

Telefonica UK Limited Annual Report and Financial Statements

Year ended 31 December 2020

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Introduction

O2 is a mobile network operator and the main commercial brand of Telefonica UK Limited which operates solely in the UK and is part of the global telecommunications group, Telefonica S.A.

Our purpose is to make every day better through personal experiences that count. Our daily activities are underpinned by our company values (Bold, Open and Trusted) and our Business Principles with the continuing focus of putting our customers at the heart of everything we do.

As a result of the COVID-19 pandemic, 2020 in general, was a challenging year for the economy, people and businesses in the UK and the rest of the World. We were not immune to the challenges presented by the pandemic and our resilience was demonstrated by the level of support we provided to our customers, our people and the nation as a whole and our strong financial performance. Despite the decline in revenue which can be attributed to unavoidable lockdown-related decline in SMIP installation, roaming services and other service revenues that was partly mitigated by hardware revenue, non-mobile ICT business growth and strong cost control. Further details on our performance are discussed throughout the report.

We continued to invest in and grow our network to help keep people connected whilst maintaining market-leading levels of customer loyalty and satisfaction. Our continuing focus is to play a bigger role in helping to get the UK back on its feet. Connectivity has never been more important and O2 provides one of the UK's most valued services and is playing a significant part to help rebuild Britain.



Our priorities

What we have achieved in 2020 and our continuing focus, is to promote our Customer Led, Mobile First strategy. This report demonstrates our ability to deliver a great customer experience, especially as the whole nation continues to navigate through unprecedented times, whilst helping our customers to get the most out of mobile connectivity.

Our priorities in 2020 were impacted by the situation businesses and the nation found themselves in, as a result of the pandemic. Our main focus areas were:

- (1) **Customer Experience:** Our simple and personal customer experience is industry leading. We continue to invest in digitalising our **Customer Service** and our transformation programme **Accelerate O2**. Our **Information Technology** and **Data** strategies underpin our core strategies such as customer experience, accelerating B2B growth opportunity and investment in future capabilities.
- (2) **Customer Propositions:** Our product and service offerings are tailored to suit different customer segments in order to help us deliver on the specific needs of our customers. Our customer segments are split between Consumer and Business. The Business segment includes: Small Medium Business (SMB), Enterprise including Multi-National Corporations (MNC) and Public Sector. Commercial partnerships are fundamental to how we deliver the best products, services and experiences to our customers. Through our Sponsorships we aim to make our customers feel special, creating unforgettable live experiences whereby our brand partnerships, together with our products and services, are intrinsically linked to enhancing customer experience.
- (3) **Sales and Service channels:** Our omni-channel approach allows customers to engage with us through any channel of choice, including Online, Telesales, My O2 (Digital Self-Serve) and Stores, as we continue to improve on our Customer Journey. As a result of the national restrictions during lockdown, we have adapted our Online channel to support the increased demand in traffic and continued to improve our self-serve experiences to meet the growing needs of our customers. We also have other routes to market through our Indirect Partners (Consumer, MVNO and Wholesale).
- (4) **Network:** The demand for mobile connectivity continues to grow rapidly every year and we continue to invest a significant amount of money in making our network even better. We play our part in helping the UK digitalisation goals through the Smart Meter Implementation Programme. In addition, we have championed the Shared Rural Network arrangement, which brings mobile network operators, the regulator Ofcom and the government together on a mission to boost current 4G landmass coverage from 67% to 84%.
- (5) **People:** The pandemic accelerated our move towards a more agile and digital way of working and our focus was on the well-being of our people during these unprecedented times. In addition, we have set our sight on becoming a truly diverse and inclusive business and we continue to make steady progress on our bold and transparent commitments through various Diversity and Inclusive initiatives and external partnerships.
- (6) **Corporate Responsibility:** Our Blueprint is our responsible business plan that sets out our commitments to operate fairly and ethically, tackle climate change and help society thrive. Our three key strategic aims focus on the issues where we believe we can make the greatest difference: Build a Greener network, Help Society thrive and Lead by example.



How we achieve our priorities

We have a business model designed to deliver against our strategic objectives and value for our stakeholders.

Customer Experience

Our customer experience strategy has remained consistent in 2020 and is underpinned by our goal to become the most recommended Telecommunications provider in the UK. We are committed to truly putting the customer at the heart of the organisation in order to achieve high levels of advocacy, measured through our Net Promoter Score (NPS). Ofcom also carries out independent research and rated us the number 1 mobile network operator in NPS as well as joint leaders for customer satisfaction.

At the start of the pandemic we became very much aware of the impact the crisis would have on our customers. Accordingly, we aligned our focus on the fundamentals of addressing essential customer needs with empathy, care and concern. We provided extra information, guidance and support to customers as well as the continuous reassurance that we are doing everything we can to keep them and our people safe within the evolving restrictions and guidance set out by government.

We carefully listened to the needs of our customers through a variety of different channels including our customer service, digital channels and customer communities and used social media to listen and understand their sentiment in the depth of the crisis. This has helped inform our customer response plan.

We offered zero-rated access to over 30 websites for all our customers, including websites offering support in financial, mental health, crime and domestic violence. In addition, we gave free data access to educational websites such as Hungry Little Minds for pre-school aged children and the online school Oak National Academy. We also offered unlimited minutes and texts to NHS workers. We further enhanced our online capabilities and social platforms to ensure we could respond quickly to queries, whilst ensuring that our service and network continued to be reliable as customers became more dependent on their mobile and connectivity during the unprecedented times. For example, we added a special filter to our system to proactively identify customers who had indicated they were in need of additional support in light of the pandemic, so we could ensure they received the help they needed. We also ensured our vulnerable customers had a minimum basic level of service during the pandemic. Our Gurus supported vulnerable customers with a how-to guide for setting up a device to be able to speak to their families and we also created Guru TV video which is being used to support our customers with various processes so they can self-serve at home.

Our NPS reflects and measures how likely customers are to recommend us. We survey a proportion of our customer base each quarter and report a 12 week rolling score on a monthly basis. We also ask customers about their relationship with O2 and the various elements of their experience which enable us to understand how customers are feeling and where we can make improvements. We also have a range of surveys which help us to diagnose what is driving the NPS rating and this contributes to the continuous improvement of delivering a great customer experience. At the end of 2020 our overall score was 29, up 11 points when compared to the end of 2019, allowing us to continue maintaining our market-leading position.

Customer Service

We strive to continually improve our service levels by listening to our customers and understanding how we can deliver the best possible customer experience across all our service touch points (Voice, Chat, Social Media, Online, MyO2 and Stores). We offer our customers help and support as well as elevating self-serve options, for example, customers are able to check their bills, look at call records and find out their upgrade options.

Customer feedback helps us to identify opportunities where we can optimise our service and journeys. Examples of this include Voice of the Customer surveys formal complaints and call reasoning analysis. A mix of quantitative and qualitative insight allows us to act quickly to fix faults or issues that can easily be resolved, whilst also enabling us to strategically identify, map and optimise the most important journeys for our customers.

Capita remain our long-term strategic partner who support our Consumer and Business customers across our voice and digitally assisted channels. Throughout 2020 we worked jointly on our COVID-19 response as well as our Business Continuity activity to ensure that the right support was in place to meet our customers' needs. We delivered, at pace, a homeworking solution for our advisors which demonstrated the agility of our partnership and allowed us to maintain our high standard of customer service. For example, we maintained acceptable service levels for all queries linked to keeping customers connected including our most vulnerable customers.

This year we have improved our overall Channel Net Satisfaction Score (NSS) by +4 points (December 2020 vs. December 2019) in spite of many external challenges across all channels due to national lockdowns. This was due to an increased usage of digital self-serve and MyO2, making it easier for customers to manage their account themselves.



Accelerate O2 (AO2)

AO2 is a company-wide initiative that will make us fit for the future and keep us ahead in a fast-moving market. It is set to deliver enhanced consumer and small office/home office (SOHO) customer experience through joined-up, data-driven customer journeys. The associated technology overhaul will deliver simplification and cost benefits across the whole of our business, which would achieve a reduction of interfaces by up to 50% and support with moving our Consumer and SOHO customers onto a single platform. The programme is structured into a number of releases across our Consumer and SOHO segments and is expected to be completed by the end of 2022. An initial release has brought all of our systems online for the first time, and launched the system capability for Business Support System and Online Charging System onto the live network. We continue to make progress against the following key goals:

- **Transform our customers' experience:** Through consistency of omni-channel experience, customers can start a journey in one channel and finish it in another e.g. baskets and retention offers associated to all channels. We will also be able to deliver relevant messages to customers in a personalised manner and enhanced billing experience including real time billing.
- **Create a step change in our ability to innovate and deliver at pace:** Centralise our product offering catalogue by moving from several product catalogues to one, making it simpler and faster to launch and manage products.
- **Make it simpler and easier for us all to work together:** Enhanced self-serve to deliver digital experiences and proactive support, aimed at moving approximately half of the voice queries to online, and to enable stores to offer better customer service through a 360-degree customer view.

Information Technology (IT)

Our main focus is to simplify and modernise our IT systems, applications, platforms and execute technology strategies, which are aligned with our business strategy to help drive customer and stakeholder values. This will help to reduce risk, be more cost effective and enable our People and customers to succeed and be future ready.

In 2020 we managed, supported and updated a number of initiatives which are detailed throughout this report, such as the ability to allow more of our people to work from home as well as zero-rating websites to help our customers during the pandemic. In addition to supporting the delivery of our digital and connectivity propositions for our Business customers.



Data

Following the pandemic outbreak, we reviewed our data strategy to ensure relevance and our strategic intents were valid. For example, our strategy was further re-enforced by customer behaviour shifting to online channels and we observed a 700% volume increase on data enabled cognitive capability within channel.

Our focus is to continue to enhance our data capability to drive improvements to customer experience and business performance. Delivering our data strategy will ensure Insight by Design – where the advanced use of data insight is embedded into everything we do. We also ensure our teams have self-serve access to data insight, based on trusted data and intelligent decisioning which provides real-time management of customer interactions across all our channels. As an example, to improve customer experience, we launched a series of data led capabilities to help identify customers who could have a better experience with us, and we proactively contacted them with appropriate suggestions to improve their service. Also, our data strategy supported the delivery of a step-change in underlying data architecture and capability paving the way for AO2 and reducing our data privacy risk.

Our Propositions

Our product and service offerings are tailored to suit customer segments to help us deliver on the specific needs of our customers. In 2020, 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 to all our customers and digital solutions for our business customers.

