Rugby World Cup (RWC) England squad we hosted 'Wear the Rose Live' in Bristol, an unmissable experience for 3,200 O2 customers, colleagues and the entire England squad. The event was aimed at igniting support at the heart of the rugby community ahead of the official launch of our England RWC campaign including events being live streamed via England Rugby channels to over 100,000 fans.

3. Our Sales and Service

Our omni-channel approach allows customers to engage with us through their channel of choice, including stores, online, voice and digital self-serve.

We operate the following channels:

- 251 Company-Owned Stores, fully owned and operated by O2
- 205 Franchise stores, operated by 13 Franchise partners
- Our website, www.o2.co.uk
- The MyO2 app, available to existing customers
- Our customer service voice teams, provided by our partner Capita

Our omni-channel approach includes our Click & Collect proposition which enables customers to place an order Online or over the phone, and pick up their order from any store. Channels play a critical role in delivering on our promise to Customers. Customers can deal with simple service queries via MyO2. For more complex queries or for customers who are more comfortable getting support from O2 in a face-to-face setting (e.g. vulnerable groups), customers can visit any of our stores for expert advice and service or pick up the phone to talk to one of our expert advisors.

We work with a number of partners to provide mobile connectivity through indirect partnerships and MVNOs.

Our stores

Direct

Our company owned stores are located across the UK giving customers the opportunity to browse and buy O2 products and services. All our stores focus on customer inspiration with digital exploration taking centre stage. In 2019 we refurbished 30 stores, and this will continue next year helping customers to learn about and be inspired by the latest technology available.

Franchisee stores

Our Franchise Business Partners tap into innovation and growth opportunities which enables us to work towards a credible omni-channel model in-line with our own long-term customer experience principles. We have partnerships with 13 Franchisees who collectively operate 45% of the O2 store estate. Engagement with them is critical, to ensure that they operate their stores with consistency, align with O2's customer experience principles and ethical standards helping to maintain a strong relationship as business partners.

o2.co.uk

We have a website, o2.co.uk, which gives Consumer and SMB customers the ability to shop online and to access their account securely to check billing and tariff information. We also provide information on the products and services we sell including mobile devices, accessories, tariffs and value-added services such as international calling, voicemail and coverage/live network status. Our customers are able to find out more about our business and leadership team. Through our website, customers can talk to us via our online web chat service for help with general support and account enquiries

My O2

MyO2 is our app available to our SMB and Consumer customers which enables them to check their bill, add or change the services they take from O2, or to deal with simple issues. It is the most popular customer destination and the highest volume service channel where customers are choosing to self-serve rather than use traditional channels. More capability has been added to the MyO2 app such as personalised tariff and device recommendations for customers close to upgrade and improvements to the upgrade experience to protect customers and our business against elements of fraud. SMBs have a dedicated service team with sector focus.

Customer service

Customers expect to interact through their channel of choice - voice, online, chat and apps.

The traditional voice contact centre has fast become the home of the most complex query as customers choose to use self-serve digital options (My O2) for simple options such as checking their bills, minutes/data allowance and use, adding additional extras and requests to change tariffs. Consequently, we continue to see a reduction in voice calls.

We have a long-standing strategic partnership with Capita who support our Consumer and Business customers across our voice and digitally assisted channels. Our customer service strategy delivers simplicity and visibility in our partner management approach and provides a clear line of accountability for the experience of customers across our assisted channels.

Customer Service has improved performance across both contact centre metrics and the number of complaints which can be seen in the statistics published by Ofcom :

Ofcom complaints (per 100k Customers)	Q1	Q2	Q3	Q4
2018	3	3	3	3
2019	2	2	3	2

Source: https://www.ofcom.org.uk/research-and-data/multi-sector-research/telecoms-complaints-data

Indirect Partners

Consumer

Consumer Indirect sells mobile connectivity via several Indirect partners in two business categories; Pay Monthly and Pre-Pay.

Pay Monthly trading occurs via four Indirect Partners; Dixons Carphone, Mobile Phones Direct, A1 Comms and TalkTalk. Pre-Pay trading occurs via a number of Distributors, Retailers (Tesco & Argos) and via Dixons Carphone.

We work closely with our partners, regularly engaging with them to foster an environment and mind-set of partnership, keeping them informed and working together to understand how we can deliver the best possible customer experience.

Small Medium Business

Our Small Medium Business (SMB) Indirect is made up of 35 x direct relationships with Partners who sell O2 products and services to business customers either directly or through their network of resellers. They offer us the opportunity to reach into different market segments and increase choice to our business customers. These Partners often deliver a compelling service wrap and product range which complements our direct routes to market.

We have an Indirect Channel Sales Team with a designated responsibility to work with these Partners and to support them and helping to grow their O2 sales, and overall business.

The SMB indirect have been awarded a number of external recognitions from the Partners such as Aerial Direct: Comms National Awards - Customer Service Award (Above £5m). Plan.com: Tech Track 100 – Placing 28th. https://www.fasttrack.co.uk/league-tables/tech-track-100/league-table/ and Sunday Times Best Small Company to Work For – Placing 7th. https://www.b.co.uk/the-lists/small-companies/. 2019 Mobile News Awards - Best Airtime Distributor.

Mobile Virtual Network Operator (MVNO)

The MVNO strategy is to partner with major brands that can extend our reach beyond our owned brands and/or existing distribution channels (online, telesales direct and indirect). Our award-winning network and focus on the customer have helped us build a roster of successful partnerships with: Tesco Mobile, Sky Mobile, Lycamobile, Truphone and Manx Telecom. The extension of agreements with Sky Mobile and Lycamobile further optimises usage of our assets allowing us to continue to invest while helping these businesses grow their mobile customer offer.

4. Our People

Our people strategy is focused on creating an environment that enables and empowers our people to perform at their best.

In 2019 we piloted agile working, supported by the creation of collaborative workspaces and coaching support. These are examples of enabling our people to work cross-functionally and at pace.

Our daily activities are underpinned by our company values, (Bold, Open and Trusted), our Business Principles and a clear focus on putting customers at the heart of everything we do.

Our employee experience principles support an employee-centric design approach to all our people processes and policies while business wide action plans ensure the employee experience is created across all physical, human and digital interactions.

Campus is our digital learning platform. In 2019 we added the ability for all our people to build and share their own learning playlists alongside access to LinkedIn learning. This provides an extensive amount of additional material and creates a space where people can connect, learn and grow.

Our communication and engagement approach utilise multiple channels including companywide face to face events, streams, (via our Workplace platform) and quarterly updates on the Company's performance. These engage our people in our strategic priorities and bring teams together to celebrate success. Alongside this there is regular activity aligned to our business priorities and people strategy such as online campaigns to bring about discussion and engagement.

Our development programme 'Big Chats Little Chats' supports our leaders to have brilliant continuous two-way conversations with our people to inspire, and to listen and understand. Meanwhile our listening tours see the Executive and Senior Management visiting our frontline teams to hear directly from our people.

A number of KPIs are tracked monthly in order to measure performance against our people strategy including our annual employee engagement survey made up of 17 core group questions and 10 additional local UK specific questions. Group questions focus on measuring Employee Net Promotor Score (eNPS) and our progress against our global People Strategy.

Local UK specific questions measure our progress in creating a culture that is Bold, Open & Trusted, and our people's level of overall motivation. Our target was set at 30.0% which we exceeded at 35.2% overall. To track our progress, eNPS questions will be asked quarterly via pulse surveys.

Our Glassdoor real time rating gives us an external measure of the experience we create for our people again linking to customer experience. Additionally, it gives us as a view of our employer brand and how we compare in the market to other employers, a factor in attracting and retaining talent. We consistently achieved our aim of maintaining a 4+ rating throughout 2019.

Human Rights, Diversity and Inclusion

We continue to work to create a diverse and inclusive environment to ensure we have the right skills and mindset now and, in the future. We achieved bronze status in the National Inclusion Standard for the work we do on inclusion. Some of the work that helped to achieve this includes launching our new family policy giving all employees up to 14 weeks paid time off and raising awareness of Menopause and Transitioning in the workplace.

Our Diversity and Inclusion policy provides clear guidance regarding our approach. It emphasizes that all our people have the right to be free from harassment, bullying, discrimination or unwanted behaviour regarding gender, gender identity, race, disability, generation, nationality, marital status, caring responsibilities, sexual orientation or political or religious beliefs. It commits us to ensuring that everyone has the same opportunities to achieve their potential and contribute to our success. It also highlights that we won't tolerate any discrimination.

We continue to review our people policies and practices to ensure they are inclusive and supportive of all groups and create an environment where difference is acknowledged, and everyone's views and opinions are respected and valued. Regular reverse mentoring sessions run by employee groups with the Executive Leadership Team ensure these views are shared directly with the Executives.

In addition, we have several other people policies covering the full range of employee lifecycle situations including family and timeout policy, employee benefits, performance management, disciplinary and grievance. We ensure fair treatment of people with disabilities in relation to their recruitment, training, and development including reasonable adjustments and practical considerations relating to disabilities and increasing the accessibility of our services making them more inclusive for disabled people. All our policies are reviewed and revised as required regularly.

We use a number of measures to track diversity and inclusion.

KPI	2018	2019
Median gender pay gap	22.0%	21.2%
Percentage of female employees	39.5%	40.0%
Percentage of black, Asian and minority ethnic (BAME) employees	6.7% (disclosure rate approx. 50%)	8.8% (disclosure rate 81%)

In October we were ranked 44th (and the only telco within the Top 50) of UK employers for social mobility on the Social Mobility Index. This recognises the work we do to champion social mobility and the actions we have taken to make sure we access and progress talent from different social backgrounds.

Operating Model

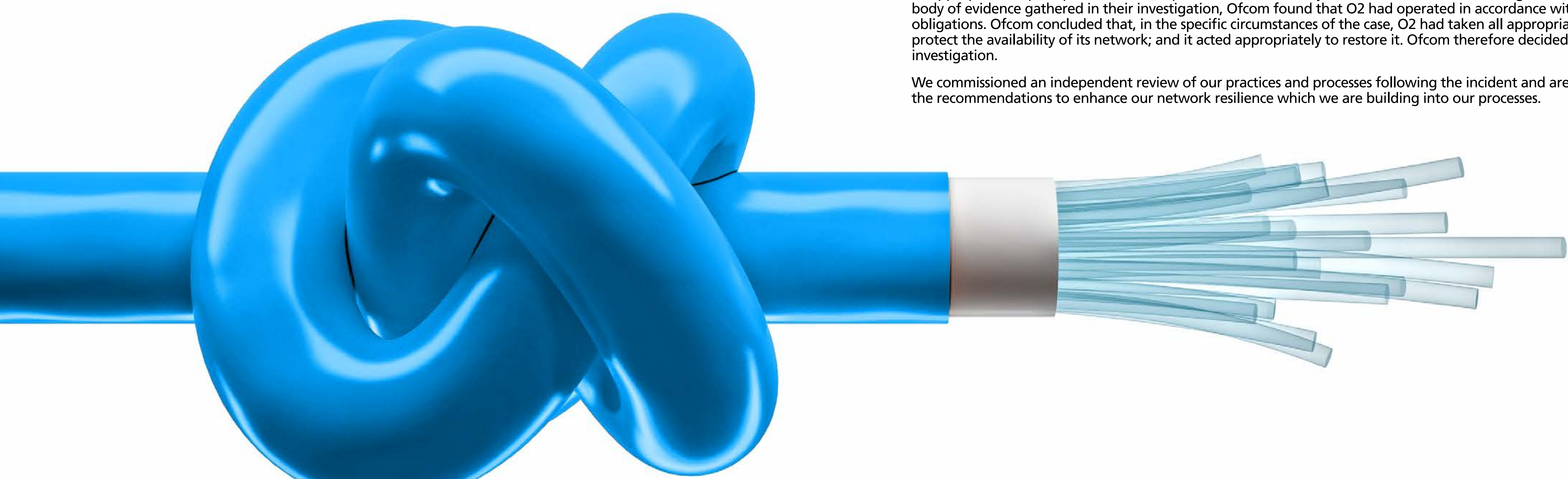
We regularly review our Operating Model to ensure our people and ways of working are set up to be the best they can be. We are focused on delivering a great service for our customers in an extremely competitive environment. In order to do this, we sometimes need to evaluate how our business operates. As a result, we decided to make some changes to our employee resources in consultation with our union partners, employee representatives and our people. The first phase of the restructure was completed in Q1 2020 and the second phase has been suspended due to COVID-19 and is likely be resumed during the course of 2020.

5. Our Technology

Our technology investment plan sets out how we can continue to thrive and grow, whilst delivering efficiencies by making focused decisions along the way.

We will continue to invest in delivering differentiated customer experiences through the provision of innovative propositions and products, extending our award-winning network whilst deploying new IT platforms to drive efficiency and effectiveness. Our plans are underpinned by significant investment in:

- Network – our network will continue to evolve to provide increased capacity, 5G expansion, IoT (Internet of Things) and Smart Metering (SMIP).
- Core capabilities – transformation for our Consumer and SMB segment;
    - Enabling consistent, personalised, joined up journeys across all channels wherever customers are in their sales and/or service lifecycle
    - Innovating and delivering at pace by making it simpler and easier for internal collaboration
    - Simplifying and refreshing our IT infrastructure, replacing siloed systems with an integrated and open platform
- Information Technology - through 3 specific activities
    - Timely and accurate reporting through Business Intelligence Evolve
    - Data decisioning - deliver real-time decisions for customers next best actions
    - Data and Artificial Intelligence (AI) – using technology advancements in AI to deliver better insight and service to our customers.



Network

Our Network priority is to deliver a stable, competitive and customer centric network. We have progressed a network strategy that strives to expand coverage and deploy 5G with the intent to improve customer experience. In October 2019 we launched our 5G network in six towns and cities across the UK and by the end of December we had 5G service in 21 towns and cities across the UK.

Our continuing network sharing arrangement with Vodafone will enable active rollout of 5G through site sharing. The Shared Rural Network (SRN) is based on collaboration and partnership between the Government, Ofcom and MNOs to invest helping to deliver increased coverage for remote areas, In March 2020 we announced that the UK landmass that receives 4G coverage from all four of the UK's mobile network operators will increase from 66% to 84%; each operator will provide 4G to at least 90% of the country's landmass; Partial Not Spots will be virtually eliminated; and over 1,800sq miles of the country will get 4G for the first time.

We continue to:

- invest in our network to help our customers, remain competitive and exploit the potential that 5G technology can provide.
- to optimise our spectrum utilisation and deliver capacity to meet the growing demand and expectation of our customers.
- further develop our core network capability and resilience.

Throughout the year we conducted independent drive testing of our network performing a series of voice calls and mobile data tests to ensure these represent a true customer experience. Reports are produced against a number of KPIs including call completion success rates and data speeds. We also crowdsource information from Tutela. This enabled us to get a technical comparison against our competitors and a customer experience view on our network. This helped to identify locations where the service was not as we expected and to improve it for our customers.

Our external recognition for our Network in 2019 includes: Uswitch Best Network for Coverage, Mobile News Awards Best Network Performance and Mobile Industry Awards Best Network for Business

Network Incident

After our 6 December 2018 network incident, Ofcom opened an investigation to examine whether O2 had taken all appropriate steps to protect, so far as possible, the availability of its network. After reviewing a substantial body of evidence gathered in their investigation, Ofcom found that O2 had operated in accordance with its its obligations. Ofcom concluded that, in the specific circumstances of the case, O2 had taken all appropriate steps to protect the availability of its network; and it acted appropriately to restore it. Ofcom therefore decided to close their investigation.

We commissioned an independent review of our practices and processes following the incident and are considering the recommendations to enhance our network resilience which we are building into our processes.

Internet of Things

The Smart Metering Implementation Programme (SMIP), led by Smart Data Communications Company (DCC) and Department for Business, Energy and Industrial Strategy (BEIS), is a key part of the UK's drive towards a low carbon economy and supports the goal of being carbon neutral as a country by 2050.

We are the Communications Service Provider for two of the three national regions (Central and South) which aims to offer every home across the UK a gas and electricity smart meter by 1st January 2021. We have the responsibility for the supply of network connectivity and Communications Hubs which link Smart Meters and in-home displays across a home area network to the Data Communications Company (DCC) and onwards to the numerous Energy Providers who serve UK citizens.

We are reviewed against 32 key operational service measures for each of the two regions we support on a monthly basis. Telefonica UK has successfully met 31 of these throughout 2019. The one measure that was challenging was "Over the Air firmware updates to Meters" and the speed within which these were carried out. A remedial plan was implemented, a number of improvements delivered in November 2019.

Our strong performance was recognised by the DCC and we were awarded the Excellence award at their Supplier Day. We also achieved "Satisfactory", the highest rating, for the fourth year in a row, in their Annual Service Report. We also won the Glotel Award for Consumer IoT initiative of the year.

O2 Information Technology

Our Technology strategy is to better inform investment choices on our IT which will deliver strategic business capabilities and performance. It supports our business focus on the customer, operational efficiency, corporate responsibility and on supporting revenue growth opportunities from our investments in 5G, and the Internet of Things. In order to increase the scope of technology innovation in O2, we have set up innovation partnerships with both commercial and academic organisations and we are working with them on strategic areas for O2 including 5G.

Technology & Automation strategies will deliver key supporting capabilities which change the way we service our customers. Customers benefit from a more proactive and effortless experience, with real-time data usage allowing resolution of issues before experience is impacted. AI & ChatBots will become more prevalent, with cognitive intelligence that will resolve many queries, with seamless connectivity to assisted channels where necessary, without the need to re-authenticate.

Business Intelligence Evolve

This is our programme to enhance our data capabilities and in line with Group strategy. The primary focus is the protection of our Customers' data ensuring compliance whilst also improving accuracy and quality of our data. We expanded our capacity and capability to deal with growth in data use by our Customers and to right size it for our Transformation and for 5G. We consolidated data centres, bringing key data services physically back to the UK. Finally, we launched O2 Motion in the Smart Cities market for transport management and a growing variety of other Enterprise customer use cases.

Data

Our Data strategy is continuously evolving to ensure it stays relevant for our customer's experience and right for our business. Specific focus is on increasing the controls we have in place to manage our customer's data, ensuring we continue to retain and gain customer trust.

Delivering our data strategy will ensure:

- Insight by Design – where the advanced use of data and the insight it creates, is embedded into everything we do;
- Intelligent Orchestration – providing customer interactions which are joined up across channels.

The data strategy describes progressive alignment to O2's wider business strategy and investment priorities. We continue to improve how we use data to help support our teams and to deliver one to one personalisation in real time for our customers. Also, we are developing AI capabilities to enhance 5G and Internet of Things customer propositions.

We've introduced Machine learning that provides predictive help to minimise potential high bill usage or fraudulent transactions when using Charge-to-Mobile to make purchases. We created Marketing campaigns through Priority, which were designed and promoted with the help of our data analytics capability, ensuring that what we provide and how we communicate, connects with our customers.

6. Corporate responsibility

As a responsible business, our approach centres on doing the right thing for our customers, our people and society.

Reducing our environmental impact (including our customers), supplier influence, or business principles and anti bribery and corruption activities are discussed below.

Our Customers

Working with stakeholders and customers will enable us to have a greater impact than we can achieve on our own.

We work with handset manufacturers to assess its sustainability credentials, providing an overall rating between 0 and 5. The higher the rating the more sustainable the phone is. This enables customers to help them make informed product decisions. We've also removed single use plastics from our own branded accessories.

We extended our partnership with the NSPCC and have helped families keep kids safe online through our award-winning multi-media campaigns: Parents vs Kids and Net Aware, which encourage parents to have regular conversations with their kids about the online world. In 2019 we had over 1.5 million actions taken by parents to keep kids safe online.

We extended our support for children at risk for from the online world by supporting the Anti Bullying week, developing research and resources to inform and help children, teachers, parents and carers to help tackle bullying online and offline. We supplied 150,000 school packs with material to help with advice and support to tackle bullying.

We have continued to help young people kick start their careers through offering inspiring and informative content and access to work experience and skills opportunities with O2 and other partners through Go Think Big. You can find out more here - https://gothinkbig.co.uk/

Further details on what we delivered on our commitment to the society can be on the Non -Financial Report and Blueprint Report published on www.o2.co.uk website.

Our People

One of our greatest assets are our people. To help drive employee awareness and engagement around corporate responsibility we enable them to take time off (paid) to get involved with volunteering and fundraising opportunities. This year our people have helped to raise over £400,000 for the NSPCC partnership.

We also offer flexible working arrangements so that our people are able to benefit from a better work/life balance. This helps to make it easier for our teams to collaborate and work together on cross-functional projects. Flexible working also contributes to our environmental commitments by helping to reduce our carbon footprint.

For the first time this year we recovered the old uniforms from stores and recycled them back into usable materials. In addition, we have reduced the use of single use plastics in our offices and stores.

and external audits throughout the business. Progress against the energy/waste and water targets are measured monthly using data from internal and external stakeholders. Data is independently verified before being used for reporting purposes.

Society

Our Blueprint 2 initiative launched in 2016 with one ambition: to help 20 million people live better with tech by 2020. This helps to give people confidence to enjoy and the opportunities thrive in the digital world. The initiative also aims to help people reduce their impact on the planet and allows O2 to operate and manage our business responsibly. We helped more than 23.7 million people live better with technology through our products, programmes and services. We will be updating our Blueprint commitments in 2020.