Consumer



Our consumer products and services deliver against our Customer Led, Mobile First strategy and our commitments which includes:

- **Custom plans;** giving our customers the ability to spread the cost of their mobile device over a period of up to 36 months, helping to lower their monthly bill. Once a customer has paid off their device, their bill automatically reduces and they do not pay for a phone they already own. We also offer tablets on 48 month plans so customers can get the device they want at an affordable price as well as financing for hardware products.
- We offer **SIM only plans** to our customers who don't want to buy a device.
- **Fair Deal** is our overarching fairness principle which ensures that our on-market price is available to all customers, whether they are existing or prospective customers. In practice, this means that existing customers will always get the same or better deals than new customers.
- **Exclusive experiences everyday** – Priority is a service which gives all our customers exclusive access to invite-only moments, perks and experiences to do the things they love.
- **Tech support** – Customers have access to O2 Guru, providing free advice to help them get the most out of their tech, tariffs, accessories and so much more.

In March 2020, we launched Disney+ on our platform, giving our new and upgrading pay monthly customers 6 months free access to its streaming service via their mobile, online and TV. Existing customers (who did not want to upgrade) had the opportunity to subscribe to the service with a reduced monthly subscription. During the pandemic, we helped support all our customers in a number of different ways as outlined in the Customer Experience section on page 5.

Business

In 2020 we announced a new suite of digital solutions to help get people and businesses back to work safely and building customer confidence. As an example, our digital solutions such as, virtual queuing, staff scheduling and appointment booking technologies proved so successful in allowing our own stores to re-open, that these solutions were offered to a range of our Business customers including retailers, supermarkets, stadiums and healthcare businesses. In addition to our Consumer products and services, we ensured businesses were armed with the necessary insight to manage the reopening of the economy from their perspective. In 2020 we won the Mobile Industry Award for Best Business Network 2020.

An example of our digital offering is an optional access to O2 Motion, a powerful big data and insights tool to help support businesses with their planning by understanding the location, movement and demographic profile of people across the UK. It provides aggregated, anonymised insight that protects individual privacy. O2 Motion has supported government agencies, transport bodies, train operating companies and academic institutions by supplying daily insight on population movement, split by age bracket and gender. This has helped business and government understand how COVID-19 is spreading and can help businesses plan for the reopening of the economy.

As well as core mobile offering, we offer connectivity solutions, voice and unified communications, security and Internet of Things (IoT). During the pandemic, our Business customers were looking at additional functions to improve ways of communication in the lockdown. In response, we launched O2 Voice for Microsoft Teams in November 2020 to provide telephony access into Microsoft Teams while ensuring users can continue to make calls to and from fixed and mobile devices.

The next generation 5G network is crucial in developing the national digital infrastructure. For example, this would significantly enhance business connectivity and support the economy as we emerge from the uncertain times. The pandemic has accelerated the digital transformation and automation plans of many companies within the industrial sectors. 5G Private Networks are the critical enablers of these plans, acting as the vital infrastructure that allows for the various use-cases to be deployed in a high speed, highly secure and low latency environment. We are conducting trials with British Sugar and Leonardo as they begin their transformation.

O2 Business works with a range of portfolio partners to provide digital connectivity and security services to our customers. This includes vendors, suppliers and both strategic and industry partners. We work with partners who underpin our ICT strategy and provide propositions that fit our customers' requirements. Example of our key partners include:

- Connectivity & Security: BT Wholesale, Cisco, TalkTalk Business, Virgin Media Business, Gamma, Palo Alto
- Unified Communications: Mitel, Microsoft, Cisco, Maintel
- Digital Workplace: VMware, Microsoft, Arvato, Google, Apple, Samsung

To help businesses adapt and ensure workplaces, and other customer-facing businesses, are safe to open up their doors – O2 Business has partnered with specialists at Bell Integration to launch a suite of IoT safeguarding solutions for businesses. The unique digital services available to O2 Business customers include:

- Thermal Imaging Tablet with Contactless Visitor Management which is an all-in-one infrared temperature sensing tablet, which can read surface body temperature (accurate to +/- 0.3 °C) from a distance of one metre. This service is combined with the capability to manage visitors from a distance and enable a contactless check-in experience whereby each visitor will need to use a unique QR code to verify their attendance. All visitor data is secure and complies with the data protection regulation.
- Handheld Thermal Imaging Scanner – The solution provides thermal imaging scanning that can be used in controlled locations with a limited number of people, as well as situations with high footfall, such as airports, transport services and public spaces.
- Social Distancing Room Management which monitors the people count and occupancy status of communal areas such as bathrooms, kitchens and meeting areas. A simple digital display unit shows green or red as to when it is safe to enter a room or communal space, in accordance with social distancing rules.



Small Medium Business (SMB)

Our Direct channels are split into segments; singleton sole traders and SOHO customers with an account size of 1 to 9 numbers and medium business segment with an account size of 10 to 499 numbers.

We always ensure that our existing customers are put first and new customers never receive preferential treatment. We offer the standard range of mobile services including voice, text and mobile broadband services. In addition we also offer SMBs a choice of split hardware and airtime contracts or more traditional bundled services. For our larger customers we provide sharer bundles allowing multiple mobile numbers to share their data allowance. In September 2020 we launched Business Flex, offering data rollover for business customers on selected tariffs, and the flexibility to change their bundle size to ensure they were not paying for unused data. Business Flex also includes unlimited International calls to the European Union. Many of our digital products have contract lengths from 30 days to 36 months, meaning that a customer can flexibly choose how long they want to have their products.

We also have a number of non-mobile products and services which includes Productivity; enabling business to communicate and work together internally and externally. Security; protecting customer information and external threats. Connectivity; enabling high speed connections and digital communication integration. Professional services; ensuring that customers have the support to setup and manage their digital and non-mobile products. Tablets and mobile broadband products for additional mobile connectivity and insurance to protect their mobile devices.

We have seen a growth in the need for digital solutions for some businesses as they have had to adapt to a new way of working during the pandemic to ensure they are able to continue to operate and remain in business. We offered free promotional periods and free trial products on key digital solutions, for example 6 months free Microsoft Teams and Professional Services products. This has provided businesses low cost solutions to help them work more flexibly and to be better supported. We also pivoted our focus towards key drivers which would best support our SMBs, in particular, we up-weighted our focus on tariffs, communications and channel drivers through the delivery of data rollover and flexible tariffs as well as payment support initiatives to help businesses throughout the pandemic. Additionally, we launched a number of non-mobile promotions that offered customers free trials of key digital products like Microsoft Teams. To help support SMBs, we offered short term contracts of 30 days to allow them to take on incremental mobile numbers to facilitate an increase in the number of their employees working from home and up to three months free line rental on some SIMO plans for new and upgrading customers. Where customers have been in financial difficulties, we offered deferred payment terms and the ability to suspend lines for up to three months. In 2020, we achieved our best ever SMB NPS performance, it was a 9-point year on year improvement and meant we were number 1 in the market.



Enterprise including Multi-National Corporations

Our larger business customers are UK based Enterprise organisations with 500+ employees including Multi-National Corporations (MNCs).

Mobile connectivity continues to be our focus for our larger business customers. Efficient and reliable remote working solutions have become increasingly important to businesses as they navigate a new model of flexible working in light of the pandemic. Customer needs help us to determine new product development and innovation and how we evolve our product offerings. This comes as the country looks towards a flexible and digitalised future working style; our research found that 45% of the workforce predict a permanent change to their company's approach to flexible working after lockdown and our range of flexible digital solutions can help businesses return to work safely.

McDonald's

We agreed a contract with McDonald's to upgrade the connectivity infrastructure within their UK and Ireland restaurants which supports their ongoing digital transformation programme. The rollout plan was ambitious with installation at 800 restaurants in less than six months. The roll out started in July 2020 and by the end of December 2020 we had successfully upgraded 809 restaurants - 62% of the programme.

Sainsbury's

We supported Sainsbury's with two programmes which involved replacing technology and future-proofing all of their stores, helping to transition their technology to connect and access their data systems for both their colleagues and customers. Our first programme transitioned their Wide Access Network locations which was achieved in 9 months, helping to migrate over 10,000 mobile and fixed lines. The second programme supported Sainsbury's Smartshop which allows its customers to scan and pay as seamlessly as possible using O2 Wifi capability. In 2020, we upgraded their local area networks, completely transforming the connectivity which helped Sainsbury's see a 20% improvement in their colleague's experience when fulfilling online orders as well as improving customer experience. In the first 6 months, sales using SmartShop grew by 23%, with some stores reaching 50%. Richard Newsome, CTO at Sainsbury's said, 'Whether it's in our stores, our depots or in our offices, the demand for great connectivity isn't going to go away, and O2 is helping us to make sure it's the best that it can possibly be.'



Public Sector

2020 has seen the increasing prominence in public sector procurement for suppliers to help demonstrate social value. This allows the public sector body to choose a supplier under a tendering process who not only provides the most economically advantageous service, but one which goes beyond the basic contract terms and secures wider benefits and improvements to economic, social and environmental well-being. Our Public Sector business has seen a growth in 2020, two of our notable wins are:

NHS England and NHS Improvement

NHS England and NHS Improvement had a four-year plan to roll out video consultations across NHS trusts in England, helping patients and hospitals to save time, money and protect the environment by taking fewer journeys. The COVID-19 outbreak challenged the NHS to adopt new ways of working to deliver patient care. This included making the most of the digital technology which could help reduce the number of attendances at NHS sites. The ability to provide video consultations would allow both patients and NHS staff to stay safely at home, where possible, and reduce the chances of catching or spreading the virus in hospitals and clinics. In March 2020 we provided the NHS with 6,500 tablets with mobile data connectivity and Digital Workplace applications to ensure the devices were secure, enabling the NHS to create an end-to-end service and help with patient care.

ENABLE Scotland

ENABLE Scotland provides social care for more than 1,000 people across Scotland. The charity's 1,800 frontline staff help deliver the vision of an equal society for every person who has a learning disability. Maintaining close engagement with their team without work mobile devices was challenging. To help overcome this, we helped deploy mobile devices so they would become more efficient and save time and money. ENABLE Scotland also sought a generic workforce management solution to update their team's rotas real time, enable them to check in and out as they started and ended shifts as well as digitalisation of certain administrative tasks.



Commercial partnerships

Commercial partnerships are fundamental to how we deliver the best products, services and experiences to our customers. Our relationships with manufacturer partners such as Apple and Samsung allow us to secure the best devices for customers. During the pandemic, we migrated the management of our commercial partners exclusively to online, using O2 and partner technologies to connect, communicate, negotiate and collaborate remotely. Our strong business relationships with our commercial partners have enabled us to meet customer needs by delivering the products, services and experiences customers value. For example, in partnership with The Walt Disney Company, we launched Disney+ which differentiates us in the market as the exclusive telco provider for the service in 2020 and beyond. Through our Priority platform we continue to offer our customers exclusive deals in partnership with key brands. Priority is recognised as a value-add consumer proposition across a range of customer interests including: Music: Amazon Music Unlimited, Film & TV on demand: Disney+, Prime Video, News and Magazines: Cafeyn, Health and Wellbeing: Calm and Digital Productivity and Security: McAfee.



Sponsorship

Through our sponsorships we aim to make our customers feel special, creating unforgettable live experiences where our products and services are intrinsically linked to enhancing the experience, underpinned by our long-term partnerships with The O2 and O2 Academy venues, Priority Tickets and England Rugby. The pandemic has had a significant impact on the sponsorship experiences due to the closure of venues and absence of spectators at sporting events as a result of the national restrictions. Despite this, there have been areas of opportunity where we've been able to continue the impact of our sponsorships. As an example, our 'This is just an interval' campaign, enabled us to use the physical assets of the O2 Academy venues to deliver a message of hope about a return to live events, attained 150 pieces of national and regional media coverage with approximately 64 million total reach (source Gorkana).

In October 2020, we renewed our sponsorship deal with the RFU to commence from September 2021, marking one of the longest shirt sponsorships in sporting history. As principal partner for the England Senior Men's and the England Senior Women's teams, the deal includes spend parity across the men's and women's games. The deal also provides our customers Priority Tickets for all England Rugby games, 48 hours before general release.

Both the men's and women's Six Nations was postponed until October and, when they did return, were played with no fans in the stadium. This was the same for the newly formed Autumn Nations Cup, bar the last game which allowed 2,000 fans to attend Twickenham. Our open letter to fans (encouraging them to wear their England shirts with even more pride and get behind their teams ahead of games) drove five times better engagement than our average organic social posts for sport.

We support live music to inspire and engage fans and create a deeper connection to live music for our customers. Being more meaningful and more relevant in people's lives enables us to appeal to fans, our customers and our people beyond traditional benefits-built loyalty and allow us to be the stand-out brand in an increasingly saturated music industry. Importantly it gives us clear customer benefits and the flexibility to talk to targeted audiences.



Sales and Service Channels

Our customers have the opportunity to engage with us through their own channel of choice including, online, voice, digital self-serve and stores. As a result of the national restrictions during lockdown, and closure of our stores in various parts of the country for a considerable length of time, we realigned our strategy with greater focus on the online channel and digital self-serve.

Online

The growth of the Online channel quickly accelerated throughout 2020 and has become our largest customer touchpoint. We were recognised externally with three awards: Best Telecommunications eCommerce and Best use of Merchandising. We were also awarded Best Online Retailer at the Mobile Industry Awards, demonstrating our leadership position in eCommerce, digital innovation and Online within the broad industry.

Our strategy aims to deliver broad and ambitious levels of growth across a wide variety of business and customer metrics. The strategy is based on robust insight, from which we develop transformational digital experiences and in turn this will drive usage and adoption of these experiences resulting in growth of our sales online. In 2020 we made transformational changes to the website, such as the re-design of the Online shop. We also responded to customer insight and changing customer behaviours quickly to optimise the website for different needs, for example increasing the size of the messaging team and altering the recommendation engine flows to cater for different customers.

During the pandemic, we immediately adapted our Online channel to support the increased demand in traffic as a result of the national restrictions. We introduced a new COVID specific page and published content to our Help and Support as well as our Contact Us pages and regularly updated them to ensure customers were kept aware of the support channels available to them during lockdowns and tier restriction changes. We also provided a comprehensive overview of the changes we were making as a business, including information about our stores and contact centre opening hours, FAQ's and a message from our Chief Executive Officer. We increased the visibility of chatbot on the Help and Support pages and introduced it to the Contact Us pages to provide an alternative source of information and interaction point with our customers.



Telesales

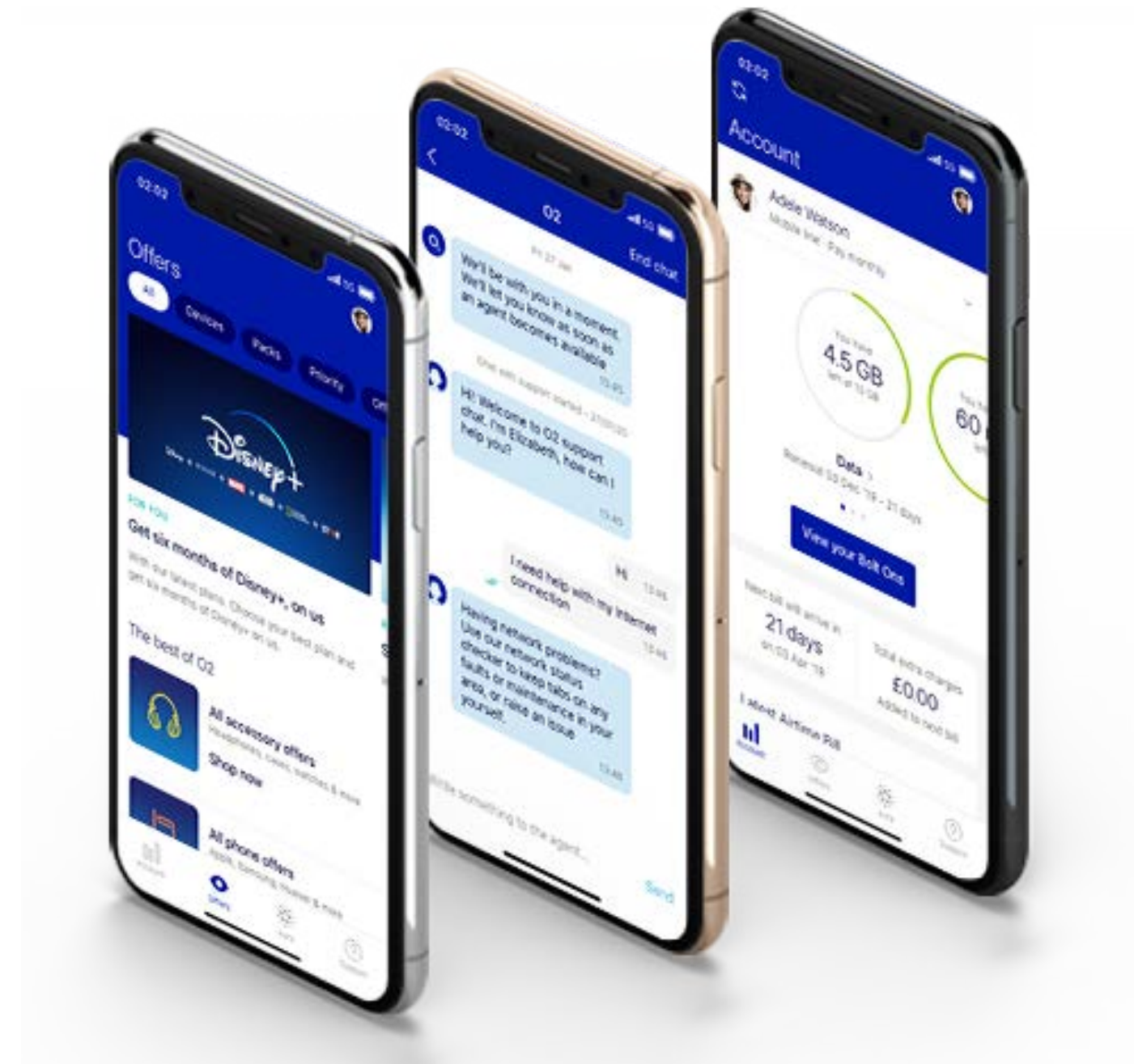
Our Telesales incorporates inbound calling, outbound calling and digital chat. Our strategy encompasses two key functions: Customer retention and new business across the key Consumer and SMB products and new business. This activity is supported in delivery by a number of key strategic principles:

- A multi-partner strategy, with our partners Capita, Concentrix and Intelling, to ensure that we have resilience, agility and competitive tension so we can provide the best quality service for optimum costs.
- A multi-skilled workforce throughout our partners enables us to support the demand during significant peaks and troughs in customer demand, linked to seasonality and key device launch events.
- A number of key commercial models designed to benefit our customers and our partners by using revenue share models to align objectives across the businesses.

We adopted the following key transformational activities due to changes in the market and customer's needs:

- Cross-selling activities to our customer base remains an area of focus and opportunity. We see this as a fundamental principle to grow our business as we increase our product offering.
- Service through sales looks at customer intent and opportunities, which will drive us to fundamentally change how we view interactions and the skills our channel requires us to deliver.
- Continued focus on real time customer interactions ensures that pro-active customer contact is both relevant and timely including the development of digital and social offerings.
- Continued blending of core Telesales skills to generate more effective customer communication channels and improving customer experience when purchasing from us.

From March 2020, we made critical key decisions to support our customers, our people and our business during the COVID-19 pandemic. These include flexible working for our people, flexible customer services, and training to ensure our people have the skills to execute on a greater range of sales skills to ensure that customers could be effectively supported with their needs.



My O2

My O2 is our digital self-service platform which allows our customers a simple and effective way to interact with us. For example, customers can check their bills, change tariff, upgrade device and resolve any simple queries. We continue to drive improvements to our self-serve channel to meet the growing needs of our customers, which has proved critical during the pandemic. In 2020 a new support section was added to the My O2 app to provide faster, simpler access to support the customer journey experience. Other new capabilities included a new order tracking service and a SIM swap capability. A new on boarding journey for the app was also introduced to ensure customers were familiar with key features. The Airtime Rewards service (where O2 customers can redeem cashback as a result of shopping with a variety of partners) was given more prominence due to the popularity of the feature as a way of helping customers save money on their mobile phone bill. User experience improvements were made to many key features including the O2 Extras journey and adding the Disney+ service. Quick links were added to the account homepage which now makes it easier for customers to add bolt ons, upgrade or change their tariff. Customer preference for using MyO2 as their core self-service journey has been evidenced by year-on-year growth in usage of 7.9%, with over 69% of the consumer base using My O2.



Our Stores

Our Store estate comprises a total of 453 stores of which 233 are company owned and 220 are franchise stores. Prior to the pandemic, 'Stores' was our biggest direct channel and the role they play on the High Street was important. In 2020, as a result of the national lockdown, our Stores had to shut at several intervals during the year. To ensure we could continue to serve our customers within the national restriction guidelines, we created tailored experiences for all customer demographics in readiness for the stores re-opening.

We followed the government's advice in relation to our stores opening and closing throughout the pandemic. During this time, we protected our retail people's base pay with no requirement for any individual to be furloughed. The safety and wellbeing of our people is paramount and during this period, we created and delivered a key activity planner to ensure everyone remained fully engaged, supported, and informed. For example, we created a detailed plan of action for all teams to execute in the run up to our stores re-opening. It was crucial that each team member followed our new guidelines and processes. We couldn't stress enough the importance of everyone adhering to the social distancing practices and following our enhanced processes.