Reducing impact on the environment

As part of our sustainability strategy, Blueprint 2, we had the following commitments:

- reducing the carbon emissions from our network by 40%, relative to data traffic
- buying 100% renewable energy for all sites where we control the energy bill
- using 16% less water per person in our corporate sites
- maintaining zero waste to landfill where operationally possible

As part of our environmental management system we undertake both internal and external audits throughout the business. Progress against the energy/waste and water targets are measured monthly using data from internal and external stakeholders. Data is independently verified before being used for reporting purposes

Carbon Footprint associated with Operations

The annual quantity of energy consumed from activities for which the company is responsible involving the combustion of gas or the consumption of fuel for the purposes of transport;

- The annual quantity of energy consumed resulting from the purchase of electricity by the company for its own use, including for the purposes of transport; and
- Greenhouse emissions.
- Scope 1: Fuel used. This is low impact and fuel used is primarily for space heating (Gas) and Fuel used in standby generators (Diesel).
- Scope 2: Electricity Consumed across the following site types (Cells/Switch Sites/ Offices and Retail).
- Scope 3: Refrigerants used in cooling systems and business travel (business mileage, flights, etc.)
- The energy efficiency measures taken are primarily around:
- The procurement and deployment of more efficient network transmission equipment.
- Upgrades to cooling systems (and their controls).
- Self-Optimising Networks (SON) which ensures that the network is operating efficiently (turning itself down during periods of low network traffic).
- The primary source of data collection is a combination of Utility Bills and Smart Meter Data which is collected, verified and reported by an independent third-party expert.
- UK Water Target: Maintain water consumption and do not increase per FTE by 2020, on track to meet and exceed this target. The UK target was to maintain water consumption at the current level (2015 bsln); we have exceeded this target at 25% less water per person, mainly achieved through users consuming less and using more water efficient equipment in kitchens/washrooms.
- UK waste Target: Ensure that no General Waste that can otherwise be diverted to recycling is sent to landfill. We have not sent waste to landfill where we have operational control
- TEF Energy Efficiency: reduce company emissions relative to data traffic by 85% by 2025. On track to meet this commitment. Our target was to reduce company emissions relative to data traffic by 40% (2015 bsln). We have exceeded this target and achieved a 78% reduction.
- Material and resource efficiency - To support a circular economy we refurbish and then reuse traded-in handsets. Where they are beyond recovery they are fully recycled – We are pleased to report that no waste was sent to landfill.
- Biodiversity and ecosystem service – While biodiversity and our ecosystem is important to us all, we focus on issues with the greatest materiality to our organisation, where we have the greatest impact. These include energy, waste and water.
- Emission to land, water and air – While emissions to land, water and air are important to us all, we focus on issues with the greatest materiality to our organisation, where we have the greatest impact which include energy, waste and water.
- We comply with Energy Saving Opportunity Scheme (ESOS) and have conducted all mandatory audits as per the requirements of the scheme and actively followed up on recommendations made within the report.

Climate Change

The key non-financial risks for O2 associated with climate change are the continued availability of renewable energy and the potential for floods to impact delivery of our services. The biggest impact on the Climate from an Operations perspective is Carbon Emissions associated with electricity consumption. Over 80% of our carbon emissions can be attributed to electricity consumption in our Network, Retail Stores and offices.

Also, the provision of products and services by O2 help enable our customers to reduce their impact on the environment for example teleconferencing services and telematics.

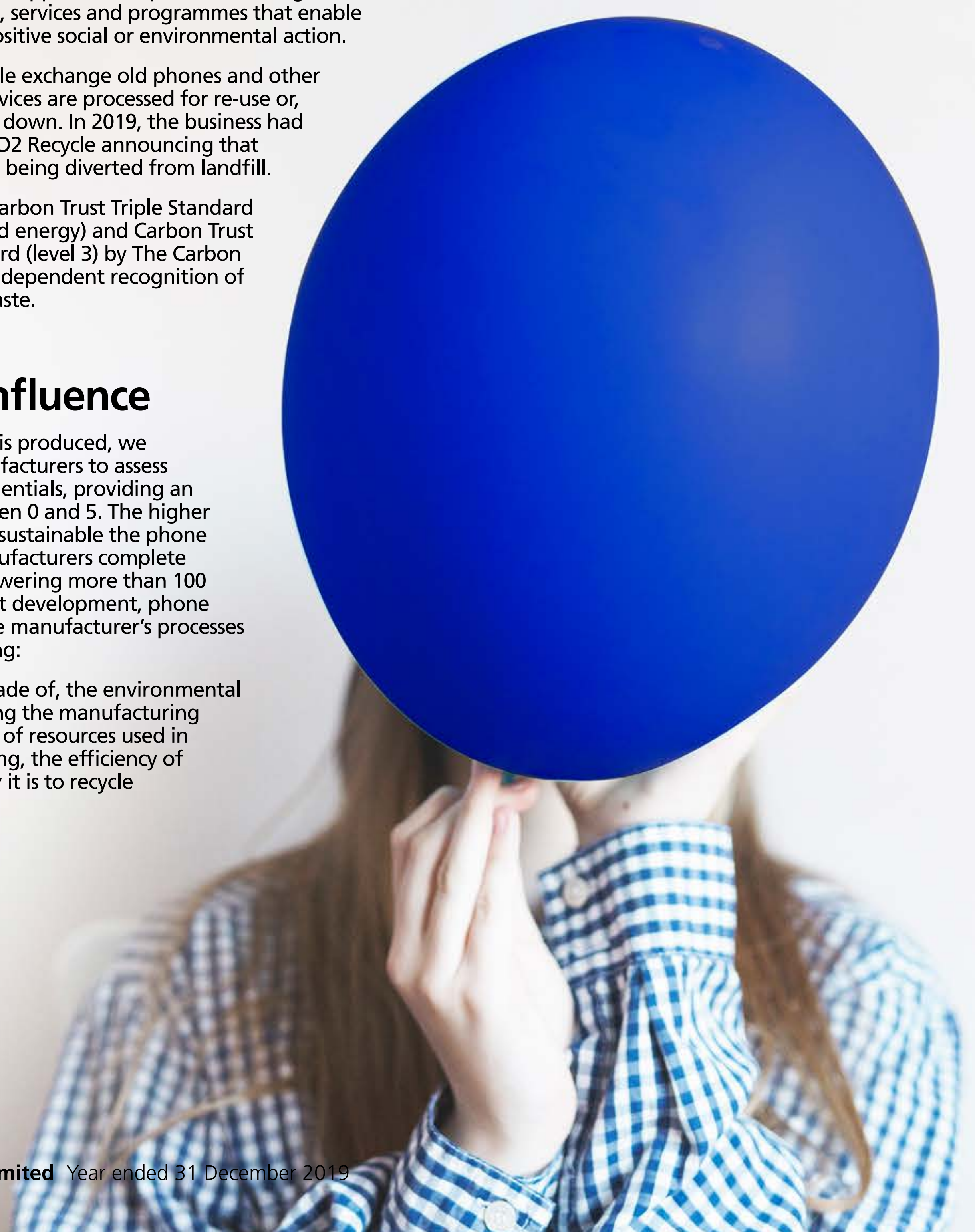
The Responsible Business Taskforce has delegated responsibility over the environmental management system standard (ISO14001:2015) to help our business become more environmentally friendly, manage compliance obligations and reduce waste.

O2 Recycle

We have a number of opportunities provided through O2's campaigns, products, services and programmes that enable customers to take positive social or environmental action.

O2 Recycle lets people exchange old phones and other gadgets for cash. Devices are processed for re-use or, recycling or stripped down. In 2019, the business had reached 10 years of O2 Recycle announcing that three million devices being diverted from landfill.

We were awarded Carbon Trust Triple Standard (for waste, water and energy) and Carbon Trust Supply Chain Standard (level 3) by The Carbon Trust Standard, an independent recognition of real reductions in waste.



Supplier influence

When a new phone is produced, we work with the manufacturers to assess its sustainability credentials, providing an overall rating between 0 and 5. The higher the rating the more sustainable the phone is. Participating manufacturers complete a questionnaire, answering more than 100 questions on product development, phone functionality and the manufacturer's processes and policies, including:

what the phone's made of, the environmental impacts caused during the manufacturing process, the amount of resources used in the phone's packaging, the efficiency of the device, how easy it is to recycle after use.

Business Principles

Our Business Principles are the behaviour and standards underpinning our ethical and responsible approach to business. We are committed to acting with integrity, commitment and transparency. Principles that are essential in promoting the relationship of trust we wish to sustain both internally and externally. Our Business Principles framework underpins our commitment to acting in a responsible, ethical and lawful manner. These principles include ethical and responsible management, our customer and employee commitments, corporate governance and internal controls, responsible communication and our commitment to the environment and societies in which we operate.

Sustainability and good Ethics are a key part of our approach to doing business and was a key focus at our 2019 employee conference. As part of our commitment of being a responsible business, every employee must complete the mandatory Business Principles training and the completion rate at year end was 98%. In addition, employees have a personal objective to support a responsible business commitment and demonstrate our Company values in their day to day activities.

To test adherence our practices and processes, key processes are audited on a periodic basis and Management information is provided to the Leadership Team on a monthly basis to monitor key trends.

Speak Up

Speak Up is our whistleblowing channel and is part of our continued commitment of being a responsible business and to encourage a Bold, Open and Trusted culture. It gives our people the chance to speak up against behavior inconsistent with our Business Principles. In 2019, 89 concerns were received which is expected level for a company of our size. All concerned received are investigated where possible.

To support Speak Up several controls are in place such as a monthly survey of a sample of our people to assess the awareness of Speak Up. There is an Executive Sponsor at Leadership level. Speak Up awareness across the Business was 59% in 2019 and our ambition is to improve on this with a number of communication initiatives.

Anti-bribery and corruption

O2 has a zero-tolerance approach to Bribery & Corruption and in recent years has significantly improved compliance process in place. These improvements have been based on Ministry of Justice best practice and have resulted in changes to policies, procedures and training.

The improvements have also been independently verified through an independent third party assessment. Our updated measures in relation to Anti-Bribery & Corruption controls are as per below:

Category	2017	2019
Communications	Established	Comprehensive
Due Diligence	Developing	Established
Monitoring	Developing	Established
Proportionate Procedures	Developing	Established
Risk Assessment	Basic	Established
Top Level Commitment	Established	Comprehensive

As previously reported we are addressing a request for disclosure made by governmental authorities which is related to possible violations of anti-bribery laws and regulations in the past.

Performance and Development

We measure our performance against our strategy through Key Performance Indicators (KPIs). While there are a number used across the business to ensure each operational element of the business is delivering against their objectives, our key indicators at the end of 2019 are as follows:

KPI	Definition	Measure	Commentary
Total accesses	Total accesses are the number of connections on the O2 network, including giffgaff, Tesco Mobile, Sky Mobile and Lycamobile.	Total accesses, including customers who use the O2 network through giffgaff, Tesco Mobile, Sky Mobile and Lycamobile, reached 34.5 million. Telefonica UK Limited's mobile base stood at 21.5 million. Contract net additions stood at 1,731,000 (190,000 excluding M2M) in 2019. Active Prepay net additions for the year were 155,000. At the end of 2019, contract customers represented 68.1% of the base (+3.0 percentage points year-on-year).	In 2019, focus on our mobile-first, Customer-Led strategy resulted in a growing base of users. Custom plans gave customers the flexibility to choose which airtime tariff suits them best proving our customer champion approach as the only UK mobile network operator to offer this level of flexibility and transparency.
Revenue	This is the total amount of revenue earned for the period.	The Company's revenue for the year ended 31 December 2019 grew to £5,976 million (2018: £5,742 million).	Revenue growth was driven by the continued success of innovative Custom Plans tariffs, higher hardware revenues, progress in the Smart Metering Implementation Programme (SMIP) and increased MVNO revenues.
Mobile service revenue	This measures the revenue being generated by the airtime usage on our mobile network.	The Company's mobile service revenue for the year was £4,026 million (2018: £4,074 million).	This reflects competition, regulation, lower year-on-year RPI increases and the impact of IFRS 15 and Custom Plans.
Average Revenue Per User (ARPU)	This measures average revenue per user.	The Company's total ARPU for the year was £13.40 (2018: £14.10).	We have stable subscription revenues as the continuing success of Custom Plans mitigates the market driven pressures on bundle prices. Customers are choosing larger bundles being offset by lower out of bundle revenue.
OIBDA*	This measures operating income before depreciation and amortisation.	The Company's OIBDA for the year ended 31 December 2019 was **£1,564 million (2018: £1,551 million). The Company's OIBDA margin was 26.2% (2018: 27.0%). OIBDA upon adoption of IFRS 16 for the year ended 31 December 2019 was £1,756 million as a result of lease rental payments being replaced with depreciation and interest costs. OIBDA margin was 29.4%.	Healthy profit and margin ensures that the business remains financially viable for the long term. We support ongoing investment as well as providing a suitable return for our shareholder.
CapEx	This measure capital expenditure in the period.	The Company's capex for the year ended 31 December 2019 was £797 million (2018: £1,312 million) as the Company continued to invest in its network for customers. Capex during 2018 included £523.6 million of Spectrum acquisition.	Ongoing investment in infrastructure, new services and innovation enables our business to optimise its capabilities while providing the service customers want. A balance is made between levels of ongoing investment to support the long term health of the business and cash returns for our shareholder.

* OIBDA is reconciled to operating profit in note 6.

**Financial KPIs have been assessed on a like for like basis applying the IAS 17 leases standard to 2019 numbers. The financial statements for the year ended 31 December 2019 have been prepared with the new leases standard IFRS 16. See note 2 for further information.

Financial performance highlights

The Company's profit for the year ended 31 December 2019 was £602 million (2018: £601 million).

The net assets of the Company as at 31 December 2019 were £2,649 million compared to £2,580 million at 31 December 2018, the movement of which is due to £602 million of profit for the year, £53 million actuarial loss after tax impacts on the defined benefit pension scheme and a dividend payment of £480 million.

The cash and cash equivalents of the Company at 31 December 2019 were £138 million compared to £104 million at 31 December 2018. The increase of £34 million is driven by £1,715 million net cash flow from operating activities, £932 million net cash flow used in investing activities and £749 million cash flow used in financing activities. The significant cash flows within these areas are: £896 million for purchase of property, plant and equipment and intangible assets; £480 million dividend payment and £70m repayment of borrowings to the Company's immediate parent, O2 Holdings Limited; and £164 million principal payments on leases.

The cash and cash equivalents of the Company at 31 December 2018 were £104 million compared to £14 million at 31 December 2017. The increase of £90 million was driven by £1,307 million net cash flow from operating activities, £1,276 million net cash flow used in investing activities and £59 million cash flow from financing activities. The significant cash flows within these areas were: £1,249 million for purchase of property, plant and equipment and intangible assets, including £524m for purchase of spectrum; £524 million proceeds for a new loan with Telfin Ireland for purchase of spectrum; and £431 million repayment of borrowings including £150 million of an existing loan with Telfin Ireland DAC, £166 million repayment of borrowings owed to O2 Holdings Limited and a £115 million Telfisa Global B.V. overdraft.

See note 2 for further information on the impacts of adoption of IFRS 16.

Principal risks and uncertainties

At O2 we operate 4 x principle risk categories and related sub-categories, through which all risks are identified, linked and managed.

Our approach is aligned to Group and its other operating businesses (OBs). This ensures we collectively undertake aligned micro and macro analysis of our OBs, the external environments and the markets in which we operate to determine and manage applicable risks to our strategy.

We have updated the categories shown here to align to the current principle risks used within O2 and the Group. As we drive continual improvement to our risk management practices and culture, these new categories better reflect the interconnections between our managed risks.

Principle Risk Categories	Sub-categories of Risk
Global risk: Possible loss of value or results derived from events that affect in a global way the entire Group in terms of its corporate reputation and sustainability, communication, corporate public relations, marketing strategy, brand, sponsorship and innovation.	• Sustainability • Compliance • Reputation
Business risk: Possible loss of value or results derived from changes in the business, competition and market scenario, changes in the regulatory framework or strategic uncertainty.	• Strategy (including Market, Economic & Political, Business Model & Adaptation • Regulation
Financial risk: Possible loss of value or results derived from adverse movements in financial variables and the inability of the Company to meet its obligations or convert its assets into cash, as well as commercial credit and fiscal risks.	• Finance • Fiscal
Operational risk: Possible loss of value or results derived from events caused by inadequacies or failures in customer service, processes, human resources, business teams and IT systems, security, enforcing contracts, laws and regulations, or due to external factors.	• Customer • Systems & Network • Security • Supply Chain • Operational Management • Legal • Human Resources

Perceived most significant and emerging risks to our strategy:

Risk category	Risk	Why this is important	How we manage it	Trend
Global: Sustainability	Reputation & Sustainability	At O2 our Blueprint plan underpins our ambition to help people live better with technology and to deliver our long-term commitment of delivering responsibility leadership. We believe in operating our business in a sustainable way and putting our customers at the heart of everything we do.	At O2 our Blueprint plan underpins our ambition to help people live better with technology and to deliver our long-term commitment of delivering responsibility leadership. We believe in operating our business in a sustainable way and putting our customers at the heart of everything we do.	Stable
Global: Compliance and Business: Regulation	Compliance & Regulation	As a customer centric company that operates in a market subject to many different regulations and laws, it is important that O2 operates within the regulatory obligations and delivers positive customer journeys and outcomes.	We continually monitor the legal and regulatory requirements applicable to O2 and apply these requirements to our operations and change activities.	Increased: Due to increased complexity of regulations and intervention from regulators
Business: Strategy	Market & Competition	The market continues to evolve at pace in relation to multiple factors e.g. technology, customer demands, product offerings, new sub-markets, new competitors, and it is important to O2 to remain relevant and attractive.	In 2019 we rolled out our 5G network to 21 towns and cities. O2 also released Unlimited Data tariffs on its Custom Plans	New: This new category has been created to recognise previous risks which are interconnected.
Business: Strategy	Economic & Political Environment	Economic and political factors present a dynamic set of challenges and risks for O2 to consider, relating to market, strategy and operations factors.	2019 has been an uncertain time in the UK both politically and economically, predominantly due to Brexit. Early indications in 2020 are that this uncertainty only increases due to the Covi-19 pandemic and the next phase of the UK leaving the EU. O2 has and continues to plan for different political and economic scenarios, which include Brexit and the Covid-19 pandemic. This planning is to ensure we continue to be successful in executing our strategy and operations as planned and to minimise negative impact to our customers and stakeholders.	Increased: Due to the increased and extended uncertainty caused by Brexit.
Business: Strategy	Transformation	Constant change at pace is an inherent requirement due to the technological evolution in the markets we operate and the healthy competition. It is therefore vital that we deliver constant change and transformational activities.	O2 is currently delivering a transformation programme which is delivering substantial technology evolution and ensuring we are well placed for the future.	New

Finance & Fiscal	Finance & Fiscal	The financial performance, liquidity and financial going concern of the company are inherent risks to the organisation, including continued access to lending markets in the UK. .	We maintain strong banking relationships across a number of key banks, also leveraging our relationship at a Group level. 2019 has seen a strong financial performance by the organisation, as reflected in our financial results. We operate continuous monitoring of credit risks through our financial and procurement processes.	Stable
Operational: Systems & Network, and Security	Cyber & System Security	As a company who facilitates the communication of data and whose customers are enthused by our services and increasingly dependent on connectivity, we recognise this as one of our greatest areas of risk. Cyber-crime is increasing in both frequency and sophistication, and presents potential impacts to service, data loss, data integrity, data accessibility, and fraud.	We work collaboratively with our regulators to understand our cyber threat landscape and we are proactive in creating security standards that will help protect us and the industry in the future.	Increased: In recognition that the implications of this risk materialising has increased, for example costs to address sophisticated cyber-crime.
Operational: Systems & Network	System availability & capacity	Customers have an ever increasing demand for our services and products. In order to continually deliver excellent customer experiences across our network and products it is key that our systems keep pace with demand and service expectations.	At O2 our Strategy and Business Plans anticipate and plan for future market direction and demand. Our operational teams then work tirelessly to deliver the functionality needed.	Stable
Operational: Supply Chain	Suppliers, partnerships & Third Parties	O2 is a highly collaborative organisation that has many important relationships with third parties, in order to deliver its products and services.	We employ strong contractual requirements to ensure the quality of procured products and services and adopt a sustainable procurement strategy that drives our suppliers to greater social contribution, environmental protection and compliance to a clear and detailed supplier code of conduct. In addition we use risk based due diligence to assess and develop our supply chain aligning their capability to our business needs. This is managed via mature procurement, supply chain management processes, and a considered third party governance framework. We are certified to operate ISO44001-compliant Collaborative Working Relationships with certain key partners	New This new category has been created to recognise previous risks which are interconnected.
Operational: Operational Management	Operational Management	This broad area of risk is of significance to O2 given it covers factors such as; customer service, processes, human resources, fraud, laws and intellectual property.	At O2 we operate an internal control framework which places responsibilities across the business to execute effective management of the Company. These internal controls and responsibilities are integrated into our daily activities to deliver assurance across all the areas of operational risk mentioned here, and more.	Stable

Changes year on year:

As we continue to ever evolve and enhance our risk management practices, the following shows where risks from our last report have moved under new categories due to them being related/interconnected:

Risks From Last Report	Movements
Network Spectrum/Capacity	Moved under 'System availability & capacity'
5G deployment plan	Now considered under 'Market & Competition', 'System availability & capacity' and 'Transformation'.
Legacy Systems architecture	Moved under 'System availability & capacity'
Breach of Data Security	Moved under 'Compliance & Regulation'
Data Privacy	Moved under 'Compliance & Regulation'
Loss of FCA Authorisation to sell FCA Regulated products	Moved under 'Compliance & Regulation'
Child Protection	Moved under 'Reputation & Sustainability'
Smart Metering	Considered under 'System availability & capacity' and 'Compliance & Regulation'.
Economic/Political Instability	Renamed to Economic & Political Environment

Details of our risk management framework can be found in the Corporate Governance statement on pages 30 to 32.