Franchise stores

The strategy for our Franchise stores is to align the in-store experience of customers to our company owned estate. From a customer perspective, our Franchise stores look and feel the same as our company owned stores. In general, the franchise strategy aligns with our retail strategy. In order to maintain the same level of high standards, we shared best practice including the guidelines and equipment to make Franchisee stores Covid-19 safe. Franchisees followed our guidance on training, COVID-19 health and safety collateral, Personal Protection Equipment (PPE) for members of staff and all changes to processes and procedures.

Unfortunately not all Franchisees were able to match our pay commitments to our people. Instead, the Franchisees took advantage of the government-backed furlough scheme to pay salaries for the majority of their employees during lockdown. Some retained their team members to run their call centres and carry out store closedown/re-opening activities.

Customer Journey

Our Customer Journey strategy is aimed at deeply understanding and improving our customer and employee journeys in order to continue to strengthen our position as the most recommended Telecommunications company in the UK. This entails delivering customer value, employee engagement and business growth as we transition into AO2.

COVID-19 presented a number of challenges and required us to take a more reactive approach to delivering our Customer Journey strategy, whilst also proactively seeking out opportunities to make things easier for our customers during this time. We re-prioritised our focus to the key customer journeys which would help support our customers and our people during the uncertainty focusing on what was important to them. As an example, we re-designed our payment deferral journey to offer customers more financial support and updated our Interactive Voice Response (IVR) journeys and messaging around self-serve, helping our customers get the best support they need.

Our customer journey commitments are measured through a number of different metrics as the key drivers of NPS, such as the number of complaints we receive. Our continued focus on improving customer experience has helped us to achieve a circa 60% improvement on the number of complaints received over the last 3 years. In 2020, our number of complaints reduced by 21% in comparison to 2019 and we have ambitions to reduce this even further as we transform our systems through AO2.

Indirect Partners

Our Indirect Partners sell mobile connectivity in two business categories; Pay Monthly and Prepay. This enables us to reach a broader range of customers and as a supplement to our direct distribution channels.

Pay Monthly trading occurs via two main indirect partners, AO.com and A1 Comms who acquire customers on our behalf, together with smaller partners, TalkTalk and, in 2020 we added Saga PLC (a company serving the needs of over 50s) with whom we operate introducer style agreements. Our arrangement with Dixons Carphone (a leading independent specialist mobile retailer in the UK) and previously one of our major partners, ceased in April 2020.

Prepay trading occurs via a number of SIM distributors, the largest being Elite, Core Communications and GK Telecoms who are able to create a national reach through a broad range of end distribution outlets such as Tesco and Argos, giving us a presence in some of the largest retailers in the UK.

The COVID-19 pandemic has had a significant impact across all of our partners, with retail closures and social distancing measures reducing footfall. This has particularly impacted the Prepay partners as they are more reliant on the high street. We work closely with our partners to understand how we can continue to provide support during these uncertain times. We have reviewed our contracts to ensure our commercial agreements were not punitive in light of the circumstances, supporting our partners and continuing to drive towards our shared commercial goal and adapting where needed to reflect the market situation. Our partners have contingency plans to protect their business and we have a business continuity plan in place to allow us to mitigate any potential risks.

MVNO and Wholesale

We select and retain the leading MVNOs, especially in complementary segments. Our award-winning network and focus on the customer has helped us build a roster of successful partnerships and enabled us to continue to invest while helping these organisations grow their mobile customer offer. Our MVNO strategy is to extend O2's reach by working with partners who bring complementary assets to our brand and distribution channels. These are Sky for quadplay, Tesco Mobile for retail distribution and Lycamobile for ethnicity demographics. We provide wholesale mobile network services to partners who resell those services to their own consumer and business customers. These include Daisy and plan.com, our distribution platforms. Our MVNOs have seen similar impacts to our own consumer and business channels.



Network

Demand for our core product (mobile connectivity) continues to grow rapidly every year and we are investing around £2m per day in making our network even better. As a result of the pandemic, our Voice traffic increased on our network by an average of 25%. This peaked in week one of lockdown, where we saw 57% more voice calls being made and customers spending up to 30% longer on their mobile. We doubled the capacity of our voice network at the start of the pandemic to support the increasing traffic. We measure our network in a customer-centric way and pride ourselves on putting the customer first. This means that we focus on creating the network that our customers expect.

We carry out a significant number of drive tests up and down the UK each year, making voice calls and data tests against our network competitors. In addition, we have integrated mobile measurements into the MyO2 app allowing us to understand the true customer experience and identify issues so we can resolve them faster and also help us to improve accuracy of our coverage maps. Every week we send out a number of surveys to customers in different postcode areas across the UK. We use these surveys, alongside the network data, to identify where we need to focus our efforts and create localised plans to improve customer satisfaction with the network. These improvements include Spectrum re-farming, which involves us moving spectrum from our 3G network to our 4G network, in order to give customers more capacity and speed, and rolling out our 2.3GHz 4G spectrum to the places that need it across the country. Deploying additional spectrum in this way has enabled us to enhance 4G capacity and improve throughput by up to 35% for approximately 200,000 UK postcodes in 2020.

We were recognised externally for our network, including:

- We were recognised externally for our network, including: Best Network Coverage in the uSwitch Broadband & Mobile Awards 2020. This is the third year in a row that we have won the award. uSwitch uses customer satisfaction survey data as a key factor to determine their winner.
- Global Wireless Solutions (GWS) awarded us the Best Network for Reliability in 2020 for the second year running. They tested the network for reliability across the country and worked with YouGov and Vanson Bourne to conduct focus group sessions. These results were used to create a final score which confirmed that O2 is the best operator for reliability, coming top in 18 out of the 36 cities tested.
- Best Network Performance at the Mobile News Awards 2020 as well as in 2019. The award is judged using independent data about our network from GWS and that score is then combined with the judge's score from a written award submission.

We are focusing on playing a bigger role in helping to rebuild Britain. Connectivity has never been more important and O2 is one of the UK's most valued services, assisting the country into recovery and work to rebuild Britain. We have been pivotal in supporting the health services emergency framework during the pandemic:

- We have assessed every hospital identified to us by the NHS trusts across the UK, that includes every Nightingale location to ensure our coverage and capacity is sufficient to cover these areas.
- We provided extra network capacity for 2,000 boost boxes that were already installed at NHS and other Emergency Service locations.
- We deployed three temporary masts and enhanced the capacity of existing in-building solutions for many hospitals around the UK.
- We have a list of priority sites around the country, including government facilities and food logistics sites that we have been monitoring carefully to ensure connectivity is maintained.



In 2020 we launched 5G in 150 towns and cities across the UK. We have continued to work with businesses and consortiums to test and build 5G use cases to enhance the way we work and live and to help rebuild Britain:

- We launched the first commercial laboratory for 5G and satellite communications in the UK as part of Project Darwin, a four-year trial programme supported by O2 and the European Space Agency and based in the Harwell Science and Innovation Campus in Oxfordshire. The laboratory is open to companies looking to test proofs of concept for connected and autonomous vehicles (CAVs) using both 5G and satellite communications.
- In another initiative as part of Project Darwin, in collaboration with the University of Glasgow and European Space Agency, we have been working with the NHS on a proof-of-concept COVID-19 Connected Mobile Health Clinic (CMHC) in order to track COVID-19 at six care homes in Glasgow. The CMHC is designed to minimise exposure of care home residents and staff to COVID-19, thereby ensuring greater efficiency for healthcare workers and enhancing the testing capability of the NHS.
- We used 5G technology to transform an ambulance into a unique remote consultation room. We partnered with Samsung for the devices, Visionable for the video collaboration software and Launchcloud for the asset tracking and compliance check elements. The trial demonstrated how Smart Ambulances can empower paramedics to treat more people with more ailments than currently possible and ease the strain on hospital resources by reducing the number of patients taken to hospital.
- In partnership with Northumbrian Water Group, O2 5G has enabled experienced technicians to remotely guide on-the-ground teams through complex tasks by relaying real-time data and instructions using augmented reality (AR) technology. Not only did this dramatically improve communication within their business, but it also boosted its productivity.
- We worked in partnership with Deloitte, Wayra and Digital Catapult to build 5G accelerators in Birmingham, Wolverhampton and Coventry. These facilities comprise of centrally located office and demonstration spaces with access to a private 5G network allowing businesses and public sector organisations to experiment with 5G features that are not yet commercially released.
- Indoor 5G population coverage increased to 2.03% in 2020 (0.55% in 2019), surpassing the end of year target of 1.3%. Outdoor 5G population coverage reached 7.47%, up from 2.23% in 2019.

In 2020, as part of our sustainability commitment we implemented the power down feature of our Self Organising Network (SON) in the East of the country and estimate it could save up to 6 million kwhs per year by effectively powering down some capacity layers when there is less customer demand.

In February 2020, we became the first operator in the UK to roll out an LTE-M network – the connectivity that enables the ‘Internet of Things’ and will lay the foundation for Britain’s smart cities, businesses and homes. Approximately 10,000 LTE-M sites are now live across the East of the country, allowing customers and businesses to make the most of next-gen IoT technologies. Businesses can use asset tracking to ensure the right products are in the right place at the right time. For example, in Utilities, sensors that monitor infrastructure to improve industry efficiencies, like gas and water meters (including smart meter tracking and pipeline monitoring), or micro generation (monitoring the status of wind or thermal generation equipment with sensors).

This low-power wide-area (LPWA) network technology offers enhanced network coverage, longer battery life and massive scalability. It is ideal for providing IoT connectivity in most use cases, even when it’s needed in hard-to-reach locations – like rural areas and underground. LTE-M will create new opportunities for businesses and help them realise the benefits of IoT solutions, making the world smarter and unlock new ways to live and work more efficiently and sustainably.

Operational Support Systems Transformation is a programme to deliver cutting edge capabilities that will support our technological ambitions which underpins our aim to continue to be a digital service provider and deliver significant business benefits through advanced automation. We have successfully delivered phase 1 of our Network configuration and inventory management transformation as well as upgrading our Network monitoring capabilities, paving the way for 5G standalone and delivering business efficiencies in excess of £800,000 and reducing risks.

We constantly monitor our network to protect our business and our customers. Cyber Security is key to our business strategy as it helps protect us against impacts to service, data loss, data integrity, data accessibility, and fraud. COVID-19 has presented its own challenges including the reliance on home working for our people. As a result, we deployed new and existing technology solutions whilst ensuring that security remains paramount. For example, an upgraded end-point security solution has been rolled out to all users ensuring that anti-virus updates are real time and abnormal behaviour patterns are automatically detected without the need to connect to our corporate network. This helps to ensure that homeworking does not increase the risk to our systems and any related data loss.

Cyber-crime continues to increase in both frequency and sophistication; and whilst increased risks associated with COVID-19 have been in focus during 2020 these remain in line with the upwards trend expected. Our multiyear Cyber Security strategy remains largely unchanged as a result and we continue to work collaboratively with a variety of sources to understand our cyber threat landscape and shape future strategic direction. We are a member of the Stop Scams UK initiative, which brings together telco and financial services industries to collaborate in tackling the growing societal problem of scams affecting our customers and UK consumers more broadly.

We have very limited Huawei equipment our core network. The Huawei equipment we do have is within the Next Generation Intelligent Network (NGIN), Security Gateway, SMS and in the Radio Access layer (RAN) that we manage (only a very small number use Huawei - 0.3% of our network sites – these are trial sites and are being replaced). Plans are in place to remove all Huawei core equipment by the end of 2022. We have sought assurances from our network sharing partner that: (i) it will be compliant with National Cyber Security Centre (NCSC) guidance; and (ii) recent UK/US measures will not impact on its ability to properly perform our network sharing arrangements (including its contractual obligation to comply with applicable laws and regulations which will include the requirements of the Telecommunications (Security) Bill when it is passed).

Our current prioritisation on core capability and culture is delivering year on year improvements in security maturity and is externally validated through an annual independent assessment together with our ISO 27001 accreditation. Changes to existing countermeasures together with the planned deployment of new technology has also enabled the safe acceleration of remote working in 2020 with enhanced controls for what was already a largely flexible workforce.



Shared Rural Network (SRN)

We also further championed the Shared Rural Network (SRN) agreement by leading the working group and senior governance forums as well as interaction between Ofcom, government and industry together on a mission to boost current landmass 4G coverage from 67% to 84%. The Shared Rural Network agreement was finalised and signed by the operators and Ofcom in March 2020. In addition, each operator has committed to providing 4G to at least 90% of the country's landmass, with over 1,800sq miles of the country getting 4G for the first time. This work will result in partial Not Spots being virtually eliminated. Delivery of this part of the programme will be the focus throughout 2021.

Smart Metering Implementation Programme (SMIP)

SMIP is a complex and diverse eco-system led by Smart Data Communications Company (DCC) and Department for Business, Energy and Industrial Strategy. It 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) and the aim was to offer every home across the UK a gas and electricity smart meter by the 1st January 2021, which has now been extended to June 2025.

The pandemic had a significant impact on the roll out of our SMIP programme. National restrictions meant installations of Comms Hubs in homes dropped and Comms Hub orders reduced but as restrictions eased, installations increased. This forced a business re-plan where the Smart Metering focus was on safeguarding service and customer experience and meant we deferred capacity related change given a decline in originally anticipated volumes and the strategic roadmap. We therefore delayed simplification, automation and optimisation that the 2020 plan would have delivered.

We launched a sophisticated hub, Dual Band Comms Hubs (DBCH), enabling millions more British homes to benefit from having smart meters. We maintained a strong and stable service throughout 2020 for Energy Suppliers and we've achieved our 99.25% network coverage obligation ahead of the January 2021 contractual milestone.



People

We continued our focus on agile working, supported by the creation of collaborative digital workspaces and coaching support, all of which are enabling our people to work cross functionally and at pace. We have adapted new ways of working whilst using technology to enable our teams to work remotely and extended this approach to our call centre teams who had traditionally been office based. In addition to this 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 2019 we decided to make some changes to our operating model in consultation with our union partners, employee representatives and our people which saw a 7.2% reduction in our overall headcount in 2020. We re-aligned our strategy to focus on the wellbeing of our people in light of the pandemic. Despite the challenging situation, it was important that our people felt supported and empowered to continue to perform at their best, given the prevailing circumstances. As a result, we took a decision not to furlough any of our People and provided financial security by protecting base pay when People were unable to attend work. In addition, we have awarded around 1% salary increase in 2020. In July 2020, we launched an incentive plan for our People called "See What You Can Do" with an opportunity to earn an award of up to £1,500 for meeting set targets which are commercially focused.

We actively engaged with our people through regular briefings from the Executive Leadership Team as well as encouraging our people to express their opinions through Workplace (our internal social platform). As an example we created a Mystery Catch-up initiative in the early days of lockdown to connect people across the business resulting in over 300 Workplace chats. We adapted Workplace to create a 'microsite' so that people who were not able to access the Intranet were able to stay informed.

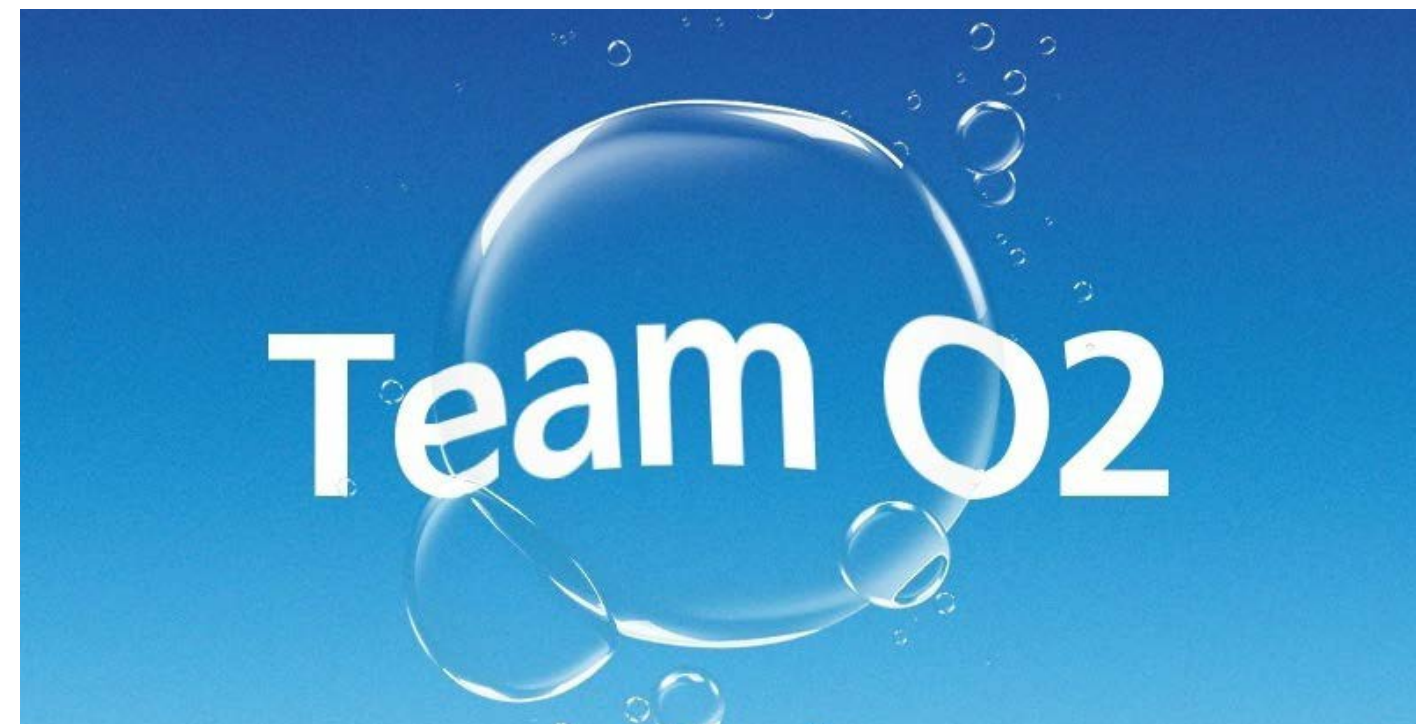
We recognise our responsibility and demonstrate our 'voice' in support of diversity and inclusion both internally and externally. 2020 saw a step change in our commitment to creating a diverse and inclusive environment. We introduced a number of programmes to accelerate our move to a truly diverse organisation such as the introduction of specific mentoring and talent development programmes across the business. For example, we launched a new career programme, Evolve, designed to actively support our people through the organisation and to help progress their career. In the first programme we have supported 39 of our people (51% of these

from our Stores) to make moves into a different area of the business. Ensuring gender and ethnicity diversity of this group has been an equal priority for this initiative as an example of our positive action to support the progression and mobility of our diverse internal talent through the organisation. In addition to this we launched Strive, an initiative to bring together our high potential talent community and provide tailored career development. This initiative allowed us to continue our focus on developing our internal talent of our people within the business.

We have introduced a number of bespoke development initiatives to support the progression and development of our people including those from the REaCH – (Race, Ethnicity and Cultural Heritage). For example, REaCH for Leadership - a leadership development programme and REaCH Mentoring – a mentoring scheme for our ethnic minority talent. In 2020, as part of our social mobility initiative, we increased our focus more broadly on the mobility of our people; putting in place a number of interventions to both increase the visibility of opportunities through the business and putting appropriate development in place so that we can promote internally before we consider external options. In addition, we launched Career Accelerator which is a work experience mentoring programme for our off-boarded graduates and apprentices to 'give back' to communities by mentoring 10 young people from less-privileged backgrounds who have demonstrated high levels of motivation and school performance.

We publicly signed up to a number of commitments on diversity against the Ethnicity Race @ Work Charter measuring ourselves against their requirements including appointing an Executive Sponsor for race, commitment at Board level to zero tolerance of harassment and bullying and making it clear that we support equality in the workplace. To demonstrate our commitments, we voluntarily published our ethnicity pay gap report together with our obligatory gender pay gap report which are available on our website. In addition, we re-affirmed our ambition to be a leading inclusive employer and to become a truly representative business by 2025. We are aligned to the Inclusive Employers National Equality Standard which benchmarks our Diversity and Inclusion efforts across the full range of the business to embed equality at an organisational, cultural and operational level.

In 2020 our focus has been on building cultural competence and ally-ship across the organisation, with the launch of our O2 Inclusion Allies initiative. This included a range of development content, tools and events to start to build the cultural competence of all of our people and to create the opportunities for everyone to play an active role in our efforts to move from an equality-based understanding of diversity and inclusion to one where equity and belonging drive action. Equality is a driver for diversity and inclusion that sets a goal of ensuring fairness at all stages of an employee's time at our company. As our efforts in the diversity and inclusion space mature, we are working hard to drive equity throughout our organisation; this is an active and conscious use of targeted positive action to address historic and current under-representation across all levels of the business and develop the culture of our people to not just understand this concept but to be consciously inclusive in their decision making and cultural competence journeys. Our ally-ship initiatives include INvolve's open letter (calling for businesses to take action and increase sustainable Black inclusion in the workplace) and by joining Cephas William's Black British Network; committing us to a series of actions to drive system change within organisations and society.