Main trend and factors likely to affect company

Network

A key future event for the company is the next Spectrum Auction in 2020. This auction will open further spectrum to the UK mobile industry and allow for the further deployment of 5G services.

In 2020 we plan to deliver further 5G network and capability and drive the infrastructure strategy to enable future capability resulting in an enhanced network experience for our customers. There are risks and opportunities. We anticipate a high number of customers moving to 'unlimited' tariffs and average bundle utilisation increasing, causing higher growth than forecast. There is also a risk of not acquiring further spectrum. Our Network team carries out regular risk management across all of the identified network risks to ensure these are adequately mitigated.

Non-Financial Statement

Under our integrated approach to reporting, we report certain matters relating to employees, social, environmental, anti-bribery and corruption and human rights. The reporting obligation to include a non- financial statement under the Non-Financial Reporting Regulations are addressed throughout the Strategic report. For ease of reference, each of the matters addressed by the regulations can be found in the following pages Employees (pages 10 to 11), Social (page 15), Environmental (pages 15 to 16), Human rights (page 11), and Anti-bribery and corruption (page 19). Additional non-financial matters on how we operate are embedded in our Business Principles (page 18). Further information is detailed in the Non-Financial Report published on the Company's website.

172(1) Statement

The Directors in the performance of their statutory duties detailed in Section 172(1) of the Companies Act 2006, have a responsibility to act in a way they consider, in good faith would most likely promote the success of the Company, for the benefit of the shareholders as a whole. In doing the Directors have had regard to:

1. The likely consequences of any decisions in the long term;
2. The interests of Company's employees;
3. The need to foster the Company's business relationship with suppliers, customers and others;
4. The impact of the Company's operation on the community and environment;
5. The desire of the Company maintaining a reputation of high standard of business conduct; and
6. The need to act fairly between shareholders of the Company.

The directors are of the opinion that they have fulfilled their obligation through the governance framework detailed in the Corporate Governance Statement on Page 35. The directors and members of the main committees are aware and have been reminded of their statutory duties. In addition, the Directors have established a formal process to ensure adequate considerations of these matters for significant arrangements.

The Telecommunications sector is under huge pressure from increased competition and regulatory intervention. Our investment plan set out how we can continue to thrive and grow thorough these challenging times, whilst delivering differentiated customer experiences, providing innovative propositions and products and investing on network infrastructure and the technology to innovate, as demonstrated throughout the strategic report. The Directors are committed to doing the right thing for our customers, our people, suppliers, business partners, community, and environment as well as taking a leading role in influencing key regulatory issues. Further details of the stakeholder engagement to demonstrate how we have considered the interest of the Company's wider stakeholders are detailed in the Stakeholder and Relationship and Engagement section of the Corporate Governance Statement.

During the year the Company extended its network sharing arrangement with Vodafone to provide 5G Multi-Operator Radio Access Network for the rollout to support provision of 5G services which will improve customer experience and enable the Company to continue its operations in the most cost efficient manner in the medium term. Sharing network infrastructure has significant environmental benefits and is consistent with government policy. Network sharing provides the fastest way to bring 5G to more parts of the United Kingdom resulting in significant benefits for our customers. Rolling out 5G has extended and deepened O2's relationships with network equipment vendors. In addition to 5G roll out, O2 and Vodafone agreed to unwind their previous network sharing in some larger urban areas improving customer choice and service.

O2 has partnered with leading businesses across the construction, retail, transport and utilities sectors to explore the innovative use of 5G which will bring substantial business benefits by delivering efficiency savings while also having the potential to unlock new 5G enabled revenue streams. In addition to the launch, O2 created 5G innovation spaces across the country providing next generation 5G test environments accessible to businesses of all sizes to help fuel future innovation that will boost the British economy as a whole.

Our people are our greatest asset and this latest technology enables our business to grow creating more opportunities for our people to increase their skills and move at pace with this developing capability. This ultimately will mean we continue to be a sustainable business.

Post Balance Sheet Events

Regulatory intervention

Under Ofcom rules, we introduced End of Contract Notification and will introduce Annual Best Tariff Notification (ABTN) by February 2021. The ECN obligation is to send a notification within 10 to 40 days before the customer's contract end date and for ABTN to send another notification at least every 12 months from the date the customer received the ECN if the customer has not acted, or if out of contract, one notification in every 12 month period. We will comply with the regulation for when it comes into force and change tone of narrative.

Annual Licence Fees

In 2015, by way of regulations (2015 Regulations), Ofcom reset the existing regulations (2011 Regulations) for Annual Licence Fees (ALFs) for the 900 & 1800 MHz bands from approximately £65m to £200m per annum for all mobile network operators (MNOs). Telefonica UK's fees were set at £49.8m pa. The 2015 Regulations were quashed in 2017 pursuant to a Court of Appeal judgment which held that they had been determined unlawfully by Ofcom. The fees regime reverted to the pre-existing 2011 Regulations and the lower fees set in these Regulations. O2 and the other MNOs brought a claim against Ofcom for repayment of the difference between the amounts paid under the unlawful 2015 Regulations and the lawful 2011 Regulations. O2's claim was initially £52.8m plus interest. This figure increased to £54.4m plus interest in 2019 due to a payment being incorrectly characterised when the claim was first formulated.

Ofcom disputed that the MNOs were entitled to claim the difference in this way, instead asserting that the MNOs were only entitled to the difference between the amount paid under the unlawful 2015 Regulations and a notional amount that would have been paid had Ofcom put in place lawful regulations at the relevant time (which Ofcom noted would have been of a similar level to the 2015 Regulation fees based on a new consultation and subsequent 2018 Regulations that came into force which set ALFs at a broadly similar level as they had been set by the 2015 Regulations). The MNOs won their claim in the High Court in 2019 and the appeal in the Court of Appeal in 2020. Ofcom is not appealing the Court of Appeal decision to the Supreme Court

O2 and Virgin Media Joint Verture

On 7 May 2020, Telefonica SA and Liberty Global announced that both companies had entered into an agreement together to create a 50:50 joint venture in the UK, bringing together the Telefonica UK (O2) and Virgin Media businesses. The arrangement is still subject to regulatory clearance has been agreed in order to create a national connectivity champion capable of competing at the highest level with the combined mobile and home connections. It is anticipated that closing of the transaction, subject to regulatory clearance is expected to take place around the middle of 2021.

COVID 19

Worldwide or national health-related events, including the outbreak of contagious diseases, epidemics or pandemics, such as COVID-19 (coronavirus), could significantly affect our operations. Such events could cause, among others, delays in the supply chain due to problems in factories or logistic services; impact on employees or third parties due to quarantine periods or infection, and also affecting global and therefore national economic growth. The latter stemming from a variety of adverse impacts on supply (paralysis of integrated production chains, freezing of productive resources) and demand (deterioration of confidence and expectations, negative income and wealth effects) caused by a substantial deterioration in financial markets, unprecedented falls in commodity prices, sharp slowdown in commercial activity or heavy restrictions on transport. Like every other business we are not immune to the consequences of the pandemic and are committed to ensuring that the Business can navigate through the unprecedented uncertain times, supporting our customers and employees as well as contributing to the recovery of the economy which we operate in by keeping Britain connected. As Britain works through this national crisis, mobile is playing a more critical role than ever to keep people connected. We are doubling some elements of our network capacity, enabling essential connectivity, supporting Britain's productivity and donating directly to those who need it - all in the pursuit of keeping Britain connected.

As a responsible business we followed government advice to help protect our people and our customers. We implemented our business continuity plans to allow office-based employees to work from home and took a decision to close our stores after trading on 23 March 2020 ahead of the national lockdown announcement by the government. During the lockdown period we implemented a work from home policy where it is possible to do so ensuring the safety and welfare of our people and the ability to continue to meet the needs of our customers. In addition, we brought in a range of temporary people measures, including the protection of base pay for all employees including paid leave for vulnerable employees and for those in self-isolation, or with caring responsibilities who are unable to work from home, including retail employees. We worked closely with the government to provide assistance to NHS workers, charities and our customers by providing 25% discount on tariffs and free data for NHS workers, unlimited free calls for Pay Monthly customers, suspended roaming charges, support for vulnerable customers and zero-rating access to support and charity websites. We were instrumental to supporting the NHS and keeping Britain connected by providing connectivity to the Nightingale hospitals across the country and donated The O2 as a training facility as well as a drive through testing facility for the NHS. We also partnered with the BBC's Big Night In to galvanize the nation to respond to the challenges that lie ahead.

Following the ease of the lockdown restrictions in phases we are committed to ensuring the continuing safety of our employees and customers and have re-engineered our retail estate, practices and procedures to align with the government guidelines for social distancing. We are mindful of the economic pressure and impact on our profitability growth and are committed to helping Britain get back to normal by supporting our customers and businesses.

The Company has shown resilience throughout this turbulent period and the need for connectivity by our customers has been just as strong, albeit their specific demands have changed. The below table outlines the main impacts to the business as a result of COVID-19 and what the business has done to address them.

Matter to consider	Impacts/Risks	Mitigations	Conclusion
Revenue	Store closures have resulted in a slow down of hardware revenue. Smart metering revenues have slowed down due to physical restrictions during lockdown. The travel ban in the UK and across many parts of Europe has resulted in reduced roaming revenues.	Improved online sales capabilities by enabling telesales teams to operate from home and adapting physical estate in order to manage the sales process under social distancing guidelines.	We have seen an increase in online channel sales and we expect other channels to pick up again as lockdown restrictions start to ease from mid-June. The reduction in roaming revenues is partially offset by a reduction in associated costs.
Liquidity	Financing becomes more expensive and unavailable in the current climate.	Key debt facility has been renewed for an additional term and the introduction of a new funding partner has enabled the Company to grow the facility whilst keeping the total cost of funding the facility flat.	No significant liquidity concerns, the risk of a loss of available funding has been mitigated through the introduction of a third funding partner.
Collections	Customers struggle to pay their bills and increased bad debt.	Following emergency changes to government regulations on Consumer Credit Agreements we initially introduced an emergency payment option for any customers finding it difficult to pay their bill as a direct result of COVID-19. Appropriate provisions have been made for the anticipated increase in bad debt as a result of the pandemic.	The volumes of customers taking the emergency payment option has been within expected levels, the impact has been considered in forward looking financial forecasts.
Costs/Capital allocation	Spend is not reviewed in light of COVID-19.	The board has reviewed discretionary expenditure and investments in view of COVID-19 and continue to execute smart spending principles to focus on core service and targeted cost management throughout the business.	Appropriate measures are now in place to review cost control and capital expenditure in light of the pandemic.
Forecasting	Forecasts are not reflective of performance during COVID-19 crisis.	We have processes in place to review the appropriateness of our financial outlooks regularly and monitor market activity on an ongoing basis. Rate and volume assumptions have been stress tested and triangulated with market insight and trading updates.	Current forecasts take account of risks associated with trading during the COVID-19 crisis.
Network Resillience	Network overload and possible degradation of services from the growth of voice / data traffic.	We proactively managed the expected voice traffic increase through increased network capacity. Data usage patterns changed as people connected from their homes rather than work locations and commuting routes with no negative impact on the network.	Network capacity planning reflects an expected impact of changes in future usage patterns as a result of COVID-19.

The Strategic report was approved by the Board on Board on 24 June 2020

By Order of the Board

Vivienne Aziba
For and on behalf of O2 Secretaries Limited
Company Secretary

Director's report

Director's Report

The Directors of the Company present their audited report for the Company, which has been prepared in accordance with the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008.

In accordance with Section 414C (11) of the Companies Act 2006 the Directors have chosen to set out in the Strategic Report certain information which fulfils the requirement of the Directors' report.

Directors and secretary

The Directors who held office during the year were as follows:

Mark Evans

Patricia Cobian

The Secretary who held office during the year was O2 Secretaries Limited.

Directors' liability insurance and indemnities

Telefonica O2 Holdings Limited (formerly Telefonica Europe plc), the Company's ultimate UK parent company, has granted an indemnity in the form permitted by UK Company Law to Directors appointed to subsidiary companies. This indemnity was in force during the financial year and at the date of approval of the financial statements.

Corporate Governance statement

Details of the Company's goverance arrangement is set on on pages 35 to 45 the Annual Report.

Stakeholder Statement

Details of how the ELT have had regard to the need to foster the Company's business relationships with suppliers, customers, and other and the effect of that regard in principal decisions taken by the Company can be found throughout the integrated report. For ease of reference the key stakeholders are detailed on page 18 of the Strategic Report and pages 39 to 45 of the Corporate Governance Statement.

UK Employee Engagement Statement

The Company solely operates in the UK and its employees are based in the UK with the exception of a handful of employees which are seconded to other group companies from time to time.

Details of how the directors have engaged with UK employees and how the directors have had regard to the UK employee interest, and the effect of that regard on principal decisions taken by the Company can be found on pages 10 to 11 of the Strategic Report and page 42 of the Corporate Governance Statement.

Dividends

The Company paid an interim dividend of £480 million during the year ended 31 December 2019 (2018: £Nil).

Political donations

In accordance with the Group policy, no political donations were made or political expenditures incurred in accordance with the Companies Act 2006, in respect of political parties during the financial year ended 31 December 2019 (2018: £Nil).

Financial risk management objectives, policies and exposure

Details of the Company's approach to financial risk management objectives and policies are set out in the financial statements in note 31 "Financial instruments and financial risk management".

Important events since the end of the financial year

The Strategic report sets out on pages 29 to 32 details of the important events affecting the Company which have occurred since the financial year end.

Capital structure and rights attached to shares

The details of the Company's capital structure including the rights attached to shares is detailed in note 28 of the financial statements.

Going concern

The Company's business activity is that of a mobile cellular telephone system provider and operator. The financial position of the Company is described on pages 19 to 20 of the strategic report. In addition, note 31 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk, liquidity risk and interest rate risk. The Directors believe that the Company is well placed to manage its business risk successfully. The Directors have reviewed the business plan for the period to 31 December 2021, and together with the commitment received from the ultimate parent company to continue providing financial support because of the net current liabilities position have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future and thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

The impact to the Company from COVID-19 is described in detail on pages 30 to 32. The Company has shown resilience throughout this turbulent period and the need for connectivity by our customers has been just as strong. The impact to the Company has been modest considering the challenges faced across the global economy. In light of this, the Directors believe that the Company is well placed to continue to mitigate the impacts of COVID-19 during 2020 and beyond.

Statement as to disclosure to auditors

So far as each Director is aware, there is no relevant audit information of which the Company's auditors were unaware. The Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

The Directors' Report has been approved by the Board on 24 June 2020

By Order of the Board

Vivienne Aziba
For and on behalf of O2 Secretaries Limited
Company Secretary

Corporate Governance Statement

The Board has chosen to report the Company's governance arrangements against the Wates Principles detailed below:

Principle One: Purpose and leadership

The Board, supported by the Executive Leadership Team, are responsible for promoting our Company's purpose of making every day better through personal experiences that count supported by our Customer Led Mobile First strategy. This is underpinned by our company values of being Bold, Open and Trusted which is demonstrated in our commitment in being a responsible business, our business principles and our company policies. Our policies and procedures are updated regularly and continually reviewed against desired behaviours and culture as well as values.

Culture

Our company values, are embedded in our performance management processes. Our leadership development programmes bring the values to life and provide leaders in the business with greater detail about what great values leadership looks like.

The 'Ourstars' site, hosted on Workplace, allows our people to recognise colleagues for demonstrating our values and to share these examples with the whole business, highlighting and celebrating our desired behaviours. The Executive Leadership Team regularly reference and demonstrate the values as well as giving awards throughout the year to those living the values across the organisation. Events through the year such as 'O2s Got Talent', and National Inclusion Week regularly encourage our people to be Bold and Open outside of their day to day roles.

Principle Two: Board composition

The Board (which is comprised of the Chief Executive Officer and the Chief Financial Officer) with the support of the Executive Leadership Team (ELT) (comprised of the two principle committees) has overall accountability and oversight responsibilities which forms part of the governance framework to deliver the Company's purpose.

Principle committees (ELT)

The ELT are members of the two principle committees; the Operating Committee and Strategy Committee (Principle Committee). The Principle Committee members are; the Chief Executive Officer, Chief Financial Officer, the General Counsel, the Chief HR Officer and Chief of; the Chief Executive Officer, Chief Financial Officer, the General Counsel, the Chief HR Officer and Chief of Staff, the Chief Marketing Officer, the Chief Operating Officer, the Sales Director, Director of Business and Directorate of Corporate Affairs. Full details of the Committee structure and the Leadership Team bios can be found on the Company's website https://www.o2.co.uk/abouto2/our-leadership-team

Delegation of authority

The Board has a number of other committees to consider specific matters within the framework of the Telefónica Group Operating Model and Delegated Authorities whilst maintaining objectivity in managing the affairs of the Company. The ELT has the necessary skills and experience to make valuable contributions in promoting the success of the Company and is committed to ensuring that the Company is managed according to the highest standards of corporate governance. The Board regularly reviews the composition of the ELT and consequently appointed the Director of Corporate Affairs to the ELT in 2019, recognising the value that those skills and experience would add to the ELT. The ELT has a 55/45 split of female vs male representatives.

Effectiveness

The ELT and the Board are committed to ongoing professional development. During the period the ELT (which include the members of the Board) participated in regular leadership and personal development sessions to ensure they have the right skills to discharge their duties and work effectively as the leadership team. In addition, the Board increased the number of meetings to distinguish its oversight and accountability responsibilities from the day today operational responsibilities of the ELT. Also, we conduct annual Committee Effectiveness reviews for all committees to ensure they operate effectively. As a result we enhanced the governance process, in particular the flow of information to the Board and Committees to ensure that the decision makers have timely and sufficient information to discharge their duties.

Principle Three: Responsibilities

Committees

The Board has established two principal committees: namely

- The Operating Committee who monitor the operating and financial performance of the UK businesses as a whole and assesses risk; and
- The Strategy Committee which monitors the external market and competitive forces in the UK, develops strategy and monitors key strategic projects. The main focus during the year included a review of the medium to long term strategic plan.

Other committees reporting directly to the Board are:

- The Assurance Forum which considers the internal control framework and assists the ELT in fulfilling certain oversight responsibilities in the areas of governance, risk management and compliance framework.
- The National Security Committee which considers policy and issues in respect of the company's specific legal obligation as a communication provider.
- The Pensions Committee which considers matters relating to the Telefonica UK Pension Plan of which the Company is the Principal Employer and liaises with the Trustee of the Plan.
- The Responsible Business Taskforce which considers matters related to the delivery of the Company's sustainability and responsibility strategy. It also considers the Company's disclosure of non-financial reporting matters. Full details of our approach to being a responsible business is published on the Company's website.

There are other forums that assist with operational matters such as the Incentives Forum which oversees all of the sale related incentive schemes, including those sponsored by a third party supplier.

Accountability

The Board and its committees have a defined charter of roles and responsibilities and terms of reference detailing their responsibilities and delegated authority. The Board has delegated authority to the Operating Committee to establish the policies and practices that govern the internal affairs of the Company. They retain oversight of the policies including the review of the policy management framework. The Board regularly receives reports from the direct committees with delegated responsibilities and deals with board reserved matters.

Information integrity

The ELT receive regular updates on all key aspects of the business including financial performance, and on strategy and operational matters. In addition, Board information on non-financial matters are monitored with KPIs for all business areas which are reviewed by at least one member of the Senior Leadership Team to ensure information integrity in order to assist the ELT with the effective monitoring of the Company's performance and inform decision making.

Principle Four: Opportunity and Risk

Opportunity

We have an agreed 3-year planning process that engages and collaborates with the relevant stakeholders across all business units to develop our Strategic ambitions. This identifies new market and product opportunities and the relevant actions that need to be taken in order to create a suitable case for investment if appropriate to do so.

How we manage our risks

We recognise that risks are inherent in all business and company activities, and that effective risk management contributes to the development of the business through an appropriate balance between growth, return and risk.

We have a comprehensive Enterprise-wide Risk Management Framework in place, which is aligned with ISO31000:2009 Principles and Guidelines for Risk Management. This is supported by our Risk Management Policy and detailed process which have been independently assessed by the BSI against the ISO31000:2009 Standard. The risk management framework forms part of the internal control framework, which is aligned to COSO (Committee of Sponsoring Organisations) standards as discussed on page 38.

Risk Appetite

Telefonica Group has established the acceptable risk level (Risk Appetite) each year for O2. This defined level enables O2 to deliver value creation, growth and performance whilst managing risk exposure in a measured accountable way. When applied to our strategy decision making, this helps the Company's management to select appropriate strategies within its acceptable risk level.

Risk Framework & Process Summary

The framework is designed to identify, assess, manage, monitor and treat significant risks that could adversely affect the future success of the organisation.

- The risk management process takes, as a starting reference, the strategy and objectives of the Company, as a basis for the identification of the main risks that may affect their achievement. Then, more broadly, our model considers three complementary perspectives: overall (top-down), local (bottom-up) and cross-functional (projects and processes). This approach includes the consideration of the external environment.
- The identified risks are assessed in a qualitative and/or quantitative way in order to prioritise the follow-up and response to these risks, usually through mitigation plans, or strategies to avoid or transfer these risks.
- Regular reporting gives management awareness of key risks and the capacity to assign the most effective resources at the optimal moment to control and respond to the risks and opportunities identified.
- Risk insight allows Internal Audit to prioritise its activities for the supervision of the internal control structures.