Our Proud @O2 Network represents the interests of our LGBT+ community. In 2020 we conducted reverse mentoring with members of our ELT and held our first ever 'virtual Pride month'. The Women's Network is an ever-present and deeply embedded group in our business. Members sit at all levels of the organisation and contribute towards an inter-sectional approach that drives equity for all.

As a leading employer in tech, we have a long-standing relationship with the Tech Talent Charter and submit our data relating to women in STEM roles and during 2020 we worked for the fifth year in succession with Girls Talk London to mentor talented lower sixth form girls on how to unlock their 'STEM' potential. We won the Mobile Industry Award – People and Culture. This award acknowledges our passion for building an inclusive, flexible working environment that enables us to all be our true selves, and our best selves.

We track a number of KPIs to regularly measure performance against our people strategy these include:

- **Employee Net Promoter Score (eNPS):** In 2020 the eNPS score was 44 against a target of 36 (which is an increase of 9 points since 2019). We actively listen to employees' feedback and track engagement throughout the year via regular Pulse surveys, an annual Global Motivation Survey and targeted listening groups. We measure engagement via a number of themes including Empowered Teams, Growth Mindset, Impact and Universal Telefonica Drivers. The results provide insight which informs our Global and Local UK People Strategies to maintain and build on a culture that is Bold, Open and Trusted (O2 values).
- **Glassdoor:** We have consistently achieved our aim of maintaining a 4+ real time rating throughout 2020. The Glassdoor real time rating gives us an external measure of the experience we create for our people, again linking to customer experience. It also gives us insight to our employer brand and how we compare in the market to other employers, a factor in attracting and retaining talent.
- **Inclusivity Scorecard:** Our inclusivity scorecard tracks our progress to being a truly inclusive employer, and our long-term evolution of mind-set and behaviours. The scorecard tracks the following metrics:

	2019	2020
Percentage of females at middle management grade	30.5%	31.5%
Percentage of black, Asian and minority ethnic employees at middle management grade	9.3%	11.0%
Percentage Under 30s at middle management grade	2.10%	2.41%

To ensure we retain and develop the talent, capabilities and skills of our people, we continue to develop the skills, capabilities, and behaviours of all our people to support the success of the future organisation.

To enable a culture of continuous learning for all our people, our internal training tool (O2 Campus) and our partnership with LinkedIn Learning both provide access to a range of learning content (technical, professional, personal development and leadership). We also provide learning events including collaborations with our corporate university, Telefonica Universitas.

Our people policies are in line with UK employment legislation with consideration always being given to putting our people at the heart of ways of working. Our Diversity and Inclusion policies provide clear guidance regarding our approach. It emphasises that all employees 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. We are committed to ensuring that all our people have the same opportunities to achieve their potential and contribute to our success. Our policies and line manager guidance ensures fair treatment of people with disabilities in relation to their recruitment, training and development and reasonable adjustments and considerations in relation to disabilities.

In addition, we have a number of people policies covering the full range of employee lifecycle situations including family and timeout policy, employee benefits, performance management, disciplinary and grievance. All our policies are reviewed regularly and revised as required. As an example, due to the pandemic, we made interim adjustments to some of our existing HR policies and processes. We introduced our Interim People Guide allowing our people access to all the adjusted policies and processes via several channels including email, Workplace, MyHR, and O2 Campus. We have regularly reviewed and updated this document and communicated any key changes to our people in line with changing government advice.

The health and safety of our people has remained our priority. We ensured our stores, offices and call centres continued to operate in a safe environment as we transitioned to home working (where possible) so that our business could continue to support our people to deliver for our customers. The Interim People Guide has positively contributed to our ability to support our people's welfare during this period of uncertainty. When surveyed, the majority of our People said they felt that they had the clarity and support they had needed during the COVID-19 pandemic so far. The survey results also allowed us to see the effectiveness of our adjusted HR policies.



Corporate Responsibility

Our corporate responsibility plan, Blueprint was launched in August 2020. The plan reflects our long-term commitment to reduce our impact on the environment and deliver a greener network for customers, championing the enabling role of mobile in delivering a more sustainable future. It sets out our responsibility to society by helping people enjoy a safer and more positive role with technology, and by improving digital access and inclusion. Blueprint illustrates our commitment to running our business responsibly for our customers, people and other key stakeholders, by championing diversity and inclusion, building an ethical culture and maintaining strong community ties. We have three commitments:

- Building a greener future by becoming a net zero business by 2025 and offering mobile and digital innovation to power a low carbon world.
- Helping society thrive by creating green, inclusive and resilient communities powered by smart technology.
- Leading by example by championing a fair and ethical business from the inside, as an inclusive employer, adopting ethical decision making and creating shared accountability.
- Further details of our Corporate Responsibility can be found in our Non-Financial Statement on page 36 and in the Streamlined Energy and Carbon Statement on page 41.

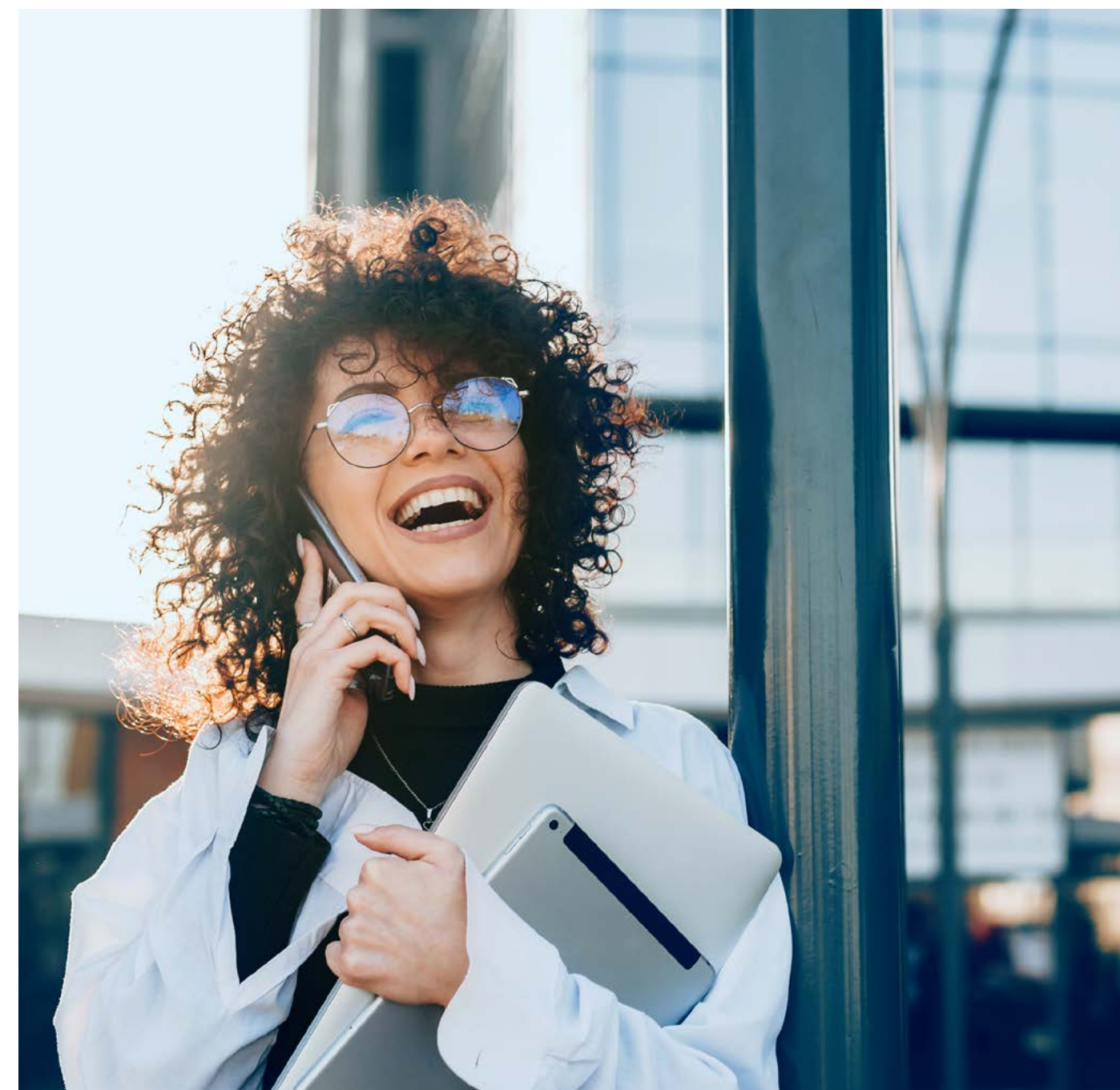
Business Principles

Our Business Principles are the behavioural standards (directed towards our people, suppliers and business partners) which underpin our ethical and responsible approach to business. To monitor adherence and key trends, our Business Principles policies, procedures and working practices are audited on a regular basis and management information is provided to the Executive Leadership Team and those persons charged with managing the affairs of the Company. The Principles make it clear that we prohibit all forms of bribery and do not permit the promising, offering or giving of any benefit or advantage to any persons on behalf of the Company. We do not offer or accept gifts, hospitality or other types of incentives which may reward or influence a business decision. We avoid or declare any conflict of interest which could place employee personal interests above those of O2's and our stakeholders.