Risk Management Execution & Oversight

The activities that underpin these risk management processes are facilitated across the business by individuals who execute their respective risk management roles and responsibilities in their team. They are supported by a dedicated Central Risk Management team and network of Risk Champions.

The most significant risks to the Business are presented to the ELT at regular intervals each year for discussion, validation and direction. This takes place via the Operating Committee and Statutory Board, with the support of the Assurance Forum. These structures drive accountability and direction for O2's risk exposures.

Details of the Principal Risks and Uncertainties facing the Business are disclosed in pages 22 to 27 of the Strategic Report.

Internal Control

The Company's internal control framework is configured as a process that is integrated into our daily activities. The Internal Control Framework incorporates preventive and verifying functions structured in an integrated way: Preventative - Company Policies, Risk Management, Monitoring and Operational Controls. The control control framework has been designed to meet the requirements of the Sarbanes Oxley Act 2002.

Internal Audit

Internal Audit is responsible for confirming the adequate function and operation of the internal control and risk management structures. It will also help to identify possible inefficiencies or non-compliance of the control system.

Each month Internal Audit reports to the ELT on the Governance, Risk and Control key performance indicators, which is based on a set of metrics covering the management of risks, the implementation of any control and/or internal audit actions identified. The status of the KPI and actions required are reported to each Business area on a monthly basis.

Principle Five: Remuneration

The focus of the Group's Remuneration Policy is to ensure that the business can attract, reward and retain the best leadership talent, enabling it to meet our strategic targets within a highly competitive and globalised setting.

The pay principles and the approach outlined below is for employees including the ELT.

A significant portion of the renumeration is delivered in variable pay, which is designed to incentivise the achievement of the Company's short- and long-term goals. The short-term variable remuneration is linked to achieving specific financial, business, customer satisfaction and sustainability objectives. The long-term variable remuneration is linked to the value creation in the Group by measuring the shareholders' return on investment and key economic financial objectives.

The positioning of base pay is based on

- the external benchmark data applicable to an individual's role
- the internal pay range or the pay points for an individual's grade and individual's performance
- the Company's overall pay budget which is determined by financial position and company performance.

There are formal negotiations with Trade Unions and consultation with employee representatives on pay and benchmarking. The pay ranges of each of our grades are set competitively using robust external market data which is reviewed at least annually.

There are two ways in which an individual's salary can be reviewed:

- Annual pay review – awards are made on an annual basis based on budget, position against external market data and individual performance.
- Exceptional pay review – requests can be submitted for out of cycle pay reviews on the basis of a retention risk and/or misalignment to the internal or external market.

Both of these processes are managed centrally by a Reward team with detailed governance and approvals in place and clear/consistent guidance being given to line managers. In delivering pay reviews in this way, it is possible to monitor all awards from a cost, equity, fairness and diversity perspective.

There is an additional level of governance for ELT pay which is strictly determined and assessed by Group Remuneration Committee. The ELT renumeration details are disclosed in notes 7 and 8 of the Financial Statements.

Details of the gender pay gap report is published on the Company's website here.

All our people on a permanent contract are eligible for our Flexible Benefits programme to help improve their lifestyle. This includes an employee share scheme which is called Share in Success Share where they can choose to invest up to £1,800 or 10% of their salary (whichever is the lower) in Telefónica, S.A. (our parent company) shares per tax year.

Principle Six: Stakeholder Relationship and Engagement

Our stakeholders are classified as any group that may be affected by our business in a significant manner such as customers, people, suppliers, strategic partners, the regulator, government, our shareholders, society and the environment. The ELT continues to promote the long-term aspirations for the company and considers the wider interest of the stakeholders. The CEO, as the chair of the ELT holds a monthly meeting with the sole Shareholder to understand the shareholders views and regularly updates the ELT to ensure alignment between the Company and the shareholder.

External impact

The ELT is committed to working with people to help them live better with tech through our Blueprint ambition to help 20 million people live better with tech by 2020. This brings our purpose to our communities and invites everyone to come together for the good and to help bring positive change. We aim to help society as a whole, not just our customers, and to improve people's lives, now and in the future. Full details of our Blueprint can be found on the Company https://www.o2.co.uk/our-blueprint

Stakeholders

The ELT promotes the Company values, Bold, Open and Trusted in dealings with all external stakeholders. Each Stakeholder Group has at least one member of the ELT as an Executive Sponsor to help manage the day to day relationship. The ELT receive regular updates on stakeholder matters.

Customer

We build relationships and listen to our customers through a number of channels.

Customer closeness – We engage our customers via online video focus groups, video interviews and broader online discussion rooms. Insight from the sessions was delivered face to face across 10 driver workshops and reports, which fed directly into our NPS plans for 2020 with clear leadership accountability. We have monthly open discussion forums with the consumer and SMB communities. We also actively listen to conversations on social networks and consider the feedback.

Our Enterprise customers have dedicated account and service management teams. This allow us to maintain an ongoing relationship with these customers. Our customer facing teams can be present within the Enterprise customer's own environment. Our partnership approach allows us to understand their ongoing and evolving business needs and priorities, and how we can help them to achieve these. Additionally, members of our ELT are sponsors for some of our Enterprise accounts to help further with customer engagement. We also actively promote and interact with our customers through industry events for example, Blue Door Events for our Enterprise Customers and Innovation Workshops.

In 2019 we introduced the 'Voice of the Customer Mission Team' – a working group made up of subject matter experts from across the business and our partner, Capita. Our role is to be the single voice of the customer across our channels. Shared ideas remove duplication of effort and seek out improvement opportunities, utilising cross directorate expertise and influence.

Customer Experience measurement programme (FanBASE) - Over 1 million customers responded to our text surveys to share their views of O2 products, services and experiences. The feedback is shared across the business including front line teams so they can learn from our customer's experience.

NPS Relationship survey – We supplement our text surveys, We use a representative sample from the fanbase and other customers from an online panel, who have opted into complete surveys to help the business to understand where we can improve and what we are doing right.

Closing the loop - As a customer led organisation, we offer all dissatisfied customers (from our text or NPS survey) the option to talk to us. Over 27,000 customers have been offered the real time URL to book an appointment, 90% of customers who have spoken to the team consider their issue resolved after this contact.

Mystery shopping - O2 employ a 3rd party agency to carry out monthly mystery shopping visits to stores throughout the UK. They are designed to monitor the compliancy of store staff during the sales experience (e.g. contract explanation, credit check process, RPI explanation). Monthly reports are issued which highlight any areas and opportunities to make improvements for our customers.

Customer Advisory Forum - 2019 saw the introduction of our new Customer Advisory Forum, chaired by the COO. This is a strategic forum for our most significant customers, who have access to our unique insights and relationships and collaborate to explore how we can create greater value. The group meets at least twice a year to share ideas and experiences around common business challenges and provide input and advice on O2's strategies and direction.

Vulnerable customers

Through our regulators, extensive research and cross industry best practice we understand the areas of our business where there is a higher likelihood of interacting with customers in vulnerable situations. In response to this, as well as training all front line colleagues, we have a number of specialist teams who focus on meeting the needs of our most vulnerable customers; this includes Customer Relations who support customers who have experienced a bereavement and those diagnosed with long-term illness, Payment Management supporting customers in financial difficulties and Access For You for customers who struggle with our conventional channels due to their personal circumstances.

We continue our work with Ombudsman Services, our Regulators and Citizens Advice and have visited a number of "Centres of Excellence" in supporting vulnerable customers, to understand other areas of vulnerability which may impact our customers; this helps us to continually develop strategies to support customers appropriately through our various service channels, new technology and self-service options.

Both Ofcom and the FCA have recently produced guidance on treating vulnerable customers fairly and there is a lot of emphasis on gathering feedback from vulnerable customers to ensure they are getting the support they need and we will continue to work with them to find the best way to do this.

Business Partners

We have focused on delivering support that would enable O2 to be "easier to do business with". We have launched a new Partner Hub which is a central area where all Partners receive their O2 communications.

We have a regular programme of engagement with each partnership segment such as weekly meetings to discuss trading performance, any day to day issues and opportunities. We have quarterly briefing sessions to cascade key messages from O2 and to discuss strategic opportunities/issues. There are feedback opportunities through Forums, informal group discussions and conferences. In addition we use Webex sessions to promote marketing campaigns and new products and Partners are encouraged to give feedback. O2 conduct an Annual Partner Survey which allows Partners to feedback on all aspects of the support they receive which in turn drives a priority action list enabling us to provide updates on the actions. The ELT engages at key Partner events.

Our People

We have various means to engage with our employees and to act upon their feedback:

Conference: We held our annual conference over three days in London for our people. The audience got to hear about our key objectives for 2019. All members of the ELT presented plans for each area with the theme of #weareo2.

Wider Leadership Team/Senior Leadership Team events: Each quarter, through face to face or livestream events, The ELT share important updates against company objectives with all leaders in our business. They will focus on key messages and initiatives so ensure that our performance continues to centre around our strategy.

Listening Tour: We run regular Listening Tours where a co-ordinated programme of the ELT and senior members of the business visit company-owned stores to engage with, obtain feedback from the ground and motivate our people on the shop-floor.

Workplace*:* Our internal social media platform where we can cascade key messages to our people and provide a forum for them to share feedback, ideas and news from around the Business.

Global Engagement Survey: every year we encourage our people to provide their views on working in the business. They can also share feedback which can help identify areas for improvement within the business which we aim to address.

Quarterly update: Each quarter, members of the ELT share our business financial results and strategy updates with our people which includes our financial and economic factors. These are held face to face across all our sites and supported with information on Workplace.

Employee representatives: On a regular basis, we engage with the trade unions and employee representatives on a broad range of employee related matters to maintain a positive and collaborative industrial climate within the business. The CEO and HR Director meets with the trade unions annually to communicate the Company's strategy and direction. In addition, there are regular meetings between the trade unions, functional leaders and HR to listen the concerns and views of the employee representatives, and act on those concerns where appropriate. We undertake collective consultation for all formal transformation activities such as change to roles, changes to terms & conditions, restructure and redundancy programmes, TUPE, compensation changes.

Telefonica UK Pension Plan ("the Plan")

The Company's Pension Plan is held and managed under trust. The fiduciary responsibility for operating the Plan is with an independent set of Pension Trustees. The Company engages with the Pension Trustees through regular communication, meetings and information sharing. The Pension Trustees consult with the Company on all their principal decisions around the operation of the Plan. Examples of decisions taken during the year include:

- Company and Trustee agreement to change the investment strategy in the Defined Contribution Section of the Plan. The changes will incorporate a greater weighting to Environmental, Social and Governance factors in the investments held by members.
- Joint agreement around a framework to monitor the long-term funding progression of the Defined Benefit (DB) Section of the Plan. This framework is a joint strategy to manage the investment and other risks associated with the DB Section pension liabilities.

Regulators

Ofcom

We are subject to sectoral regulation administered by Ofcom, the Communications Regulator. The UK regulatory regime is wide ranging and includes regulation designed to: protect consumers; provide universal services; ensure the availability of electronic networks and services; and address enduring competition problems. Ofcom is also responsible for policy relating to spectrum, including setting Annual Licence Fees and administering spectrum awards. It is essential that we have a full, constructive working relationship with the regulator.

In 2019 Ofcom implemented the following initiatives.

- Bill spend caps: Delivers the capability for our customers to set a usage cap to their account. The customer's account will be barred once the agreed usage limit is reached.
- Text to Switch: The new text functionality to help improve the customer experience when they want to switch providers.

In our relationship with Ofcom, we seek to further the interests of the Company so we can always deliver great experiences for our customers. We have a regulatory team responsible for managing the relationship with Ofcom, including developing regulatory policy; responding to consultation documents and requests for information; and managing enforcement investigations. The team provides updates to the ELT on a regular basis. Our CEO meets with Ofcom's CEO on a quarterly basis and there are regular meetings between members of our ELT and senior officials in Ofcom.

We responded to Ofcom consultations relating to the proposed forthcoming award for 700 MHz and 3.6 - 3.8 GHz spectrum. That spectrum is expected to be auctioned in spring 2020. Also we engaged in Ofcom's reviews of the Business Connectivity market and Physical Infrastructure market, which culminated, in July 2019, in a regulatory duty on Openreach to provide unconstrained access to its ducts and poles and charge controls on ethernet circuits (used in the provision of mobile backhaul services).

In 2019, Ofcom conducted several enforcement investigations into the company. In November 2019, Ofcom found that we had not breached our statutory duty to take appropriate measures to protect our network, in relation to the December 2018 network outage.

FCA

O2 continues to maintain a strong relationship with the FCA. We report on various metrics such as finance and complaints which are shared on a quarterly basis. The complaints is published on our website here. We engaged with the FCA on the implementation of the Senior Managers Review Framework which came into force on 9 December 2019. There were no FCA determinations against us.

ICO

The ICO is the UK's independent body set up to uphold information rights. The Executive Leadership Team monitors regulatory complaints, personal data breaches and any regulatory sanctions. We seek a constructive engagement with the regulator in all areas and take appropriate remediation actions to drive continuous improvement in support of our customer led strategy.

We engage with ICO to foster a constructive relationship with the regulator in support of our business strategy. We engage in a range of ways including consultations, industry initiatives and day to day contact. In 2019 we responded to ICO's Consultation on "Age appropriate design: a code of practice for online services" and on "The accountability toolkit".

Government

We work with the Government to help secure a more progressive and favourable policy environment for our business priorities. We have regular meetings and written correspondence, either through the Public Affairs team, or directly with the CEO and issues that matter to the Business and our Customers. An example negotiating and securing the Single Rural Network.

Analysts and Media

We engage with analysts and the media to increase understanding and perceptions of our business externally. Launching our 5G service in October generated over 500 pieces of coverage across all types of media outlets including broadcast. We also secured extensive press coverage when we announced we had increased paternity leave to 14 weeks for all permanent employees, acknowledging the importance of sharing and caring responsibilities and flexible working as part of our employee benefits. Many pieces highlighted that the policy is one of the best available in the retail sector.

Suppliers

Every year O2 spends a significant amount with its supply base in order to meet our bought in requirements for goods and services. It's important that we purchase the correct quality and the best price from those suppliers to meet our requirements.

Our default position is to purchase through competitive Request For Proposals wherever possible and in-line with our Group's model. This ensures interaction with potential vendor base that is larger than just existing suppliers.

The Supplier relationship management covers Service Level Agreement compliance, continuous improvement, risk management, innovation, and commercials. All suppliers are managed within a governance framework, according to their tiering. For example, we have monthly service reviews, quarterly relationship meetings and bi-annual executive strategic discussions.

As a business certified to *ISO 44001* Collaborative Business Relationships Management, we have identified specific supply areas where we want a collaborative relationship and we work with such suppliers. Within a formal relationship management model design to maximise the value of the relationship to both parties and optimise our collective performance in support of the end customers. As part of the Telefonica group we routinely survey our Suppliers to understand their experience of doing business with Telefonica. Additionally we carry out local relationship reviews where we review and optimise our working relationship.

We share our sustainability requirements with suppliers and, via contractual terms, commit our suppliers and their extended supply chain to align to them. For example, our procurement goal is to manage and minimise emissions in our supply chain. To this end we contractually require suppliers to have active carbon reduction programmes and we have contractually agreed programmes (as independently assessed by the Carbon Trust) with 20% of our supply chain emission sources.

Additionally we also collaborate via the Joint Audit Cooperation (JAC) an Memorandum of Understanding between other mobile operators to assess suppliers in our common supply chains against a synthesis of our collective ethical codes. It's an initiative that we have participated in for many years. Each year we collectively assess approximately 100 suppliers in our common supply chains. In the 2019 campaign we have:

- driven 20 x JAC Academy audits by our suppliers to our audit standard
- conducted 20 x surveys of workers in our collective supply chains
- driven 93 x JAC audits collectively

We prohibit all forms of forced labour by our suppliers. Following government guidelines, we identify 'at risk' areas of our supply chain and engage with those suppliers to assess how they manage Modern slavery risk. This happens as part of our general management of human rights in the supply chain. A full explanation of our approach to managing Modern slavery risks can be found in the our Modern Slavery Statement published annually on the Company's website.

During 2019 we strengthened our management of suppliers involved in work that falls under the Construction Design Management (CDM) Regulations and other safety critical activities. Such suppliers must now have Safe Contractor Safety Scheme in Procurement accreditation. You can see the suppliers involved in different activities in our non-financial report.

The Corporate Governance Statement was approved by the Board on 24 June 2020

Order of the Board

Vivienne Aziba

For and on behalf of O2 Secretaries Limited

Company Secretary

Statement of Directors' Responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

Directors' confirmation

The directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

In the case of each director in office at the date the Directors' Report is approved:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

The Statement of Directors' responsibilities was approved by the Board on 24 June 2020

By Order of the Board

Vivienne Aziba

For and on behalf of O2 Secretaries Limited

Company Secretary

Independent auditors report

Report on the audit of the financial statements

Opinion

In our opinion, Telefonica UK Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2018, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 32, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Graham Lambert (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Uxbridge

June 2020

Statement of comprehensive income

For the year ended 31 December 2019

	Note	2019 £m	2018 £m
Revenue	6	**5,976**	5,742
Operating costs	6	**(5,046)**	(4,917)
Net impirment losses on financial and contract	6	**(149)**	(89)
Operating profit	6	**781**	736
Financial income	10	**17**	7
Financial expense	10	**(33)**	(28)
Profit before taxation		**765**	715
Taxation	11	**(163)**	(114)
Profit for the year		**602**	601
Other comprehensive loss			
Items that will not be reclassified to profit or loss:			
Actuarial loss on retirement benefit obligations	26	**(59)**	-
Income tax related to other comprehensive loss	27	**6**	-
Other comprehensive loss for the year		**(53)**	-
Total comprehensive income for the year		**549**	601

The accompanying notes on pages 53 to 96 are an integral part of these financial statements.

Statement of financial position

For the year ended 31 December 2019

	Note	31 December 2019 £m	31 December 2018 £m
Non-current assets			
Property, plant and equipment	13	**2,817**	2,670
Right of use assets	14	**606**	-
Intangible assets	15	**1,356**	1,503
Investments	16	**14**	14
Deferred tax assets	27	**6**	3
Trade and other receivables	18	**342**	237
Other financial assets	19	**57**	12
Retirement benefit asset	26	**-**	23
		5,198	4,462
Current assets			
Inventories	17	**120**	93
Trade and other receivables	18	**1,747**	1,993
Other financial assets	19	**64**	74
Cash and cash equivalents	20	**138**	104
		2,069	2,264
Current liabilities			
Borrowings	21	**(2)**	(72)
Lease liabilities	22	**(186)**	-
Trade and other payables	23	**(2,577)**	(2,644)
Current tax liabilities		**(74)**	(138)
Provisions	24	**(37)**	(14)
		(2,876)	(2,868)
Net current liabilities		**(807)**	(604)
Total assets less current liabilities		**4,391**	3,858
Non-current liabilities			
Borrowings	21	**(964)**	(964)
Lease liabilities	22	**(411)**	-
Trade and other payables	23	**(231)**	(204)
Deferred tax liabilities	27	**(52)**	(45)
Retirement benefit obligation	26	**(12)**	-
Provisions	24	**(72)**	(65)
		(1,742)	(1,278)
Net assets		**2,649**	2,580
Equity			
Ordinary share capital	28	**10**	10
Capital reserve	28	**23**	23
Retained earnings		**2,616**	2,547
Total equity		**2,649**	2,580

The accompanying notes on pages 53 to 96 are an integral part of the financial statements. The financial statements on pages 49 to 96 were approved by the Board of Directors on 24 June 2020 and were signed on its behalf by:

Mark Evans

Director

Statement of changes in equity
For the year ended 31 December 2019

	Ordinary share capital	Capital reserve	Retained earnings	Total equity
	Note 28	Note 28		
	£m	£m	£m	£m
Balance at 1 January 2018	10	-	1,946	1,956
Total comprehensive income for the year	-	-	601	601
Capital contribution	-	23	-	23
Balance at 31 December 2018	**10**	**23**	**2,547**	**2,580**
Profit for the year	-	-	602	602
Other comprehensive loss	-	-	(53)	(53)
Total comprehensive income for the year	**-**	**-**	**549**	**549**
Dividends paid (Note 12)	**-**	**-**	**(480)**	**(480)**
Balance at 31 December 2019	**10**	**23**	**2,616**	**2,649**

The accompanying notes on pages 53 to 96 are an integral part of these financial statements.

Statement of cash flows
For the year ended 31 December 2019

	Note	2019 £m	2018 £m
Profit before taxation		**765**	**715**
Adjustments to reconcile profit before tax to net cash flows:			
Property, plant and equipment depreciation	13	533	520
Right of use asset depreciation	14	181	-
Intangible asset amortisation	15	261	295
Increase in other provisions		42	2
Increase in bad debt provision	24	4	25
Impairment of investment in subsidiaries		1	11
Share based payment expense		2	1
Net foreign exchange gain		-	(1)
Net financial expenses		16	21
Operating profit before adjustments for working capital changes		**1,805**	**1,589**
(Increase)/decrease in inventories		(27)	10
Decrease in trade and other receivables		157	90
Decrease in trade and other payables		(2)	(245)
Decrease in other provisions		(12)	(9)
Company contributions to retirement benefit obligation		(25)	-
Corporation tax paid		(194)	(144)
Interest received		13	16
Net cash flow generated from operating activities		**1,715**	**1,307**
Purchase of property, plant and equipment and intangible assets		(896)	(1,249)
Increase in other financial assets		(35)	(23)
Share subscription in subsidiary undertaking		(1)	(4)
Net cash flow used in investing activities		**(932)**	**(1,276)**
Dividends paid		(480)	-
Principal elements of lease payments		(164)	-
Lease interest paid		(14)	-
Other interest paid		(21)	(34)
Proceeds from borrowings		-	524
Repayment of borrowings		(70)	(431)
Net cash flow (used in)/generated from financing activities		**(749)**	**59**
Net increase in cash and cash equivalents		**34**	**90**
Cash and cash equivalents at 1 January		**104**	**14**
Cash and cash equivalents at 31 December		**138**	**104**

The accompanying notes on pages 47 to 85 are an integral part of these financial statements.

1. General information

The principal activity of Telefonica UK Limited (the "Company") is that of a mobile cellular telephone system provider and operator. The Company is incorporated in England and Wales and is domiciled in the United Kingdom. Telefonica UK Limited is a private company limited by shares registered in England and Wales under the number 1743099. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX.

2. Changes in accounting policies and disclosures

2.1 New and amended standards adopted by the Company

The Company has applied the following standards and amendments for the first time for the annual reporting period commencing 1 January 2019:

IFRS 16 Leases

On 1 January 2019 the new IFRS 16 Leases accounting standard became effective, resulting in changes in the accounting policies applied in prior periods.

The standard sets out the requirements for recognising right of use assets and lease liabilities. The Company has adopted IFRS 16 using one of two transition methods: the modified retrospective transition method, with the cumulative effect from initial application recognised as an adjustment to the opening balance of retained earnings at the date of initial application, 1 January 2019. Accordingly, the 2018 information presented for comparative purposes has not been restated i.e. it is prepared and presented in accordance with the accounting standards effective during that period: under IAS 17 Leases and related interpretations.

Under the provisions in IFRS 16, it is possible to elect to apply certain practical expedients to reduce complexity in the application of the new requirements. The main practical expedients applied by the Company are:

- Lease assessment: the Company did not reassess whether a contract is or contains a lease on the date of initial application of IFRS 16 for all contracts identified as leases under previous accounting standards.
- Right of use asset measurement: for a vast majority of leases previously classified as an operating lease the Company recognised a right of use asset at the date of initial application measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.
- Discount rates: the Company applies a single discount rate to a portfolio of leases with reasonably similar characteristics such as lease term, class of underlying asset, currency and economic environment.
- Initial direct costs: the Company excluded initial direct costs from the measurement of the right of use asset at the date of initial application.

The Company did not need to make any adjustments to the accounting for assets held as lessor under operating leases as a result of the adoption of IFRS 16.

The details of the new significant accounting policies and the nature of the main changes to previous accounting policies in relation to lease accounting under the new model in IFRS 16 are set out in Note 3. The most significant impacts relate to the first-time recognition of right of use assets and lease liabilities; reduction in operating lease rental expenses in profit and loss; increase in lease interest expense and right of use depreciation charges in profit and loss.

The impacts of adopting IFRS 16 on the Company's financial statements for the year ended 31 December 2019 are set out below:

Income statement

	31 December 2019 IFRS 16 £m	31 December 2019 IAS 17 £m	31 December 2019 IFRS 16 impact £m	
Revenue	**5,976**	**5,976**	-	
Operating costs before right of use depreciation	**(4,865)**	**(5,056)**	191	(a)
Right of use depreciation	**(181)**	**-**	(181)	(b)
Total operating costs	**(5,046)**	**(5,056)**	**10**	
Net impairment losses on financial and contract assets	**(149)**	**(149)**	**-**	
Operating profit	**781**	**771**	**10**	
Financial income	**17**	**17**	-	
Financial costs	**(33)**	**(19)**	(14)	(c)
Profit before taxation	**765**	**769**	**(4)**	
Taxation	**(163)**	**(163)**	-	
Profit for the year	**602**	**606**	**(4)**	

(a) The decrease in operating costs is driven by a reduction in lease expenses as these have been replaced by depreciation of right of use assets and interest costs on lease obligations.

(b) The increase in right of use depreciation expense is related to the recognition of new right of use assets that are depreciated over the lease term.

(c) The increase in lease interest expense is related to interest on recognition of lease obligations.

Statement of financial position

	31 December 2019 IFRS 16 £m	31 December 2019 IAS 17 £m	31 December 2019 IFRS 16 impact £m	
Non-current assets				
Property, plant and equipment	2,817	2,817	-	
Right of use assets	606	-	606	(d)
Intangible assets	1,356	1,356	-	
Investments	14	14	-	
Deferred tax assets	6	6	-	
Trade and other receivables	342	342	-	
Other financial assets	57	57	-	
	5,198	**4,592**	**606**	
Current assets				
Inventories	120	120	-	
Trade and other receivables	1,747	1,755	(8)	(e)
Other financial assets	64	64	-	
Cash and cash equivalents	138	138	-	
	2,069	**2,077**	**(8)**	

	31 December 2019 IFRS 16 £m	31 December 2019 IAS 17 £m	31 December 2019 IFRS 16 impact £m	
Current liabilities				
Borrowings	(2)	(2)	-	
Lease liabilities	(186)	-	(186)	(f)
Trade and other payables	(2,577)	(2,570)	(7)	(e)
Current tax liabilities	(74)	(74)	-	
Provisions	(37)	(39)	2	(g)
	(2,876)	**(2,685)**	**(191)**	
Net current liabilities	**(807)**	**(608)**	**(199)**	
Total assets less current liabilities	**4,391**	**3,984**	**407**	
Non-current liabilities				
Borrowings	(964)	(964)	-	
Lease liabilities	(411)	-	(411)	(f)
Trade and other payables	(231)	(231)	-	
Deferred tax liabilities	(52)	(52)	-	
Retirement benefit obligation	(12)	(12)	-	
Provisions	(72)	(72)	-	
	(1,742)	**(1,331)**	**(411)**	
Net assets	**2,649**	**2,653**	**(4)**	
Equity				
Ordinary share capital	10	10	-	
Capital reserve	23	23	-	
Retained earnings	2,616	2,620	(4)	
Total equity	**2,649**	**2,653**	**(4)**	

(d) The right of use assets reflect the contractual right to use assets over a period of time in exchange for consideration.

(e) The decrease in trade and other receivables and increase in trade and other payables is primarily driven by timing differences between when lease payments are made and interest charges are applied.

(f) The increase in lease liabilities relates to the recognition of the present value of lease payments due on right of use assets held.

(g) The decrease in provisions relates to certain leased properties that would have been recognised as onerous leases under previous accounting standards but under IFRS 16 the liability was already recognised within lease liabilities.

Adjustment on initial application of new reporting standard IFRS 16

The initial application of new reporting standard IFRS 16 Leases had an impact on the statement of financial position as follows:

At 1 January 2019	£m
Non-current right of use assets	734
Current prepayments	(33)
Total assets	**701**
Non-current lease liabilities	(522)
Current lease liabilities	(179)
Total liabilities	**(701)**
Impact in equity	**-**

The operating lease commitments disclosed as at 31 December 2018 have been reconciled to the opening lease liabilities recognised as follows:

At 1 January 2019	£m
Operating lease commitments disclosed as at 31 December 2018	**508**
Adjustments as a result of a different treatment of extension and termination options	168
Leases without cancellation cost	73
Discounting using the incremental rate of borrowing rate at the date of initial application	(48)
Lease liability recognised as at 1 January 2019	**701**

The weighted average incremental borrowing rate applied to lease liabilities recognised in the statement of financial position at the date of initial application was 2.21% for leases relating to our joint arrangement with Cornerstone Telecommunications Infrastructure Limited and 1.99% for all other leases.

2.2 New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Company. Those that are expected to have an impact on the Company are set out below.

Definition of Material – amendments to IAS 1 and IAS 8

The IASB has made amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors which use a consistent definition of materiality throughout International Financial Reporting Standards and the Conceptual Framework for Financial Reporting, clarify when information is material and incorporate some of the guidance in IAS 1 about immaterial information.

In particular, the amendments clarify:

- that the reference to obscuring information addresses situations in which the effect is similar to omitting or misstating that information, and that an entity assesses materiality in the context of the financial statements as a whole, and
- the meaning of 'primary users of general purpose financial statements' to whom those financial statements are directed, by defining them as 'existing and potential investors, lenders and other creditors' that must rely on general purpose financial statements for much of the financial information they need.

The Company does not expect the change in definition of Material to significantly impact the financial statements however the change in definition is relevant to the user of the financial statements.

Definition of a Business – amendments to IFRS 3

The amended definition of a business requires an acquisition to include an input and a substantive process that together significantly contribute to the ability to create outputs. The definition of the term 'outputs' is amended to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. The amendments will likely result in more acquisitions being accounted for as asset acquisitions.

Sale or contribution of assets between an investor and its associate or joint venture - amendments to IFRS 10 and IAS 28

The IASB has made limited scope amendments to IFRS 10 Consolidated financial statements and IAS 28 Investments in associates and joint ventures.

The amendments clarify the accounting treatment for sales or contribution of assets between an investor and its associates or joint ventures. They confirm that the accounting treatment depends on whether the non-monetary assets sold or contributed to an associate or joint venture constitute a 'business' (as defined in IFRS 3 Business Combinations).

Where the non-monetary assets constitute a business, the investor will recognise the full gain or loss on the sale or contribution of assets. If the assets do not meet the definition of a business, the gain or loss is recognised by the investor only to the extent of the other investor's interests in the associate or joint venture. The amendments apply prospectively.

3. Significant accounting policies

3.1 Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Standards Interpretations Committee ("IFRS IC") interpretations, as adopted for use in the EU. In addition the financial statements have been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared using historical cost principles, except for the following:

- Certain trade receivables held to sell – measured at fair value through profit or loss
- Defined benefit pension plan – measured at fair value of plan assets

The principal accounting policies of the Company applied in the preparation of these financial statements are set out below. The IFRS accounting policies have been applied consistently to all periods presented. In accordance with s400 of the Companies Act 2006, consolidated financial statements have not been prepared as the Company and its subsidiaries are included in the consolidated financial statements of O2 Holdings Limited, the parent company, and Telefónica, S.A., the ultimate parent company, for the year ended 31 December 2019

3.2 Presentation of financial information

Operating items in the statement of comprehensive income are derived from the primary operations of the Company as a telecommunications provider. Items in the statement of comprehensive income recognised below operating profit represent activities that are not directly attributable to the Company's primary operations.

3.3 Basis of accounting

These financial statements comprise the financial statements of the company and its share of jointly controlled entities as at 31 December 2019.

3.4 Going concern

The Directors have reviewed the business plan for the period to 31 December 2021, together with the commitment received from the ultimate parent company to continue providing financial support and on this basis have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future and thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

The impact to the Company from COVID-19 is described in detail on pages 30 to 32. The Company has shown resilience throughout this turbulent period and the need for connectivity by our customers has been just as strong. The impact to the Company has been modest considering the challenges faced across the global economy. In light of this, the Directors believe that the Company is well placed to continue to mitigate the impacts of COVID-19 during 2020 and beyond.

3.5 Joint arrangements

IFRS11 establishes principles for the financial reporting of parties to joint arrangements. It defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when the decisions about the relevant activities require the unanimous consent of the parties sharing control. Joint arrangements that meet the definition of joint operations are accounted for by integrating assets and liabilities, and the related revenues and expenses, in proportion to the joint operator's interest in the arrangement.

Upon adoption of IFRS 11 in 2014, the Company determined its interests in Cornerstone Telecommunications Infrastructure Limited, which is engaged in maintaining and managing the non-radio (passive) assets supporting the mobile wireless network of Vodafone Limited and Telefonica UK Limited, and in Digital Mobile Spectrum Limited, which is engaged in the provision of services in relation to spectrum auction obligations, to be classified as joint operations. These are accounted for as joint operations by recognising the assets and liabilities and the related revenues, expenses and share of commitments in proportion to the Company's contribution to and participation in the joint operations.

3.6 Functional and presentation currency

For the purpose of the financial statements, the results and financial position of the Company are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for the financial statements.

In preparing the financial statements, transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on the dates of the transactions. At each reporting date, the monetary assets and liabilities that are denominated in foreign currencies are retranslated at rates prevailing at each reporting date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the profit or loss for the year. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the year except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity.

3.7 Revenue from contracts with customers

Revenue, which excludes value added tax and other sales taxes, comprises mobile service revenue and hardware and other revenue (each as described in more detail below).

Mobile service revenue includes revenue earned for usage of the Company's wireless network for voice, text message and data transmission by the Company's customers, subscription fees (including those earned from the Company's MVNO partners), inbound roaming (earned from foreign mobile operators whose customers roam onto the Company's network), outbound roaming (earned from the Company's customers roaming outside their domestic coverage area) and interconnect revenue (earned from other telecommunication operators whose customers terminate calls on the Company's network).

Hardware revenue principally consists of revenue from the sale of mobile devices, including smartphones and other mobile handsets sold through the Company's direct distribution channels under the Refresh proposition, where hardware is recognised as a separate performance obligation, as well as the sale of tablets, smart-tech (e.g. smart watches and fitness devices) and accessories (e.g. mobile phone cases, screen protectors, chargers, cables, portable batteries, headphones and speakers). Hardware revenue is recognised when the products are delivered to the customer. Hardware billing will typically include an upfront amount and the remaining payments are spread over the contract term. Where the implied financing element of these payments is significant when compared with the other performance obligations in the contract, a portion of the revenue is allocated to significant financing and is charged to the profit and loss as interest costs over the term of the contract.

Other revenue principally consists of revenue from the Company's integrated mobile, Wi-Fi and fixed-line offerings to business customers and related business offerings and insurance sales. These revenues are recognised on the provision of both goods and services, with revenue recognition on delivery of each separate performance obligation.

Under IFRS 15, for bundled packages that combine mobile service, hardware and other revenue, the total revenue is allocated to each performance obligation based on their standalone selling prices in relation to the total consideration of the package and is recognised when (or as) the obligation is satisfied, regardless of whether there are undelivered items. Consequently, when bundles include a price difference on equipment, the adoption of these new requirements results in an increase of revenues recognised from the sale of handsets and other equipment, generally recognised upon delivery to the end customer, offset by a reduction of ongoing service revenue over subsequent periods. To the extent that the packages are marketed at a price difference, the difference between the revenue from the sale of equipment and the consideration received from the customer upfront is recognised as a contract asset on the statement of financial position and amortised over the term of the contract.

Under IAS 18 Revenue, which was the revenue standard adopted in the year ended 31 December 2017 prior to the adoption of IFRS 15, the portion of the total consideration that was contingent upon delivery of undelivered elements was not allocated to delivered elements.

IFRS 15 requires the recognition of an asset for those incremental costs (sales commissions and other third party acquisition costs) directly related to obtaining a contract and that are expected to be recovered. These are subsequently amortised over the same period as the revenue associated with such asset. Costs to obtain a contract are expensed when incurred if the Company estimates that their amortisation period is one year or less.

3.8 Operating costs

Operating costs principally include costs of acquiring, retaining and servicing customers, network and non-network accommodation costs in relation to the Company's properties, network maintenance costs, IT and system support costs and marketing costs. Marketing costs comprising advertising, promotion, sponsorship and communication are also expensed as incurred.

3.9 Staff costs

Staff costs comprise wages and salaries and related direct employment costs for permanent employees.

3.10 Employee benefits

Pension obligations

The Company operates both defined benefit and defined contribution plans. A defined benefit plan is a pension plan that sets the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the Company pays fixed contributions on behalf of employees and under which there is no legal or constructive obligation to pay further contributions for employees' service in the current and prior periods.

The Company participates in the Telefonica UK Pension Plan ("Plan") that provides benefits for the majority of UK employees in the UK Group. The Plan had both defined benefit and defined contribution sections. On 28 February 2013 the defined benefit sections of the Plan was closed to further benefit accrual.

Telefonica O2 Holdings Limited (formerly Telefonica Europe plc) (the Company's ultimate UK parent company) acted as Sponsor and Principal Employer of the Plan up to 14 December 2018. On this date a deed was signed by the trustees to transfer the plan into the Company as the majority of employees participating in the plan are employees of the Company. The transfer was made via a capital contribution from Telefonica O2 Holdings Limited (formerly Telefonica Europe plc) for £23.1 million, being the net asset position of the plan on the transfer date. Disclosures over the defined benefit sections of the Plan are provided in note 26.

In its capacity as a participating employer of the defined contribution section of the Plan, the Company pays contributions into the Plan on behalf of employees. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

The Company accounted for the defined benefit section of the Plan as though it were a defined contribution plan up until 14 December 2018 as there was no arrangement for charging out the net defined benefit cost between participating employers. The net defined benefit cost of the defined benefit sections, as assessed in accordance with the advice of a qualified, independent actuary measuring actual liabilities using the projected unit method and taking assets at market value, was recognised by Telefonica O2 Holdings Limited (formerly Telefonica Europe plc) up to 14 December 2018. The cost from 14 December 2018 was recognised by the Company.

Share based payments

The Company recognises an expense for share awards and share options, which are equity settled, based on the fair value of the share awards or share options granted as compensation for the services rendered by employees. The fair value is calculated at the grant date using an adjusted statistical model and excludes the impact of non-market conditions. Instead, the expense is adjusted for the effect of non-market conditions at each reporting date through the number of share awards or share options expected to be exercisable.

The effect of market and non-vesting conditions is included in the fair value at the date of grant and is recognised as an expense in employee costs irrespective of whether the market or non-vesting condition is satisfied. Telefónica S.A. recharges the Company for the cost of share schemes and therefore the share-based transaction is not settled in the Company's equity instruments.

3.11 Taxation

The charge for current tax is based on the results for the period as adjusted for items which are non-assessable or disallowed.

Deferred income tax is provided in full, using the statement of financial position liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable future taxable profits will be available against which deductible temporary differences can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax and current tax is determined using tax rates (and laws) that have been enacted or substantively enacted and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Income tax relating to items recognised in other comprehensive income or in equity is also recognised directly in other comprehensive income or in equity respectively.

3.12 Dividend distribution

Interim dividend distributions are recognised in the period in which they are paid. Final dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's Board.

3.13 Financial income and expense

Financial income principally consists of interest income on Company deposits, interest income from balances with other group companies and gains arising from foreign exchange rate hedging instruments. Financial expense principally consists of interest expense on Company borrowings, leases and losses arising from foreign exchange rate hedging instruments. The Company utilises foreign exchange rate hedging instruments to hedge foreign exchange rate exposure principally in respect of Euro and US dollar payments with regard to roaming agreements and not for speculative purposes.

3.14 Leases

The Company adopted the following IFRS 16 Leases accounting policies from 1 January 2019.

Adoption of IFRS 16 has resulted in almost all leases being recognised in the statement of financial position, since the distinction between operating and finance leases is removed is removed for lessee accounting. Under the new standard, an asset (that is, the right to use the leased item) and a financial liability to pay rentals are recognised. The Company has elected not to apply the general requirements to short-term leases and leases of low-value assets. The Company has also elected not to recognise non-lease components separately from lease components for those classes of assets in which non-lease components are not significant with respect to the total value of the arrangement.

The Company acts as a lessee on a large number of lease agreements. These include leases of third party mobile masts (towers), circuits, office buildings and stores and land where towers are located. These contracts were generally accounted for as operating leases under previous accounting standards, with lease payments being recognised on a straight-line basis as an expense in the income statement over the contract term.

Right of use assets are initially recognised at the initial measurement of lease liabilities plus any lease payments made at or before the commencement date; less any lease incentives received; plus any initial direct costs incurred and an estimate of costs to be incurred in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease.

Right of use assets are subsequently measured using the cost model by charging depreciation to profit and loss over the term of the lease and adjusting for any remeasurement of the lease liability or impairment of the asset.

Lease liabilities are initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by interest rate implicit in the lease if it can be readily determined, or the incremental borrowing rate of interest required to finance the expected payments during the lease term. Lease payments included in initial measurement comprise fixed payments, less any incentives receivable; variable lease payments that depend on an index or rate; amounts expected to be paid under residual value guarantees; the exercise price of a purchase option if the Company is reasonably certain to exercise that option and payments for penalties for terminating the lease, if the lease term reflects the Company exercising an option to terminate the lease.

The Company determines the lease term as the non-cancellable term of the contract, together with any period covered by an extension (or termination) option whose exercise is discretionary for the Company, if there is reasonable certainty that it will be exercised (or it will not be exercised). In its assessment, the Company considers all available information by asset class in the industry and evaluates all relevant factors (technology, regulation, competition, business model) that create an economic incentive to exercise or not a renewal/cancellation option. In particular, the Company takes into consideration the time horizon of the strategic planning of its operations. After the commencement date, the Company reassesses the lease term if there is a significant event or change in circumstances that is within its control that may affect its ability to exercise (or not to exercise) an option to extend or terminate (for example, a change in business strategy).

Lease liabilities are subsequently measured by increasing the carrying amount to reflect interest on the lease liability; reducing the carrying amount to reflect the lease payments made; and remeasuring the carrying amount to reflect any reassessment or lease modifications. Interest will be charged to profit and loss.Information on the impact of initial application of IFRS 16 is disclosed in Note 2.

3.15 Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation. The cost of property, plant and equipment includes directly attributable incremental costs incurred in their acquisition and installation. Subsequent costs are included in the assets' carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Depreciation is provided on property, plant and equipment from the date they are available for use over their estimated useful lives on a straight-line basis. The lives assigned to property, plant and equipment are:

Land and buildings	
Freehold buildings	40 years
Leasehold buildings	Unexpired portion of lease or 40 years, whichever is shorter
Plant and equipment	
Network assets	5 - 20 years
Computers and office equipment	2 - 5 years

The assets' useful lives and residual values are reviewed, and adjusted if appropriate, at each statement of financial position date.