We have a zero-tolerance approach to Anti Bribery and Corruption (ABC) and our policy is aligned with our Business Principles and the Ministry of Justice (MoJ) Guidance on the UK Bribery Act 2010. As previously reported, we are addressing a request for disclosure made by governmental authorities which is related to possible violations of ABC laws and regulations in the past. Our ABC framework has continued to evolve following an independent assessment against the Ministry of Justice Principles undertaken during 2019. The key updates are:

Ministry of Justice Principles	Independent Assessment (2019)	Progress made during the period
Communications and Training	Comprehensive	<p>All employees are required to complete the mandatory Business Principles E-Learning Training. During 2020 99.6% of employees completed 45,951 e-learning training modules.</p> <p>Business Principles and Speak Up guidance is also incorporated in the induction process for all new employees.</p>
Due Diligence	Established	<p>We have enhanced compliance due diligence screening in place for higher risk suppliers and business partners.</p> <p>Mandatory Compliance approval is also in place for all Public Sector arrangements which are conditional to additional services provided by pre-designated third parties.</p>
Monitoring	Established	<p>Data analytic compliance monitoring has been introduced to improve oversight of employee gifts and hospitality trends.</p> <p>Compliance and Ethics Dashboards are in place to provide enhanced oversight of key gifts and hospitality trends.</p>

Ministry of Justice Principles	Independent Assessment (2019)	Progress made during the period
Proportionate Procedures	Established	<p>We have updated our ABC policy to include:</p> <ul style="list-style-type: none"> • New reporting and authorisation requirements for the giving and receiving of Private Sector gifts and hospitality. • Improved guidance on what constitutes a bribe and prohibitions on the giving and receiving of excessive gifts and hospitality. • Enhanced gifts and hospitality restrictions when dealing with the Public Sector and Public Officials
Risk Assessment	Established	<p>We continually review our ABC risk and the scope has been expanded to include risks associated with licences and permits for infrastructure, sponsorships, donations and government business and lobbying.</p> <p>We have implemented enhanced compliance monitoring activities where emerging risks have been identified.</p>
Top Level Commitment	Comprehensive	<p>We do not tolerate bribery and corruption and our people are encouraged to 'Speak-Up' up on any suspected breaches of our Business Principles.</p> <p>Regular Compliance updates are in place for those persons charged with managing the affairs of the Company which includes reports on Business Principles Training and Speak-up Awareness compliance measures.</p>



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 behaviour inconsistent with our Business Principles. In May 2020, we launched a new Speak Up system which increased the options and functionality through which our people can report their concerns and communicate with Internal Audit. To support Speak Up several measures are in place such as a monthly survey of a sample of our people to assess the awareness of Speak Up and the effectiveness of the process. We have an Executive Sponsor at Leadership level and periodic updates are provided including reporting on key performance indicators. For 2020, an average Speak Up awareness KPI of 83% was achieved, showing an improvement from 59% in 2019, which we will continue to build upon in 2021.

Non-Financial Report

Under our integrated approach to reporting, we report certain matters relating to employees, social, environmental, ABC and human rights. The reporting obligation to include a non-financial statement under the Non-Financial Reporting Regulations are addressed throughout the Strategic report and a separate Non-Financial statement on page 36. For ease each of the matters addressed by the regulations can be found in the following pages; Employees (People and Human rights) - pages 19 to 21), ABC and Business Principles (page 22) and full details of our Social and Environmental commitments are detailed in the Non-Financial statement (page 36).

172(1) Statement

We have a responsibility to promote the success of the Company in good faith for the benefit of our ultimate shareholder whilst having regard, at least, to the following matters:

- The likely consequences of any decisions in the long term;
- The interests of the Company's employees;
- The need to foster the Company's business relationship with suppliers, customers and others;
- The impact of the Company's operation on the community and environment;
- The desire of the Company to maintain high standard of reputation and business conduct; and
- The need to act fairly between shareholders of the Company (there are no minority shareholders).

The Directors have put in place a governance framework which includes best practice procedures to support the assessment of those matters necessary to make informed decisions in furtherance of the long-term success and sustainability of the Company. The Directors who are also part of the Executive Leadership Team have the delegated authority for the day-to-day management of the business activities including the implementation of the objectives which underpin the Company's purpose whilst retaining sufficient oversight and accountability for significant matters. Further details of our governance arrangement can be found in the Corporate Governance Statement on page 46.

The COVID-19 pandemic presented challenges for all businesses and the wider economy. As a business we were not immune to these challenges and we made a decision to re-align our 2020 plans at the start of the pandemic and to prioritise the support to our People, Customers, Community, Government and Business partners as discussed through our integrated reporting approach on how we achieve our priorities on page 2. We kept our People informed of the plan to navigate through the unprecedented times including the business performance. Despite our stores being closed and the trading challenges posed by the government restrictions throughout the year, we protected everyone's base pay and did not take advantage of the Government Furlough scheme available to all businesses. To ensure we remain a resilient business, we understand that our People are vital to the long-term success of the Company so in July we launched an incentive plan with an opportunity for our People to earn an award of up to £1,500 for meeting commercially focused targets. Further details on the consideration of what matters to our People can be found in the People section on page 19.

Stakeholder engagement is fundamental to the understanding of our relevance and how we can achieve our purpose of making every day better through personal experience that count. The Executive Leadership Team has a framework for regular engagement with all key stakeholders, including our People, Customers, the Regulators and the Government and our Shareholder. The Executive Leadership Team oversee customer sentiment and feedback, such as NPS, brand metrics and complaints, and are involved in the engagement with key business customer groups such as regular customer advisory sessions and relationship meetings. In addition, there are regular meetings with employees and engagement surveys and meetings with the Regulators and the Government to ensure that we are well positioned to support our Customers as well as contributing to a sustainable society as a whole. Further details of the stakeholder engagement and the outcomes are detailed in principle six of the Corporate Governance Statement on pages 46 to 51.

Due to the pandemic it became evident that digital connectivity mattered more than ever so we concentrated our focus on supporting the Government and delivering for the NHS, keeping people connected, reducing loneliness, supporting online learning, and helping people to keep working. We worked closely with the Government and the NHS to support the nation and play a vital role in rebuilding Britain. The CEO and COO had regular meetings with the UK government, and we worked with the UK, Northern Ireland, Scottish and Welsh governments in support of their efforts during the pandemic. This

involved ensuring our network provided the connectivity needed during lockdown, support for vulnerable customers including access to zero rating websites, the NHS track and trace app, providing free data bundles to NHS workers and supporting the Department for Education's Get Help with Technology scheme. We established a new Community Calling scheme with environmental charity Hubbub, to refurbish and gift smartphones and tablets to the most vulnerable people in six cities across the UK. In addition, we met regularly with the UK government to discuss a range of issues from the establishment of the Shared Rural Network (SRN) to the proposed new telecoms security regime to be put in place when the Telecoms Security Bill becomes law.

We met with our most strategic business customers where we shared unique insights and collaborated to explore how we can create greater value for Britain, our people and our businesses and this provided an opportunity to discuss challenges and to learn and share strategies as a group especially during the pandemic. We offered free innovation sessions to our customers where our business and technology experts helped customers to work through business challenges and apply design thinking to help them to grow and flourish. We organised a virtual Blue Door conference with more than 30 interactive sessions and exclusive networking opportunities, giving our customers the chance to hear from subject-matter experts and come together to discuss cutting-edge technology and the key challenges facing businesses today. We created a series of advisory papers to support our customers – ranging from practical advice to address short term requirements and technologies that will support current and emerging challenges to our opinions to drive longer term business survival and growth in addition to help drive businesses towards being more sustainable. As a result of our customer insight we were able to develop and evolve our product offering to suit our customers. Further details of the customer engagement can be found on page 49 of the Corporate Governance Statement.

As a Company we understand the need to further a sustainable environment and have committed to building a greener network with a goal to be net zero by 2025 and reduce our carbon footprint within our business operations as we continually look for ways to remove or reduce our plastic use, both in our offices and in our stores. For example we do not use plastic bags in our shops, we have reduced the plastic used in SIM-card packaging and promoted the use of re-usable tableware in our offices as well as recycling uniforms in our stores. We have also increased the usage of e-receipts - up 40% year on year. 2020 saw the increase of single-use plastics due to the heightened safety measures because of the pandemic. We joined forces with TerraCycle to introduce a PPE (Personal Protective Equipment) recycling scheme which allows all PPE used in our stores to be recycled responsibly via TerraCycle's Zero Waste Box. In total, 112 kg of PPE waste was saved from potentially ending up in landfill or other sites such as waterways in 2020 through the scheme. Further details of our corporate responsibility can be found in the Non-Financial Statement on page 36.

Principal risks and uncertainties

We operate four principal risk categories and related sub-categories, through which all risks are identified, linked and managed. Our approach is aligned to Telefonica Group and its other operating businesses (OBs). This ensures we collectively undertake aligned micro and macro analysis of our business, the external environments and the markets in which we operate to determine and manage applicable risks to our strategy.

Principal Risk Categories	Sub-categories of Risk
Business risk: Possible losses in value or results derived from the situation of the competition and the market, changes in the business model, innovation, strategic uncertainty, the regulatory framework, as well as events that affect the sustainability and reputation of the Company.	<ul style="list-style-type: none"> Strategy, including: <ul style="list-style-type: none"> Market & Competition Economic & Political Environment Business Model Adaptation & Innovation Regulation DPO (Data Privacy) Sustainability Reputation
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.	<ul style="list-style-type: none"> Finance Fiscal
Operational risk: Possible losses of value or results derived from the events caused by the inadequacy or failure of the network and computer systems, security, customer service, human resources, as well as operational management.	<ul style="list-style-type: none"> Customer Systems & Network Security Supply Chain Operational Management People
Legal & Compliance risk: Possible losses in value or results derived from legal or compliance-related aspects.	<ul style="list-style-type: none"> Legal Compliance

Perceived most significant and emerging risks to our strategy:

Principal Risk categories	Sub Risk categories	Why this is important	How we managed it	Trend
Business risk	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, so it is important to us to remain relevant and attractive as a business.	<p>Expanded our 5G network to over 150 towns and cities.</p> <p>Added Disney+ to our O2 Extras offering, to keep customers and families entertained.</p> <p>The proposed joint venture between O2 and Virgin Media, which is subject to regulatory clearance.</p> <p>Pledges on investment, skills and the levelling up agenda to create a National Connectivity Champion that benefits even more consumers and businesses.</p>	Stable: Due to our response to the market through competitive market offerings and the proposed joint venture.
Business risk	Strategy: Economic & Political Environment	Economic and political factors present a dynamic set of challenges and risks for us to consider, relating to market, strategy and operational factors. We are resilient but not immune, for example, the magnitude of the enduring impacts of COVID-19 on consumer and business behaviour is currently unknown.	We continue to plan for different political and economic scenarios, which include the continuing impact of the pandemic and Brexit. This is to ensure we continue to be successful in executing our strategy and operations as intended to minimise negative impact to our customers and stakeholders.	Increased: Due to the economic impact of the pandemic and the implications of the UK exit from the European Union.
Business risk	Strategy: Business Model, Adaptation & Innovation	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.	We continue to deliver on our AO2 transformation programme which is delivering substantial technology evolution and ensuring we are well placed for the future. Details of the transformation programme can be found on page 6.	Stable: We are confident that plans are in place to react to any moves in the market.