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income when the asset is derecognised.

Property, plant and equipment not in use are classified as assets in the course of construction and will not be depreciated. Once they are available for use they will be reclassified to the relevant category of property, plant and equipment and will be depreciated in line with the above accounting policy.

3.16 Intangible assets

Radiocommunications licences

Licence fees paid to the Government, which permit telecommunications activities to be operated for defined periods,

are capitalised at cost and are amortised from the date of commercial launch of the service over the initial 20 year term of the licence on a straight line basis. The remaining useful lives of the licences are as follows:

Licence	Remaining useful life
3G – 1,800 MHz and 2,100 MHz	2 years
4G – 800 MHz	13 years
4G – 2.3 GHz	18 years
5G – 3.4 GHz	18 years

Software

Software is capitalised and measured at the cost incurred to acquire and bring into use the specific software. These costs are amortised over the estimated useful lives of the software of between 2 and 6 years on a straight line basis. Costs that are directly associated with the production of identifiable unique software products controlled by the Company, which are expected to generate economic benefits over a period of more than one year, are recognised as intangible assets. Computer software development costs recognised as intangible assets are amortised over the estimated useful lives of the software on a straight line basis.

Development costs are only capitalised if the Company can demonstrate all of the following: the technical feasibility of completing the asset so that it will be available for use or sale; an intention to complete the asset and use or sell it; an ability to use or sell the asse; future economic benefit is expected; adequate technical, financial and other resources are available; and an ability to reliably measure expenditure.

Intangible assets not in use are classified as assets in the course of construction and will not be amortised. Once they are available for use they will be reclassified to the relevant category of intangible assets and will be amortised in line with the above accounting policy.

3.17 Impairment of non-financial assets

Non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

3.18 Investments

Investments are stated at cost less accumulated impairment losses in the Company's statement of financial position. An impairment loss is recognised for the amount by which the investment's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an investment's fair value less costs to sell and value in use.

3.19 Inventories

Inventories comprise mainly handsets and are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out basis, after provisions for obsolescence. Cost comprises costs of purchase and costs incurred in bringing inventory to its current location and condition.

3.20 Financial assets

(i) Classification

The Company classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income or through profit or loss); and
- those to be measured at amortised cost.

(ii) Recognition and derecognition

Financial assets are recognised on the date the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

Trade receivables that are sold without recourse are derecognised at the point they are factored. Any fee incurred to effect factoring is netted against cash received and expensed in the income statement.

(iii) Measurement

At initial recognition, the group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

(iv) Impairment

The Company assesses on a forward looking basis the expected credit losses associated with its financial assets carried at amortised cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

The Company provides services to individuals and business customers on credit terms. The Company expects that some debts due will not be paid as a result of the default of a small number of customers. The Company uses estimates based on historical results and future expectations, the economic and competitive environment and other relevant factors to determine the provision for credit losses. A significant, unanticipated downturn in the major economies that the Company operates in or negative industry trends could require an increase in the estimated level of debts that will not be collected, which would negatively impact the operating results. The level of provision required is reviewed on an ongoing basis. The carrying amount of credit losses provision for each reporting period is set out in Note 31.1.

3.21 Cash and cash equivalents

Cash and cash equivalents includes cash on hand, other short-term highly liquid investments with original maturities of three months or less, and short term deposits repayable on demand with Telfisa Global B.V., a related party. Bank overdrafts are shown within borrowings in current liabilities on the statement of financial position.

3.22 Borrowings

Borrowings are recognised initially at fair value net of transaction costs incurred. Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between the cost and the redemption value being recognised in the statement of comprehensive income over the period of the borrowings on an effective interest basis. Accrued interest on borrowings is included within the carrying value.

3.23 Trade and other payables

Trade payables and other payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. They are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business, if longer). If not, they are presented as non-current liabilities.

Trade payables and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

3.24 Provisions and contingent liabilities

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Restructuring provisions could comprise, amongst other items, employee termination payments, and these are recognised in the period in which the Company becomes legally or constructively committed to payment. An asset retirement obligation provision is made for the present value of the cost of restoration of mast sites at the date of acquisition of the site.

4. Accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates and assumptions. It also requires management to exercise judgement in the process of applying the Company's accounting policies. A reasonably possible change in the facts and circumstances on which these estimates are based could have a material impact on the Company's earnings and financial position. The areas involving a higher degree of judgement or complexity and areas where assumptions and estimates are significant to the consolidated financial statements are discussed below.

Significant accounting judgements

The Company has the following significant accounting judgement where making a different judgment may result in a material adjustment to the income and expenses reported for the period and to the carrying amounts of assets and liabilities at the end of the period.

Joint arrangements

The Company participates in a joint arrangement where control of the arrangement is shared with another party. Judgement is required to classify joint arrangements in a separate legal entity as either a joint operation or as a joint venture which depends on management's assessment of the legal form and substance of the arrangement taking into account relevant facts and circumstances such as whether the owners have rights to substantially all the economic outputs and, in substance, settle the liabilities of the entity.

The classification can have a material impact on the financial statements. The Company accounts for its interest in its joint operation by recognising the assets and liabilities and the related revenues, expenses and share of commitments in proportion to the Company's contribution to and participation in the joint operation.

Critical accounting estimates

The critical assumptions concerning the future and key sources of estimation uncertainty at the reporting period that may cause a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

4.1 Pension benefits

The cost of the defined benefit pension plan and the present value of the pension obligation are determined using an actuarial valuation. An actuarial valuation involves making various assumptions. These include the discount rate, future salary increases, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long term nature, a defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of corporate bonds with at least an AA rating, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. The mortality rate is based on publically available mortality tables. Future salary increases and pension increases are based in expected future inflation rates.

Further details about the assumptions and sensitivities are given in note 26.

Other key sources of estimation uncertainty

Other key sources of estimation uncertainty which are not expected to give rise to a material adjustment in the reporting period are discussed below.

4.2 Property, plant and equipment and licences

Accounting for property, plant and equipment and licences involves the use of estimates and judgements for determining the useful lives over which they are to be depreciated or amortised and the existence and amount of any impairment.

Property, plant and equipment and licences are depreciated or amortised on a straight line basis over their estimated useful lives and taking into account their expected residual values. When the Company estimates useful lives various factors are considered including expected technological obsolescence and the expected usage of the asset. The Directors regularly review these asset lives and change them as necessary to reflect the estimated current remaining lives in light of technological changes, future economic utilisation and physical condition of the assets concerned. A significant change in asset lives can have a significant impact on depreciation and amortisation charges for the period.

It is not practicable to quantify the impact of changes in property, plant and equipment asset lives on an overall basis as asset lives are individually determined and there is a significant number of assets in use. The impact of any change would vary significantly depending on the individual changes in assets and the classes of assets impacted.

The Company assesses the impairment of property, plant and equipment and licences whenever there is reason to believe that the carrying value may not exceed the fair value and where a permanent impairment in value is anticipated. The determination of whether the impairment of these assets is necessary involves the use of estimates that includes, but is not limited to, the analysis of the cause of potential impairment in value, the timing of such potential impairment and an estimate of the amount of the impairment. The Company considers technological obsolescence, discontinuance of services and other changes in circumstances as indications of the need to perform an impairment test. A significant change in the facts and circumstances that were relied upon in making the estimates may trigger the requirement for recording impairment and may have a material adverse impact on the operating results and financial condition of the Company. The carrying amount of property plant and equipment and licences for each reporting period is set out in Notes 13 and 14 respectively.

4.3 Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. This obligation may be legal or constructive deriving from regulations, contracts, normal practices or public commitments that lead third parties to reasonably expect that the Company will assume certain responsibilities. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, taking into account all available information. Given the uncertainties inherent in the estimates used to determine the amount of provision, actual outflows of resources may differ from the amounts recognised originally on the basis of the estimates.

The asset retirement obligation provision is based on assumptions covering the discount rate, expected lease renewals and the expected cost of restoring the sites. The payment dates of these asset retirement obligation costs are uncertain but are currently anticipated to be over the next 17 years. The carrying amount of provisions for each reporting period is set out in Note 24.

4.4 Right of use assets and lease liabilities – lease terms

The lease term used in the calculation of right of use assets and lease liabilities is estimated. Lease term estimates are based on the non-cancellable period; plus periods covered by options to extend the lease, where such options depend only on the Company and where exercise is assessed to be reasonably certain, taking into account the specific situation of the lease. In addition certain assumptions have been required to calculate the discount rate, based principally on the incremental borrowing rate of interest required to finance the expected payments during the lease term.

5. Operating segments

As at 31 December 2019 and 31 December 2018, the Company had only one reportable segment, which is the mobile telecommunications business in the UK. The mobile telecommunications segment derives revenue from the operation of a cellular communications network, and the sale of mobile and data services to the Company's customer base.

6. Revenue and operating profit

The total revenue and significant revenue streams for the period are detailed below:

	2019	2018
	£m	**£m**
Revenue		
Mobile service revenue	**4,026**	4,074
Hardware and other revenue	**1,950**	1,668
Total revenue	**5,976**	5,742
Operating costs (excluding depreciation, amortisation and management fees)	**(4,031)**	(4,057)
Impairment losses on financial and contract assets	**(159)**	(99)
Reversal of impairment losses on financial and contract assets	**10**	10
Operating profit before depreciation, amortisation and management fees	**1,796**	1,596
Management fees*	**(40)**	(45)
Operating profit before depreciation and amortisation (OIBDA)	**1,756**	1,551
Property, plant and equipment depreciation	**(533)**	(520)
Right of use asset depreciation	**(181)**	-
Intangible asset amortisation	**(261)**	(295)
Operating profit	**781**	736

*Management fees include payables to other Telefónica Group companies

Operating costs included:

	2019 £m	2018 £m
Staff costs (Note 7)	**399**	377
Capitalised development costs - permanent staff	**(53)**	(48)
Capitalised development costs - third party labour	**(80)**	(65)
Auditors' remuneration	**1**	1
Cost of inventories recognised as an expense	**1,402**	1,310
Net write downs of inventories recognised in the year	**1**	3
Operating lease rentals payable	**-**	166
Restructuring costs (Note 24)	**27**	5
Impairment of investments in subsidiary undertakings	**1**	11
Decrease in provision for amounts owed by Group companies	**-**	(4)
Joint operation operating costs	**45**	45
Other operating expenditure	**2,288**	2,256

7. Employees

The costs incurred in respect of employees were:

	2019 £m	2018 £m
Wages and salaries	**323**	307
Social security costs	**37**	35
Other pension costs (note 26)	**37**	34
Share based payments (note 32)	**2**	1
Total staff costs	**399**	377

The monthly average number of employees (including executive directors) were:

	People in post		Full time equivalent	
	2019 No.	2018 No.	2019 No.	2018 No.
Sales and marketing	**4,577**	3,770	**3,985**	3,213
Operations	**1,407**	1,929	**1,392**	1,848
Administration	**831**	868	**812**	844
Total monthly average employees	**6,816**	6,567	**6,189**	5,905

During the year ended 31 December 2019 customer service employees were reclassified from operations to sales and marketing.

8. Key management and Directors' compensation

The company's employees and directors participated in a number of employee incentive share schemes operated by Telefónica S.A. (see Note 32 for further details).

During the current year, no directors accrued retirement benefits under a defined benefit pension plan (2018: None). One director (2018: Two) accrued retirement benefits under a defined contribution pension plan during the year. One of the directors participated in long term incentive-schemes in the year (year ended 31 December 2018: One).

Directors of the Company are part of the key management of the Company. Key management is defined as the Operating Committee of the Company. Key management compensation for services to the Company for the period were as follows:

	2019 £000	2018 £000
Salaries and short-term employee benefits	**6,370**	6,209
Post-employment benefits	**50**	51
Share-based payments	**2**	1
Total key management compensation	**6,422**	6,260

The remuneration of the Directors of the Company for the year ended 31 December was as follows:

	2019 £000	2018 £000
Aggregate emoluments in respect of qualifying services	**1,431**	2,338
Aggregate amount of company contributions paid to a pension scheme	**11**	8
Total directors' remuneration	**1,442**	2,346

In respect of the highest paid Director during the period:

	2019 £000	2018 £000
Aggregate emoluments in respect of qualifying services	**1,796**	1,549
Aggregate amount of company contributions paid to a pension scheme	**-**	-
	1,796	1,549

The highest paid Director is a member of the Telefonica UK Pension Plan.

9. Auditors' remuneration

The aggregate fees paid to auditors during the year for audit and other services are analysed below:

	2019 £'000	2018 £'000
Audit services:		
UK audit fees	**744**	687
Audit-related assurance services	**50**	-
Total audit and audit-related fees	**794**	687

The fees in 2019 and 2018 were paid to PricewaterhouseCoopers LLP.

10. Financial income and financial expense

	2019	2018
	£m	£m
Financial income		
Interest income on cash, cash equivalents and other financial assets	**15**	4
Interest income from other group companies	**2**	3
Total financial income	**17**	7
Interest payable to other group companies	**(18)**	(22)
Lease interest	**(14)**	-
Other financial costs	**(1)**	(6)
Total financial expense	**(33)**	(28)
Net financial expense	**(16)**	(21)

11. Taxation

Analysis of charge in the year

	2019	2018
	£m	£m
Current tax - current year	**153**	146
Current tax - adjustment in respect of prior years	**-**	(42)
Deferred tax - current year (note 27)	**12**	12
Deferred tax - adjustment in respect of prior years (note 27)	**(2)**	(2)
Taxation	**163**	114

The tax assessed for the year varied from the amount computed by applying the corporation tax standard rate to profit before taxation. The difference was attributable to the following factors:

	2019	2018
	£m	£m
Profit before taxation	**765**	715
Profit before taxation multiplied by rate of corporation tax in the UK of 19% (2018: 19%)	**145**	136
Effects of:		
Expenses not deductible for tax purposes	**19**	22
Effect of change in tax rate	**1**	(1)
Adjustments in respect of prior years*	**(2)**	(43)
Total taxation	**163**	114

The corporation tax main rate was set at 19% from 1 April 2017.

12. Dividends paid

	2019	2018
	£m	£m
Interim dividend for the year of £9.60 (2018: £Nil) per share	**480**	-
	480	-

13. Property, plant and equipment

	Land and buildings	Plant and equipment	Assets in the course of construction	Total
	£m	£m	£m	£m
Cost				
At 1 January 2018	**357**	**7,043**	**268**	**7,668**
Additions	-	-	705	705
Reclassifications	28	517	(604)	(59)
Disposals	(1)	(296)	-	(297)
At 31 December 2018	**384**	**7,264**	**369**	**8,017**
Additions	-	-	683	683
Reclassifications	26	684	(710)	-
Disposals	(85)	(1,859)	-	
At 31 December 2019	**325**	**6,089**	**342**	**6,756**
Accumulated depreciation				
At 1 January 2018	**267**	**4,881**	**-**	**5,148**
Charge for the year	19	501	-	520
Reclassifications	-	(25)	-	(25)
Disposals	(1)	(295)	-	(296)
At 31 December 2018	**285**	**5,062**	**-**	**5,347**
Charge for the year	25	508	-	533
Disposals	(85)	(1,856)	-	(1,941)
At 31 December 2019	**225**	**3,714**	**-**	**3,939**
Net book amount				
At 31 December 2019	**100**	**2,375**	**342**	**2,817**
At 31 December 2018	99	2,202	369	2,670

During the year ended 31 December 2019 amounts of £1,503 million cost and £1,503 million accumulated depreciation were disposed of relating to legacy assets no longer in use. The disposal had £Nil impact on the net book amount of property, plant and equipment.

14. Right of use assets

	Land and buildings	Plant and equipment	Total
	£m	£m	£m
Cost			
At 31 December 2018	-	-	-
Initial application of IFRS 16	541	193	734
At 1 January 2019	541	193	734
Additions	101	41	142
Disposals	**(67)**	**(32)**	**(99)**
At 31 December 2019	575	202	777
Accumulated depreciation			
At 31 December 2018	-	-	-
Initial application of IFRS 16	-	-	-
At 1 January 2019	-	-	-
Charge for the period	**122**	**59**	**181**
Disposals	(7)	(3)	(10)
At 31 December 2019	115	56	171
Net book amount			
At 31 December 2019	**460**	**146**	**606**
At 31 December 2018	-	-	-

Right of use assets have been recognised from 1 January 2019. See note 2 for further information on first time adoption of IFRS 16 Leases.

15. Intangible assets

	Licences	Software	Assets in the course of con-struction	Total
	£m	£m	£m	£m
Cost				
At 1 January 2018	**4,641**	**1,679**	**21**	**6,341**
Additions	206	-	401	607
Reclassifications	-	149	(90)	59
Disposals	-	(48)	-	(48)
At 31 December 2018	**4,847**	**1,780**	**332**	**6,959**
Additions	-	-	114	114
Reclassifications	318	120	(438)	-
Disposals	-	(440)	-	(440)
At 31 December 2019	**5,165**	**1,460**	**8**	**6,633**
Accumulated amortisation				
At 1 January 2018	**3,711**	**1,472**	**-**	**5,183**
Charge for the year	152	143	-	295
Reclassifications	-	25	-	25
Disposals	-	(47)	**-**	(47)
At 31 December 2018	**3,863**	**1,593**	**-**	**5,456**
Charge for the year	158	103	-	261
Disposals	-	(440)	**-**	(440)
At 31 December 2019	**4,021**	**1,256**	**-**	**5,277**
Net book amount				
At 31 December 2019	**1,144**	**204**	**8**	**1,356**
At 31 December 2018	**984**	**187**	**332**	**1,503**

The licences are assets permitting the Company to operate its “3G”, “4G” and “5G” networks in the UK.

During the prior year the Company secured 80 MHz of spectrum in an Ofcom auction, at a cost of £523.6 million. This included 40MHz of immediately useable (2.3GHz) spectrum, which was all of the spectrum available in this band, as well as 40MHz of 3.4 GHz spectrum, earmarked for 5G. The 3.4GHz spectrum was reclassified from assets in the course of construction to licenses during the year ended 31 December 2019 and amortisation commenced as the licence was in use from October 2019.

During the year ended 31 December 2019 amounts of £392 million cost and £392 million accumulated amortisation were disposed of relating to legacy assets no longer in use. The disposal had £Nil impact on the net book amount of intangible assets.

During the year ended 31 December 2018 a transfer was made from property, plant and equipment to software amounting to £59 million to better present certain assets. Additional amortisation of £29 million was charged in the year relating to the population of assets affected to record amortisation at the rate appropriate for the assets.

16. Investments

Cost and net book value	Shares in subsidiary undertakings £m
At 1 January 2019	14
Additions	1
Impairment	(1)
At 31 December 2019	**14**

Acquisition of Statiq Limited
On 30 April 2019, the Company acquired 100% of the shares of Statiq Limited for a cash consideration of £715,000, from Telefonica Digital Limited, a fellow subsidiary within the Telefónica Group.

Investments in subsidiaries are held at historical cost less any provisions for impairment.

The subsidiary undertakings and joint arrangements as at 31 December 2019 are detailed below, all of which are included in the O2 Holdings Limited Group financial statements:

Name and address	Country of incorporation and operation	Activity	Portion of ordinary shares held %
O2 Unify Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	IT and communications solutions	100%
giffgaff Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Mobile communications network	100%
Weve Ltd 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Mobile marketing and commerce services	100%
Statiq Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Audience data solutions	100%
DX Communications Limited The Ca'D'Ore, 45 Gordon Street, Glasgow, G1 3PE	Scotland	Dormant entity	100%
O2 Redwood Limited 260 Bath Road, Slough, Berkshire, SL1 4DX	England & Wales	Dormant entity	100%
Cornerstone Telecommunications Infrastructure Limited Hive 2, 1530 Arlington Business Park. Theale Reading Berkshire RG7 4SA	England & Wales	Mobile infrastructure network joint operation with Vodafone Group plc	50%
Digital Mobile Spectrum Ltd 24/25 the Shard, 32 London Bridge Street, London, SE1 9SG	England & Wales	Provision of services in relation to spectrum auction obligations	25%

All share holding portions remain the same as at 31 December 2018, with the exception of the acquisition of Statiq Limited.

Cornerstone Telecommunications Infrastructure Limited ("CTIL") is a company owned 50:50 by the UK Group and Vodafone, and was formed as part of the network sharing agreement signed between these parties in 2012 which is accounted for by the UK Group as a joint operation under IFRS 11.

The 50% interest in CTIL is legally held by O2 Cedar Limited (10%) and O2 Networks Limited (40%). However, the Company, as the main operating entity of the UK Group, has the beneficial rights and obligations relating to the UK Group's interest in assets, liabilities, revenues and costs of this joint operation, and consequently the UK Group's interest in the joint operation has been integrated into these separate financial statements.

17. Inventories

	2019 £m	2018 £m
Mobile devices and other equipment	**120**	93

In the opinion of the Directors there is no material difference between the statement of financial position value of inventories and their replacement cost.

18. Trade and other receivables

Non-current:	**2019 £m**	2018 £m
Trade receivables	**155**	48
Contractual assets (Note 25)	**103**	74
Costs of obtaining a contract (Note 25)	**25**	39
Prepayments	**59**	76
	342	237

Current:	**2019 £m**	2018 £m
Trade receivables	**866**	987
Other receivables	**3**	-
Amounts owed by ultimate parent	**1**	-
Amounts owed by subsidiaries	**56**	129
Amounts owed by other group and related undertakings	**26**	40
Amounts owed by associates	**21**	20
Contractual assets (Note 25)	**166**	137
Costs of obtaining a contract (Note 25)	**97**	115
Prepayments	**359**	396
Accrued income	**152**	169
	1,747	1,993

Amounts owed by other group and related undertakings relate to trading activities are unsecured, interest free and repayable on demand.

At the year ended 31 December 2019, the Company had no provisions relating to amounts owed by other group companies (2018: £nil). This assessment is undertaken each financial year through an examination of the financial position of the related party.

19. Other financial assets

	2019 £m	2018 £m
Current other financial assets		
Other financial assets	**64**	74
	64	74

	2019 £m	2018 £m
Non-current other financial assets		
Other financial assets	**57**	12
	57	12

Included within total other financial assets of £121 million (2018: £86 million) is £112 million (2018: £74 million) of loan notes issued upon factoring of trade receivables; £57 million (2018: £63 million) of which is due within one year.

20. Cash and cash equivalents

	2019 £m	2018 £m
Cash and cash equivalents		
Short term deposits	**138**	104
	138	104

The Company's short term deposits are deposited with Telfisa Global B.V., a related party.

21. Borrowings

	2019 £m	2018 £m
Current unsecured borrowings		
Amounts owed to other group companies	**2**	72
	2	72
Non-current unsecured borrowings		
Amounts owed to other group companies	**964**	964
	964	964

The current amounts owed to other group companies were granted to fund general trading activities and are unsecured, interest free and repayable on demand. £70 million was repaid during the year ended 31 December 2019.

Non-current amounts owed relate to two loans of £440 million (2018: £440 million) and £524 million (2018: £524 million) with Telfin Ireland.

The maturity date of the loan of £440 million is 30 June 2023. The purpose of this loan was to assist with the acquisition of 800MHz 4G spectrum. The loan had an interest rate based on LIBOR plus 272 basis points up until 30 June 2018 and LIBOR plus 105 basis points from 1 July 2018 and is calculated on a quarterly basis. The effective rate of interest on the loan for 2019 was 1.87% (2018: 2.59%).

The loan of £524 million has a maturity date of 30 June 2022. The loan has an interest rate based on LIBOR plus 90 basis points up and is calculated on a quarterly basis. The effective rate of interest on the loan for 2019 was 1.72% (2018: 1.66%). The purpose of this loan was to assist with the acquisition of 2.3GHz 4G and 3.4GHz 5G spectrum.

22. Lease liabilities

	2019 £m	2018 £m
Current lease liabilities	**181**	-

	2019 £m	2018 £m
Non-current lease liabilities	**411**	-

Maturity of lease liabilities

		2018
	2019	**£m**
Within one year	**£m**	-
Later than one year but not later than five years	**186**	-
Later than five years	**328**	-
Total lease liabilities	**83**	-
	597	

The future minimum lease payments for operating leases for the year ended 31 December 2018 is included in note 29. Upon first time adoption of IFRS 16 Leases these operating leases are recognised as lease liabilities on the statement of financial position. See note 2 for further information on first time adoption of IFRS 16.

23. Trade and other payables

	2019	2018
Current	**£m**	**£m**
Trade payables	**787**	732
Amounts owed to immediate parent	**1**	-
Amounts owed to ultimate parent	**8**	10
Amounts owed to subsidiaries	**75**	85
Amounts owed to other group and related undertakings	**96**	98
Amounts owed to associates	**107**	163
Other taxation and social security	**336**	280
Other payables	**174**	161
Accrued expenses	**722**	804
Contractual liabilities (Note 25)	**270**	309
Deferred income	**1**	2
Total current trade and other payables	**2,577**	2,644
Non-current		
Contractual liabilities (Note 25)	**229**	203
Amounts owed to group and related undertakings	**2**	1
Total non-current trade and other payables	**231**	204

Amounts owed to other group companies relate to trading activities (including tax loss transfers) are unsecured, interest free and repayable on demand.

24. Provisions

A breakdown of the Group's current and non-current provisions is as follows:

	31 December 2019				31 December 2018			
	Restructuring	**Asset retirement obligation**	**Other provisions**	**Total**	Restructuring	Asset retirement obligation	Other provisions	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Current	**26**	**3**	**8**	**37**	3	11	-	14
Non-current	**-**	**72**	**-**	**72**	1	64	-	65
	26	**75**	**8**	**109**	4	75	-	79

	Restructuring	**Asset retirement obligation**	**Other provisions**	**Total**
	£m	£m	£m	£m
At 1 January 2018	**5**	**81**	**-**	**86**
Charge for the year	5	-	-	5
Utilised in the year	(6)	(3)	-	(9)
Amounts released to the income statement	-	(3)	-	(3)
At 31 December 2018	**4**	**75**	**-**	**79**
Charge for the year	27	10	8	**45**
Utilised in the year	(2)	(10)	-	**(12)**
Amounts released to the income statement	(3)	-	-	**(3)**
At 31 December 2019	**26**	**75**	**8**	**109**

Restructuring provisions

Restructuring provisions include the full costs of planned business restructuring programmes, entered into during the current and prior years.

Asset retirement obligation provision

The Group has certain legal obligations relating to the restoration of leased property to its original condition at the end of the lease term. This obligation relates principally to the Group's share of obligation for assets held in Cornerstone Telecommunications Infrastructure Limited, and to mast sites.

The provision is based on assumptions covering the discount rate, expected lease renewals and the expected cost of restoring the sites. The payment dates of these asset retirement obligation costs are uncertain but are currently anticipated to be over the next 17 years.

The provision recognised represents the best estimate of the expenditure required to settle the present obligation at the current statement of financial position date. Such cost estimates, expressed at current price levels at the date of the estimate are discounted at 31 December 2019 using rates in the range of 1.26% - 1.67% (2018: 1.33% - 2.05%) per annum. The initial discounted cost amount has been capitalised as part of property, plant and equipment and depreciated over the life of the assets.

25. Contractual assets and liabilities and capitalised costs

The movement of contractual assets and capitalised costs during the year ended 31 December 2019 is as follows:

	At 1 January 2018	**Additions**	**Disposals**	**Reclassifications**	**At 31 December 2019**
	£m	**£m**	**£m**	**£m**	**£m**
Non-current contractual assets (Note 18)	**74**	**137**	**-**	**(108)**	**103**
Contractual assets	79	137	-	(108)	108
Impairment losses	(5)	-	-	-	(5)
Current contractual assets (Note 18)	**137**	**329**	**(408)**	**108**	**166**
Contractual assets	144	333	(408)	108	177
Impairment losses	(7)	(4)	-	-	(11)
Total	**211**	**466**	**(408)**	**-**	**269**

The balance of the contract assets account represents amounts recognised as revenue but not yet due. The amounts recognised as contract assets are amortised over the contractual period. Included within contract assets is £23 million (2018: £32 million) of right of return assets related stock provided franchise retail stores. A corresponding £23 million (2018: £32 million) right of return obligation is included within contract liabilities.

	At 1 January 2018	**Additions**	**Disposals**	**Reclassifications**	**At 31 December 2019**
	£m	**£m**	**£m**	**£m**	**£m**
Non-current capitalised costs (Note 18)	**39**	**50**	**-**	**(64)**	**25**
Of obtaining a contract	39	50	-	(64)	25
Impairment losses	-	-	-	-	-
Current capitalised costs (Note 18)	**115**	**64**	**(146)**	**64**	**97**
Of obtaining a contract	115	64	(146)	64	97
Impairment losses	-	-	-	-	-
Total	**154**	**114**	**(146)**	**-**	**122**

The movement of contract liabilities of contracts with customers during the year ended 31 December 2019 is as follows:

	At 1 January 2018	**Additions**	**Disposals**	**Reclassifications**	**At 31 December 2019**
	£m	**£m**	**£m**	**£m**	**£m**
Non-current contractual liabilities (Note 23)	203	17	(3)	13	229
Current contractual liabilities (Note 23)	309	1,690	(1,717)	(12)	270
Total	**512**	**1,707**	**(1,720)**	**-**	**499**

Contract liabilities are unperformed performance obligations mainly related to prepaid airtime, set up fees and other prepaid services.

The maturity schedule of contract liabilities at 31 December 2019 is as follows:

	2020	2021	2022	Subsequent years	Total
	£m	£m	£m	£m	£m
Contractual liabilities – activation fees	142	-	-	-	142
Contractual liabilities – sale of prepay cards	34	-	-	-	34
Other contractual liabilities	94	94	91	44	323
Maturity of performance obligations	**270**	**94**	**91**	**44**	**499**

26. Retirement benefit schemes

Telefonica O2 Holdings Limited (formerly Telefonica Europe plc) (the Company's ultimate UK parent company) acted as Sponsor and Principal Employer of the Plan up to 14 December 2018. On this date a deed was signed by the trustees to transfer the plan into the Company as the majority of employees participating in the plan are employees of the Company. The transfer was made via a capital contribution from Telefonica Europe plc for £23.1 million, being the net asset position of the plan on the transfer date.

The Telefónica UK Pension Plan ("the Plan") comprises the following:

- The defined benefit scheme of the Telefónica UK Pension Plan
- The defined contribution scheme of the Telefónica UK Pension Plan
- The UK defined benefit Unfunded Plan

The net defined benefit expense and actuarial valuation impacts of the defined benefit scheme, as assessed in accordance with the advice of a qualified, independent actuary, measuring actuarial liabilities using the projected unit method and taking assets at market value, are recognised in the statement of total comprehensive income of Telefonica O2 Holdings Limited (formerly Telefonica Europe plc) up to the date of transfer to Telefonica UK limited on 14 December 2018.

The Plan provides the pension benefits for the majority of Telefonica's UK employees, including those of Telefonica UK Limited. Participating companies whose employees are members are the Plan account for the defined benefit sections of the plan as though it were a defined contribution plan as there is no contractual arrangement or stated policy for charging out the net defined benefit cost between participating employers. Telefonica UK Limited therefore expensed any contributions payable to the defined benefit sections of the plan for the period up to 14 December 2018.

With effect from 28 February 2013 the defined benefit scheme of the Plan was closed to new entrants and further benefit accrual. The only funding provided into the defined benefit scheme of the Plan after this date has been the additional deficit funding payments and the section 75 payment. Members' defined benefit pensions will continue to be increased in deferment by reference to the Consumer Prices Index but will not retain the link to any future increases in salary. Upon closure, members of the defined benefit scheme of the Plan were given the option to become members of the defined contribution scheme of the Plan. The defined contribution scheme of the Plan remains open to new entrants and further contributions and the employer contributions are recognised as part of the staff costs in the participating entities. The assets of the Plan are held independently of the Group's finances. The trustee of the Plan acts in accordance with its responsibilities under pension regulations and trust law. They act in the interests of the members and beneficiaries of the Plan and operate independently from the Group.

The liabilities of the UK defined benefit Unfunded plan is recorded within the statement of financial position of O2 Holdings Limited, as it relates to ex-employees of O2 Holdings Limited. The costs arising from the Unfunded plan are borne by O2 Holdings Limited, and are reflected on the statement of comprehensive income of the Company.

The total charge included in the Company's statement of comprehensive income of Telefonica UK Limited for the Plan is as follows:

	2019	2018
	£m	£m
Defined contribution scheme contributions expensed	**37**	34
Total pension costs	**37**	34

Actuarial valuation

A full valuation of the defined benefit section of the Plan was undertaken as at 30 September 2017 by a suitably qualified independent actuary. The valuation used the projected unit method.

The initial results of the actuarial valuation of the Plan as at 30 September 2017 have been updated to 31 December 2019 by a third party qualified actuary in accordance with the requirements of IAS 19. The defined benefit liabilities have been measured using the projected unit credit method. Plan assets are stated at fair value.

The Plan's assets are currently invested in a diversified range of credit assets and long-dated inflation linked gilts, which are aligned to the Plan's liability characteristics. A £25 million contribution was paid to the defined benefit scheme by the Company during the year ended 31 December 2019 (2018: £nil).

The amounts included in the statement of financial position arising from obligations in respect of the defined benefit scheme of the Plan are as follows:

	At 31 December 2019 Funded	At 31 December 2018 Funded
	£m	£m
Fair value of assets	**1,565**	1,404
Present value of defined benefit obligations	**(1,577)**	(1,381)
Net (obligation)/asset recognised in the statement of financial position	**(12)**	23

Movements in the present value of the plans' funded defined benefit obligations in the current and preceding period were as follows:

	2019	2018
	£m	£m
At start of year	**1,381**	1,618
Interest expense	**39**	39
Past service credit	**-**	(3)
Actuarial loss/(gain) on demographic assumptions	**2**	(13)
Actuarial loss/(gain) on financial assumptions	**199**	(186)
Actuarial gain on experience adjustments	**(4)**	(30)
Benefits paid	**(40)**	(44)
At end of year	**1,577**	1,381

Movements in fair value of the various plans defined benefit scheme assets in the current and preceding period were as follows:

	2019	2018
	£m	£m
At start of year	**1,404**	1,465
Interest income	**40**	35
Return on plan assets in excess of interest income	**138**	(50)
Company contributions	**25**	-
Scheme expenses paid	**(2)**	(2)
Benefits paid	**(40)**	(44)
At end of year	**1,565**	1,404

The Company expects to contribute £25 million to the defined benefit scheme during the year ended 31 December 2020.

The amounts recognised in the statement of comprehensive income in respect of the defined benefit scheme are as follows:

	2019	2018
	£m	£m
Return on plan assets in excess of interest income	**(138)**	50
Actuarial loss/(gain) on demographic assumptions	**2**	(13)
Actuarial loss/(gain) on financial assumptions	**199**	(186)
Actuarial gain on experience adjustments	**(4)**	(30)
Total loss/(gain) recognised in other comprehensive income*	**59**	(179)

*The gain in 2018 was recognised in other comprehensive income of Telefonica O2 Holdings Limited (formerly Telefonica Europe plc).

The main financial actuarial assumptions used in the valuation were as follows:

	2019	2018
-		
Life expectancy (male currently age 40 / 60) in years	**88.0/86.8**	88.2/87.0
Life expectancy (female currently age 40 / 60) in years	**90.2/88.9**	90.4/89.1
Nominal rate of increase of pensions in payment (RPI max 5%)	**2.90%**	3.05%
Discount rate	**2.05%**	2.85%
Inflation assumption		
- CPI	**1.95%**	2.20%
- RPI	**2.95%**	3.20%

Plan assets are valued by reference to quoted market prices in active markets.

At 31 December 2019, the weighted average duration of the defined benefit obligation of the funded plan was 22 years (2018: 23 years).

The position and results reported are subject to the accuracy of the assumptions used.

A reduction in the discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the discount rate will have an opposite effect of similar magnitude.

An increase in the inflation rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A reduction in the inflation rate will have an opposite effect of similar magnitude.

There is also uncertainty around the future life expectancy of the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

The following table summarises the estimated sensitivity of the disclosed liability value to changes in the principal assumptions that have been used in the calculations:

Charge by assumption	Liabilities increase by:
Decrease discount rate by 0.25%	£98 million
Increase inflation rate by 0.25%	£94 million
Increase life expectancy by 1 year	£41 million

Investment commentary

As at 31 December 2019, the Plan was fully invested in line with the SIP. The Plan's assets were invested in a diversified range of credit assets and long-dated inflation linked gilts, which are aligned to the Plan's liability characteristics. This strategy is achieved through a mixture of direct investments in the target asset classes and derivatives. This includes the Liability Driven Investment strategy which aims to reduce the Plan's exposure to interest rate and inflation risk.

The Plan's exposure at the end of the reporting period for each category of assets is as follows:

	2019	2018
Equities		
Equity instrument funds	**0%**	0%
Credit instruments		
AAA rated	**3%**	7%
AA rated	**67%**	65%
A rated	**8%**	6%
BBB and lower	**28%**	26%
Not rated	**25%**	28%
Cash/other	**10%**	3%
Liabilities	**(41%)**	(35%)

The figures above are as at the statement of financial position date. Market values of Plan's assets, which are not intended to be realised in the short-term, may be subject to significant changes before they are realised. All equity securities and credit opportunities have quoted prices in active markets.

Risks

The main risks to which the Company are exposed in relation to the Plan are:

Longevity risk

The assumptions adopted by the Company make allowance for future improvements in life expectancy. However, if life expectancy improves at a faster rate than assumed, this would result in greater payments from the Plan and consequently increases in the Plan's liabilities. The Company and the Plan's Trustee reviews the mortality assumption on a regular basis to minimise the risk of using an inappropriate assumption.

Investment risk

The Plan invests its assets in a portfolio of global corporate bonds, liquid credit and synthetic equity, with a Liability Driven Investment overlay to provide interest and inflation rate hedging. The Plan's liabilities are valued with respect to long dated bond yields, so the value of assets and liabilities may move out of line as investment conditions change. In addition because the duration of the Plan's assets is shorter than the duration of the Plan's liabilities, there is a risk that the Trustee will not be able to reinvest the Plan's assets at assumed rates. The Plan's Trustee reviews the structure of the investment portfolio on a regular basis to minimise these risks.

Yield risk

A fall in bond yields will increase both the value of the Plan's assets and liabilities. At present the value of the Plan's liabilities is greater than the value of its assets, and as a result there is a risk that the value of the liabilities may grow in monetary terms by more than the value of the Plan's assets, increasing the deficit in the Plan.

Inflation risk

The majority of the Plan's liabilities increase in line with inflation and so if inflation is greater than expected, the liabilities will increase. The Plan has hedged some of the inflation risk and will continue to monitor this risk.

	2019 Funded	**2019 Unfunded**
Year	**Expected benefit payments (£m)**	
2020	31	-
2021	33	-
2022	36	-
2023	41	-
2024	44	-
Rest of time	3,056	5

Other pension plans

The Company also operates a defined contribution scheme in the UK. The assets of these defined contribution arrangements are held separately from those of the Company in independently administered funds. The expense, in the statement of comprehensive income, relating to the defined contribution section of the Plan is equal to the contributions paid over the period presented, which totaled £37 million for the year ended 31 December 2019 (2018: £34 million).

27. Deferred taxation

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	£m
At 1 January 2018	**(34)**
Prior year credit to statement of comprehensive income	2
Current year charge to statement of comprehensive income	(12)
Current year credit to other comprehensive income	2
At 31 December 2018	**(42)**
Prior year credit to statement of comprehensive income	2
Current year charge to statement of comprehensive income	(12)
Current year credit to other comprehensive income	6
At 31 December 2019	**(46)**

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered.

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. The movement in deferred income tax assets and liabilities (prior to offsetting of balances) during the financial year is as follows:

Deferred tax liabilities	**Property, plant and equipment £m**	**Intangible assets £m**	**Total £m**
At 1 January 2018	(22)	(13)	(35)
Current year charge to statement of comprehensive income	(13)	1	(12)
Prior year credit to statement of comprehensive income	2	-	2
At 31 December 2018	(33)	(12)	(45)
Prior year credit to statement of comprehensive income	2	(1)	1
Current year charge to statement of comprehensive income	(6)	(2)	(8)
At 31 December 2019	(37)	(15)	(52)

Deferred tax assets	**Pensions £m**	**Provisions £m**	**Total £m**
At 1 January 2018	-	1	1
Current year credit to other comprehensive income	-	2	2
At 31 December 2018	-	3	3
Current year charge to statement of comprehensive income	(4)	-	(4)
Current year credit to other comprehensive income	6	-	6
Prior year credit to statement of comprehensive income	-	1	1
At 31 December 2019	2	4	6

Net deferred tax liability	**£m**
At 31 December 2019	**(46)**
At 31 December 2018	(42)

There were no unrecognised deferred tax assets of liabilities at 31 December 2019 (2018: £nil).

In the Spring Budget 2020, the Government announced that from 1 April 2020 the corporation tax rate would remain at 19% (rather than reducing to 17%, as previously enacted). This new law was substantively enacted on 17 March 2020. As the proposal to keep the rate at 19% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. However, it is likely that the overall effect of the change, had it been substantively enacted by the balance sheet date, would be to increase the tax expense for the period by £5 million, and to increase the net deferred tax liability to £51 million.

28. Ordinary share capital and capital reserve

Share capital

	Number of authorised shares	31 December 2019 £	Number of authorised shares	31 December 2018 £
Share capital				
Called up, allotted and fully paid				
Ordinary A shares of 20 pence each	**10,001,100**	**2,000,220**	10,001,100	2,000,220
At end of year	**10,001,100**	**2,000,220**	10,001,100	2,000,220
Ordinary B shares of 20 pence each	**40,004,400**	**8,000,880**	40,004,400	8,000,880
At end of year	**40,004,400**	**8,000,880**	40,004,400	8,000,880
Total shares	**50,005,500**	**10,001,100**	50,005,500	10,001,100

The Company has two classes of issued share capital comprising Ordinary A and Ordinary B shares of 20 pence each. Each share class ranks pari passu. Subject to the Company's Articles of Association and applicable law, the Company's shares confer on the holder the right to receive notice of and vote at General Meetings, the right to receive surplus assets on a winding up of the Company, and an entitlement to receive any dividend declared on ordinary shares.

Capital reserve

On 14 December 2018 the Telefonica UK Pension Plan ("the Plan") transferred into the Company via a capital contribution from Telefonica O2 Holdings Limited (formerly Telefonica Europe plc) for £23.1 million, being the net asset position of the plan on the transfer date. This transfer created a capital reserve in the Company.

29. Financial commitments and contingent liabilities

Operating lease commitments

The Company leases various offices, shops, vehicles and mast sites under non-cancellable operating lease agreements. These leases have various terms and renewal rights.

From 1 January 2019 the Company has recognised right of use assets and lease liabilities.

At 31 December 2018 the Company was committed to making the following total future lease payments in respect of operating leases for each of the following periods:

	2018 £m
Future minimum rentals payable under non-cancellable operating leases expiring:	
Within one year	158
Between one and five years	257
After five years	93
	508

From 1 January 2019 the Company has recognised right of use assets and lease liabilities in respect of these commitments. See notes 2, 14 and 22 for further information.

Capital commitments

Contracts placed for expenditure not provided in the accounts are as follows:

	2019 £m	2018 £m
Contractual commitments placed for expenditure not provided in the accounts:		
- Property, plant and equipment	**192**	244
- Intangible assets	**490**	493
- Operating expenditure (excluding operating leases)	**1,579**	1,807
Total	**2,261**	2,544

The Company has no contingent liabilities or guarantees on which material losses are expected. The Group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations.

The Company does not believe there are any pending legal proceedings which would have a material adverse effect on its financial position or results of operations.

30. Related party disclosures

During the year the Company entered into transactions with related parties as follows:

	2019 £m	2018 £m
Income		
Subsidiaries	**223**	190
Other group undertakings	**36**	30
Joint operations/ventures	**209**	205
Expenses		
Ultimate parent	**(25)**	(23)
Other group undertakings	**(97)**	(107)
Joint operations/ventures	**(86)**	(159)
Dividends		
Parent	**480**	-

Outstanding balances as at 31 December 2019 arising from sale or purchase of goods and services are unsecured and receivable or payable within 12 months from the statement of position date and are disclosed in notes 18 and 23. Loans with related parties are disclosed in note 21.

Related party transactions with Directors and key management are detailed in note 8.

31. Financial instruments and financial risk management

31.1 Financial risk factors and management

The Company's principal financial liabilities, other than derivatives, comprise bank overdrafts, other loans, finance leases and trade and other payables. The purpose of these financial liabilities is to raise finance for the Company's operations. The Company has various financial assets such as trade receivables, cash and short term deposits.

The main sources of risk arising from the Company's financial instruments are market risk (including currency risk), credit risk and liquidity risk. Sensitivity analysis of these risks has not been considered as the Company mitigates efficiently against these risks. Management of the Company's financial risks is achieved mostly through being a part of the larger Telefónica group, which operates group wide policies in each area and is able to hedge positions on a group basis. The principal financial risks of the Company and how the Company manages these risks are discussed below.

(a) Market risk

(i) Foreign currency risk

The Company operates mainly in the United Kingdom. The Company is exposed to transactional foreign exchange risks arising from various currency movements, primarily with respect to the Euro and US dollar that can affect its results and financial position. At 31 December 2019, if Sterling had strengthened by 5% against the Euro, the recalculated profit before tax would have been £0.6 million higher (2018: £1.2 million). At 31 December 2019, if Sterling had weakened by 5% against the Euro, the recalculated profit before tax would have been £0.7million lower (2018: £1.4 million). At 31 December 2019, if Sterling had strengthened by 5% against the US dollar, the recalculated profit before tax would have been £1.1 million higher (2018: £1.4 million). At 31 December 2019, if Sterling had weakened by 5% against the US dollar, the recalculated profit before tax would have been £1.2 million lower (2018: £1.5 million). This is mainly as a result of foreign exchange gains/losses on translation of Euro and US dollar trade and other payables, roaming assets and liabilities and balances held with Telfisa Global B.V.

The Company also has a small amount of transactional exposure. Such exposure arises from revenues and purchases by an operating unit that is in currencies other than the unit's functional currency. Significant exposures are managed through the use of foreign exchange contracts and the Telefónica group managing positions on a group wide basis.

(ii) Cash flow and fair value interest rate risk

Interest rate risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company's interest rate risk arises primarily from the effects of movements in interest rates on the value of the Company's long-term borrowings and interest received on cash and cash equivalents. The Company's long term borrowings and other financial assets are at fixed interest rates. The majority of the Company's cash and cash equivalents are deposited with a central Telefónica group company that pays interest at variable market rates.

(b) Credit risk

Credit risk is the risk that a counterparty will not meet its obligation under a financial instrument or customer contract, leading to a financial loss.

The Company's principal credit risks are attributable to its trade receivables and contract assets. Trade receivables and contract assets as presented in the statement of financial position are net of provisions for estimated credit losses.

At the statement of financial position date there were no significant concentrations of credit risk, with exposure spread over a large number of counter-parties and customers. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the statement of financial position. The Company does not require collateral in respect of financial assets.

(i) Trade receivables and contract assets

The Company provides services to individuals and business customers on credit terms. The Company expects that some debts due will not be paid as a result of the default of a small number of customers. The expected credit loss rates are based on historical results and future expectations, the economic and competitive environment and other relevant factors to determine the provision for credit losses. A significant, unanticipated downturn in the major economies that the Company operates in or negative industry trends could require an increase in the estimated level of debts that will not be collected, which would negatively impact the operating results. The exposure to credit risk is monitored on an ongoing basis.

The Company applies the IFRS 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables and contract assets. The contract assets relate to unbilled revenue and have substantially the same characteristics as the trade receivables for the same types of contracts.

The loss allowance was determined for trade receivables and contract assets at 31 December 2019 and 31 December 2018 as follows:

	Contract assets		Trade receivables	
	31 December 2019 £m	**31 December 2018 £m**	**31 December 2019 £m**	**31 December 2018 £m**
Current amounts	**285**	223	**1,014**	1,074
Amounts past due:				
Less than 90 days	**-**	-	**59**	63
Between 90 and 180 days	**-**	-	**23**	17
Between 180 and 360 days	**-**	-	**30**	12
Over 360 days	**-**	-	**55**	25
Loss allowance	**(16)**	(12)	**(160)**	(156)
Total	**269**	211	**1,021**	1,035

Amounts above are presented including VAT.

For the receivables which are not impaired and which are overdue at the reporting date, there has been no indication that their payment obligations will not be met.

The movement in the trade receivables and contract assets loss allowance during the year is as follows:

(c) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting its obligations associated with financial liabilities.

Management of the Company's liquidity risk is achieved mostly through being a part of the larger Telefónica group, which operates group wide policies in this area. The Company holds financial assets primarily in short-term deposits with a central Telefónica group company that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

The following tables set out contractual undiscounted cash outflows of financial liabilities, including interest payments:

31 December 2019	**> 1 year**	**< 1 year**	**Total**
	£m	£m	£m
Borrowings	997	19	**1,016**
Trade and other payables	3	2,394	**2,397**
	1,000	**2,413**	**3,413**

31 December 2018	**> 1 year**	**< 1 year**	**Total**
	£m	£m	£m
Borrowings	1,108	90	**1,198**
Trade and other payables	-	2,337	**2,337**
	1,108	**2,427**	**3,535**

Supplier financing arrangements

The Company operates a supplier financing scheme for certain suppliers that allows them to be paid earlier than the invoice due date. The Company evaluates supplier arrangements against a number of indicators to assess if the payable continues to hold the characteristics of a trade payable or should be classified as borrowings; these indicators include whether the payment terms exceed customary payment terms in the industry. The balances contained within trade payables under this arrangement amounted to £342 million at 31 December 2019 (2018: £302 million). At 31 December 2019 none of the payables subject to supplier financing arrangements met the criteria to be reclassified as borrowings.

31.2 Capital management

The Company's capital comprises share capital and retained earnings.

The Company's objectives when managing capital are to safeguard the Company's ability to continue to operate as a going concern, to maintain optimal capital structure commensurate with risk and return and to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Company may pay dividends to its shareholder, return capital to its shareholder, issue new shares or sell assets to reduce debt or draw down more debt.

The Company's total capital and gearing is as follows:

	31 December 2019 £m	31 December 2018 £m
Total borrowings (note 21)	966	1,036
Less: cash and cash equivalents (note 20)	(138)	(104)
Net debt	828	932
Total equity	**2,649**	**2,580**
Total capital	3,477	3,512
Gearing ratio	24%	27%

31.3 Financial assets

The classification of financial assets for the year ended 31 December 2019 is as follows:

	Fair value through profit or loss Held to sell £m	Amortised cost £m	Total carrying amount £m
Trade receivables	-	155	155
Contractual assets	-	103	103
Other financial assets	-	57	57
Non-current financial assets	**-**	**315**	**315**
Trade receivables	407	564	971
Contractual assets	-	166	166
Other financial assets	-	64	64
Accrued income	-	152	152
Cash and cash equivalents	-	138	138
Current financial assets	**407**	**1,084**	**1,491**
Total financial assets	**407**	**1,399**	**1,806**

For the years ended 31 December 2019 and 31 December 2018 there are no financial assets classified as: fair value through profit or loss using the fair value option; fair value through other comprehensive income (debt or equity instruments); or hedges.

All financial assets held at fair value through profit or loss are classified as level 2 in the measurement hierarchy and are measured using other directly observable market inputs.

There are no financial assets classified as level 1 (quoted prices) or level 3 (inputs not based on observable market data).

31.4 Financial liabilities

For the years ended 31 December 2019 and 31 December 2018 all financial liabilities were held at amortised cost.

32. Share based payments

The main share-based payment plans in place during the period are as follows:

Telefonica Performance Investment Share Plan 2018-2022

The Telefónica, S.A. General Shareholders' Meeting on 8 June 2018 approved a new instalment of the long-term share-based incentive "Performance and Investment Plan" for certain senior executives and members of the management team of the Telefonica Group.

The term of the plan is a total of five years divided into three phases, each of a three year duration. The first cycle was deemed to have started on 1 January 2018 and will end on 31 December 2020. Under the terms of the Plan, employees will be entitled to receive a certain maximum number of shares of Telefónica S.A., upon fulfillment of certain requirements, namely:

1. The final delivery of shares is conditional upon the employee remaining in the entity's employ during the vesting period.

2. The final number of shares granted is subject to certain performance conditions based on:

    a. 50% of the total shares shall be delivered upon achievement of a certain Total Shareholder Return ("TSR") target that must be satisfied during the period in which the evolution of the TSR of the Telefónica Group is measured.

    b. 50% of the total shares shall be delivered if a certain free cash flow ("FCF") target is met.

Thus, if certain performance levels and FCF targets are achieved, the employee is entitled to receive 100% of the maximum number of shares awarded, whereas if only one of the targets is met, the employee shall receive the related shares.

448,864 shares were assigned in the first phase with a fair value of €6.46 per share for the FCF linked shares and €4.52 per share for TSR linked shares.

547,298 shares were assigned in the second phase with a fair value of €6.46 per share for the FCF linked shares and €4.52 per share for TSR linked shares.

Talent for the future Share Plan (TFSP) 2018-2022

The TFSP is a long-term programme aimed to recognise and reward employees with consistent outstanding performance, with high potential and key skills.

At the General Shareholders' Meeting of Telefónica S.A. held on 8 June 2018, a long-term share-based incentive plan called "Talent for the Future Share Plan" was approved for certain Telefonica Group employees.

Under this Plan, a certain number of shares of Telefónica S.A. will be delivered to participants selected by the company who have opted to take part in the scheme and meet the requirements and conditions stipulated to this end.

The term of the plan is a total of five years divided into three phases, each of a three year duration. The first cycle was deemed to have started on 1 January 2018 and will end on 31 December 2020. Under the terms of the Plan, employees will be entitled to receive a certain maximum number of shares of Telefónica S.A., upon fulfillment of certain requirements, namely:

1. The final delivery of shares is conditional upon the employee remaining in the entity's employ during the vesting period.
2. The final number of shares granted is subject to certain performance conditions based on:
    a. 50% of the total shares shall be delivered upon achievement of a certain Total Shareholder Return ("TSR") target that must be satisfied during the period in which the evolution of the TSR of the Telefónica Group is measured.
    b. 50% of the total shares shall be delivered if a certain free cash flow ("FCF") target is met.

Thus, if certain performance levels and FCF targets are achieved, the employee is entitled to receive 100% of the maximum number of shares awarded, whereas if only one of the targets is met, the employee shall receive the related shares.

50,750 shares were assigned in the first phase with a fair value of €6.46 per share for the FCF linked shares and €4.52 per share for TSR linked shares.

47,750 shares were assigned in the second phase with a fair value of €6.46 per share for the FCF linked shares and €4.52 per share for TSR linked shares.

Other share-based payment plans

Global Employee Share Plan 2019-2021

The Global Employee Share Plan 2019 was launched on 20 May 2019. Under the plan employees were offered the option to acquire Telefónica S.A. shares during a twelve-month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements.

The total term of the plan is two years. Employees joining the plan could acquire Telefónica S.A. shares through maximum monthly instalments of €150 (or the local currency equivalent) up to a maximum of €1,800 over a period of 12 months (acquisition period) and the minimum contribution to be made by each participant would be €25 per month. Those employees who hold the shares for a further twelve months after the end of the acquisition period, are entitled to receive one free share for every two acquired shares, within the Plan conditions.

The acquisition period commenced in July 2019 and will end in June 2020. The plan's shareholding period will come to an end in July 2021. Shares will be delivered in July 2021 at the end of the vesting period.

33. Contingent Liabilities

Phones 4u

Legal proceedings have been issued in the High Court against the Company by the Administrators of Phones 4u. The Company has vigorously denied the allegations and filed its defence to this claim in April 2019. No provision has been made in relation to this matter.

34. Other matters

As disclosed in previous years the Company has been addressing a request for disclosure made by governmental authorities which is related to possible violations of anti-bribery laws and regulations. The Company continues to co-operate with the governmental authorities investigating this matter which is still ongoing. Also the Company continues to conduct its own internal investigation on the matter. Whilst it is not possible at this time to predict the full scope or duration of this matter or its eventual outcome, the Company considers it can make a reliable estimate of the outcome and has made an accrual for this amount at 31 December 2019 (31 December 2018 : no accrual was made).

Disclosure of the matters required by IAS 37 has not been provided as permitted by IAS37 para 92 as the directors believe that further disclosure will be seriously prejudicial to future developments on this matter.

35. Subsequent events

Annual Licence Fees

In 2015, by way of regulations (2015 Regulations), Ofcom reset the existing regulations (2011 Regulations) for Annual Licence Fees (ALFs) for the 900 & 1800 MHz bands from approximately £65m to £200m per annum for all mobile network operators (MNOs). Telefonica UK's fees were set at £49.8m pa. The 2015 Regulations were quashed in 2017 pursuant to a Court of Appeal judgment which held that they had been determined unlawfully by Ofcom. The fees regime reverted to the pre-existing 2011 Regulations and the lower fees set in these Regulations. O2 and the other MNOs brought a claim against Ofcom for repayment of the difference between the amounts paid under the unlawful 2015 Regulations and the lawful 2011 Regulations. O2's claim was initially £52.8m plus interest. This figure increased to £54.4m plus interest in 2019 due to a payment being incorrectly characterised when the claim was first formulated.

Ofcom disputed that the MNOs were entitled to claim the difference in this way, instead asserting that the MNOs were only entitled to the difference between the amount paid under the unlawful 2015 Regulations and a notional amount that would have been paid had Ofcom put in place lawful regulations at the relevant time (which Ofcom noted would have been of a similar level to the 2015 Regulation fees based on a new consultation and subsequent 2018 Regulations that came into force which set ALFs at a broadly similar level as they had been set by the 2015 Regulations). The MNOs won their claim in the High Court in 2019 and the appeal in the Court of Appeal in 2020. Ofcom is not appealing the Court of Appeal decision to the Supreme Court.

O2 and Virgin Media Joint Venture

On 7 May 2020, Telefonica SA and Liberty Global announced that both companies had entered into an agreement together to create a 50:50 joint venture in the UK, bringing together the Telefonica UK (O2) and Virgin Media businesses. The arrangement is still subject to regulatory clearance has been agreed in order to create a national connectivity champion capable of competing at the highest level with the combined mobile and home connections. It is anticipated that closing of the transaction, subject to regulatory clearance is expected to take place around the middle of 2021.

Covid-19

Worldwide or national health-related events, including the outbreak of contagious diseases, epidemics or pandemics, such as COVID-19 (coronavirus), could significantly affect our operations. Such events could cause, among others, delays in the supply chain due to problems in factories or logistic services; impact on employees or third parties due to quarantine periods or infection, and also affecting global and therefore national economic growth. The latter stemming from a variety of adverse impacts on supply (paralysis of integrated production chains, freezing of productive resources) and demand (deterioration of confidence and expectations, negative income and wealth effects) caused by a substantial deterioration in financial markets, unprecedented falls in commodity prices, sharp slowdown in commercial activity or heavy restrictions on transport. Like every other business we are not immune to the consequences of the pandemic and are committed to ensuring that the Business can navigate through the unprecedented uncertain times, supporting our customers and employees as well as contributing to the recovery of the economy which we operate in by keeping Britain connected. As Britain works through this national crisis, mobile is playing a more critical role than ever to keep people connected. We are doubling some elements of our network capacity, enabling essential connectivity, supporting Britain's productivity and donating directly to those who need it - all in the pursuit of keeping Britain connected.

As a responsible business we followed government advice to help protect our people and our customers. We implemented our business continuity plans to allow office-based employees to work from home and took a decision to close our stores after trading on 23 March 2020 ahead of the national lockdown announcement by the government. During the lockdown period we implemented a work from home policy where it is possible to do so ensuring the safety and welfare of our people and the ability to continue to meet the needs of our customers. In addition, we brought in a range of temporary people measures, including the protection of base pay for all employees including paid leave for vulnerable employees and for those in self-isolation, or with caring responsibilities who are unable to work from home, including retail employees. We worked closely with the government to provide assistance to NHS workers, charities and our customers by providing 25% discount on tariffs and free data for NHS workers, unlimited free calls for Pay Monthly customers, suspended roaming charges, support for vulnerable customers and zero-rating access to support and charity websites. We were instrumental to supporting the NHS and keeping Britain connected by providing connectivity to the Nightingale hospitals across the country and donated The

O2 as a training facility as well as a drive through testing facility for the NHS. We also partnered with the BBC's Big Night In to galvanize the nation to respond to the challenges that lie ahead.

Following the ease of the lockdown restrictions in phases we are committed to ensuring the continuing safety of our employees and customers and have re-engineered our retail estate, practices and procedures to align with the government guidelines for social distancing. We are mindful of the economic pressure and impact on our profitability growth and are committed to helping Britain get back to normal by supporting our customers and businesses.

The Company has shown resilience throughout this turbulent period and the need for connectivity by our customers has been just as strong, albeit their specific demands have changed. The below table outlines the main impacts to the business as a result of COVID-19 and what the business has done to address them.

Matter to consider	Impacts/Risks	Mitigations	Conclusion
Revenue	Store closures have resulted in a slow down of hardware revenue. Smart metering revenues have slowed down due to physical restrictions during lockdown. The travel ban in the UK and across many parts of Europe has resulted in reduced roaming revenues.	Improved online sales capabilities by enabling telesales teams to operate from home and adapting physical estate in order to manage the sales process under social distancing guidelines.	We have seen an increase in online channel sales and we expect other channels to pick up again as lockdown restrictions start to ease from mid-June. The reduction in roaming revenues is partially offset by a reduction in associated costs.
Liquidity	Financing becomes more expensive and unavailable in the current climate.	Key debt facility has been renewed for an additional term and the introduction of a new funding partner has enabled the Company to grow the facility whilst keeping the total cost of funding the facility flat.	No significant liquidity concerns, the risk of a loss of available funding has been mitigated through the introduction of a third funding partner.
Collections	Customers struggle to pay their bills and increased bad debt	Following emergency changes to government regulations on Consumer Credit Agreements we initially introduced an emergency payment option for any customers finding it difficult to pay their bill as a direct result of COVID-19. Appropriate provisions have been made for the anticipated increase in bad debt as a result of the pandemic.	The volumes of customers taking the emergency payment option has been within expected levels, the impact has been considered in forward looking financial forecasts.
Costs/Capital allocation	Spend is not reviewed in light of COVID-19.	The board has reviewed discretionary expenditure and investments in view of COVID-19 and continue to execute smart spending principles to focus on core service and targeted cost management throughout the business.	Appropriate measures are now in place to review cost control and capital expenditure in light of the pandemic.
Forecasting	Forecasts are not reflective of performance during COVID-19 crisis.	We have processes in place to review the appropriateness of our financial outlooks regularly and monitor market activity on an ongoing basis. Rate and volume assumptions have been stress tested and triangulated with market insight and trading updates.	Current forecasts take account of risks associated with trading during the COVID-19 crisis.
Network Resilience	Network overload and possible degradation of services from the growth of voice / data traffic.	We proactively managed the expected voice traffic increase through increased network capacity. Data usage patterns changed as people connected from their homes rather than work locations and commuting routes with no negative impact on the network.	Network capacity planning reflects an expected impact of changes in future usage patterns as a result of COVID-19.

Disposal of legacy assets

During the year ended 31 December 2019 amounts of £1,418 million cost and £1,418 million accumulated depreciation were disposed of relating to legacy assets no longer in use. Subsequent to 31 December 2019 we identified further legacy assets no longer in use of £85 million cost and £85 million accumulated depreciation. Consequently we disposed of a total of £1,503 million cost and £1,503 million accumulated depreciation during the year ended 31 December 2019. The disposals had £Nil impact on the net book amount of property, plant and equipment.

36. Parent company and controlling party

The Company's immediate parent company is O2 Holdings Limited, a company incorporated in England and Wales, which prepares consolidated financial statements. Consolidated financial statements of O2 Holdings Limited may be obtained from 260 Bath Road, Slough, Berkshire, SL1 4DX.

The Company's ultimate parent company and controlling party is Telefónica, S.A., a company incorporated in Spain, which prepares consolidated financial statements. Consolidated financial statements of Telefónica, S.A. may be obtained from Gran Via 28, Madrid, Spain.