Principal Risk categories	Sub Risk categories	Why this is important	How we managed it	Trend
Business risk	Reputation: Sustainability	We believe in operating our business in a sustainable way and putting our customers at the heart of everything we do.	Our Blueprint is our responsible business plan which sets out our commitments to tackle climate change, help society thrive and operate fairly and ethically.	Stable: We operate an ethical approach to all aspects of our business, underpinned by our Blueprint and core business principles.
Business risk, Legal & Compliance risk	Legal Compliance Regulation Data Privacy	As a customer centric company that operates in a market that is subject to many different regulations and laws, it is important that we operate within the regulatory obligations and deliver positive customer journeys and outcomes.	We continually monitor the legal and regulatory requirements applicable to us and apply these requirements to our operations and change activities.	Increased: Due to increased complexity of regulations and intervention from regulators
Financial risk	Liquidity risk	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.	Despite the impacts of COVID-19, we have seen a strong financial performance as reflected in our financial results. We continue to maintain strong banking relationships across a number of key banks and leverage our relationship at a Group level. We operate continuous monitoring of credit risks through our financial and procurement processes.	Stable: We are confident that access to long term liquidity will continue to be available.

Principal Risk categories	Sub Risk categories	Why this is important	How we managed it	Trend
Operational risk	Customer	In a highly competitive market where customers are facing unprecedented challenges to their daily lives, it is more important than ever that we understand how their needs are changing so that we can adapt, remain relevant and find new revenue opportunities.	Our strategy is built on a framework where commercial challenges were pitted against the customer's needs so that strategic initiatives had to solve both. These customer needs were then translated into a North Star vision, which is now used as a reference point for all in the business from product innovation to advertising narrative. Additionally, we take special care to ensure that it has appropriate and agreed Marketing consent from all of its customers, and conducts a range of customer experience surveys to obtain feedback from them.	Decreased: The industry standard measurement for customer experience is Net Promotor Score (NPS). By our own scoring we significantly improved in 2020 and also in independent scoring by Ofcom, we came top amongst the Mobile Network Operators in 2020.
Operational risk	Systems & Network	Customers have an ever increasing demand for our products and services. 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.	Our Strategy and Business Plans anticipate and plan for future market direction and demand. Our approach to strategic planning and investment is considerate of prioritisation of risk mitigation whilst also being mindful of the upcoming benefits of planned transformation programmes.	Stable: We have applied conscious focus and investment in key areas in 2020, and have seen positive risk exposure control and reductions in many areas of our network and systems, as well as effectively addressing the COVID-19 related risks.

Principal Risk categories	Sub Risk categories	Why this is important	How we managed it	Trend
Operational risk	Security (including Cyber)	Globally cyber-crime is increasing in both frequency and sophistication. This presents potential impacts in our ability to provide services, prevent data loss and to ensure the continued confidentiality, integrity and availability of data.	We work collaboratively with our regulators to understand our cyber risk landscape and we are proactive in implementing security standards and controls to help mitigate these risks. We routinely benchmark our cyber security capability, and adopt new technologies to protect our customers and the business against the latest cyber threats. Investment in cyber security improvement programmes continues. 2021 will see the introduction of the new Telecoms Security Bill and, working closely with Ofcom, we are planning the implementation of any additional controls.	Stable: Although 2020 brought new challenges with regards to remote working, minor changes to our existing controls were sufficient to allow this without introducing additional risk. As such we have not seen an increase in our risk profile, and we have focussed on the continued effectiveness of existing controls.
Operational risk	Supply Chain	We are a highly collaborative organisation with many important third-party relationships to deliver our 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 with a clear and detailed supplier code of conduct. Additionally, we identify and monitor key suppliers to ensure we understand their financial stability and can respond in a timely manner to any growing risk of financial failure in the direct supply chain.	Increased: Supplier financial stability risks have clearly increased due to COVID-19 and are expected to continue into 2021, however we have experienced limited significant consequential impact.

Principal Risk categories	Sub Risk categories	Why this is important	How we managed it	Trend
Operational risk	Operational Management People	This broad area of risk is of significance to us given it covers factors such as customer service, processes, human resources, fraud, laws and intellectual property.	We operate a robust internal control framework. The internal controls and responsibilities are integrated into daily activities to deliver assurance across all the areas of operational risk mentioned here, and more.	Stable: Our mature control environment and remote working capabilities have proven resilient despite the potential for disruption from COVID-19.

Changes year on year:

As we continue to ever evolve and enhance our risk management practices, the following shows where risks from our last annual report have been reclassified due to being related/interconnected:

Risks From Last Report	Movements
Global risks	This principal risk category has been removed
Legal & Compliance risks	New principal risk category
Compliance risks	Moved from 'Global' risk category to new 'Legal & Compliance' risk category.
Legal risks	Moved from 'Operational' risk category to new 'Legal & Compliance' risk category.
Sustainability Reputation	Moved from previous 'Global' risk category to 'Business' category.
DPO (Data Privacy)	Elevated to sub-risk category of 'Business' risk category
Human Resources	Renamed 'People'

Post Brexit

The plans we put in place to mitigate any potential risk as a result of Brexit were successful. We have not identified any material adverse effect on our business and we do not anticipate any material effect going forwards. We will continue to monitor any potential risk that may arise as the government continues to negotiate trade deals.

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 2020 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 36.2 million (2019: 34.5 million). The Telefonica UK Group's Limited's mobile base stood at 27.022.4 million (2019: 25.821.5 million). Contract net additions in 2020 stood at 1,177,940,000 (excluding M2M: decrease of 195,432,000). Active Prepay net additions decreases for the year were 121,120,000.	In 2020 contract net additions (excluding M2M) went backwards due to the expiration of the Dixons Carphone agreement as well as the impact of the national lockdowns due to Covid-19. However, this was offset by the continuing rollout of the Smart Metering (SMIP) programme driving overall additions.
Revenue	This is the total amount of revenue earned for the period.	The Company's revenue for the year ended 31 December 2020 fell to £5,718 million (2019: £5,976 million).	The decline in revenue was driven by reduced roaming and other Covid-19 impacts, partially offset by increased hardware and wholesale revenue.
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 £3,743 million (2019: £4,026 million).	The decline was driven by Covid-19 related roaming restrictions.

OIBDA*	This measures operating income before depreciation and amortisation.	The Group's total ARPU Company's OIBDA for the year ended 31 December 2020 was £11,401,754 million (2019: £12,701,756 million). The Company's OIBDA margin was 30.6% (2019: 29.4%).	Revenue decline has been partially mitigated by commissions savings and strong cost control. 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 2020 was £817 million (2019: £797 million) as the Company continued to invest in its network for customers. Capex during 2020 included £83.5 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 performance highlights

The Company's profit for the year ended 31 December 2020 was £581 million (2019: £602 million). The net assets of the Company as at 31 December 2020 were £2,658 million compared to £2,649 million at 31 December 2019, the movement of which is due to £581 million of profit for the year, £23 million actuarial loss after tax impacts on the defined benefit pension scheme and a dividend payment of £549 million.

The cash and cash equivalents of the Company at 31 December 2020 were £76 million compared to £138 million at 31 December 2019. The decrease of £62 million is driven by £1,481 million net cash flow from operating activities, £932 million net cash flow used in investing activities and £611 million cash flow used in financing activities. The significant cash flows within these areas are: £917 million for purchase of property, plant and equipment and intangible assets; £549 million dividend payment, £165m proceeds of borrowings received from the Company's subsidiary, giffgaff Limited, and £202 million principal payments on leases.

O2 and Virgin Media Joint Venture

On 7 May 2020, Telefónica, S.A. 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 O2 and Virgin Media businesses. The proposed joint venture arrangement means that Telefonica O2 Holdings Limited, the ultimate UK parent company, would contribute its entire issued share capital in O2 Holdings Limited and its group (O2 Group) (and the Liberty Global Group will contribute the same for Virgin Media) to a co -controlled joint venture company in consideration for shares in that company. The arrangement is still subject to regulatory clearance which is expected to complete in the summer. The proposed joint venture will create a national connectivity champion capable of competing at the highest level with a combined mobile and fixed offering. The Company has been involved in the reorganisation of certain necessary pre-completion matters in readiness for the completion of the proposed joint venture arrangement.

Post Balance Sheet Events

In January 2021, we announced a new Master Services Agreements for Cornerstone Telecommunications Infrastructure Limited (CTIL), the jointly owned and managed venture between O2 and Vodafone. The new arrangement will provide operational simplicity and efficiency, in addition it will enable CTIL to generate revenue by offering space on infrastructure to third parties.

In March 2021 we announced an investment of £448m in Ofcom's spectrum auction to secure the right spectrum for our business needs. We obtained 8 x 3.6 GHz lots and 2 x 700 MHz paired frequency lots. This additional spectrum will allow for further coverage and capacity improvements in our network, demonstrating our continued commitment to the UK Market and the very best connectivity for our customers.

On 8 April 2021 Telefónica S.A. and Liberty Global announced the appointment of Lutz Schüller as CEO and Patricia Cobian as CFO of the proposed joint venture company if approved by the Regulatory authorities. Consequently, Mark Evans will step down as CEO of the Telefonica UK Group upon the completion of the proposed joint venture arrangement.

On 14 April 2021 the Competition and Markets Authority made an announcement that it has provisionally cleared the proposed merger of Virgin Media, and Virgin Mobile with O2.

The Strategic report was approved by the Board on 28 April 2021.

By Order of the Board

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

A large underwater scene with many fish swimming. In the bottom center, a child is seen from behind, reaching up with both hands towards the fish. The water is a deep blue, and the fish are of various species and sizes.

Non-financial report statement

Corporate Responsibility

We take being a responsible business seriously and believe the way we do business matters. Through our Blueprint strategy, we aim to leave the lightest footprint on our planet and to enhance people's lives with the use of our products, services and digital expertise.

We are committed to do the right thing for our customers, our people and wider stakeholders, underpinned by our company values – Bold, Open and Trusted. In addition, our Business Principles form our ethical code of conduct to help guide behaviours at all levels of the organisation.

The pandemic underlined the importance of staying connected with our families, workplaces, and wider communities. In 2020, we focused our efforts to help those most in need and believe we continued to play a crucial role in helping to rebuild a more sustainable, inclusive and connected country.

Our Blueprint strategy

We refreshed our responsible business plan for 2020-2025 which sets out our clear commitments to tackle climate change, help society thrive and operate fairly and ethically. Our Blueprint strategy contributes to the United Nations' Sustainable Development Goals, which aim to tackle pressing global challenges including climate change, injustice, and inequality.

Our three key strategic aims focus on the issues where we aim to make the greatest difference: building a greener future, helping society thrive and leading by example.

A Greener Future

We plan to reduce emissions, conserve our planet's natural resources, minimise our environmental impacts and support others to make more sustainable choices through digital connectivity. To underline our belief that mobile can contribute to a more sustainable future, we set ourselves two focused climate-action targets as part of our Building a Greener Future strategic pillar - to become a net zero carbon business in our own operations by 2025 and supporting Telefonica Group to reduce emissions in our value chain by 39% in 2025 and reach "net zero" in 2040. At the end of 2020, we achieved a 29% reduction in carbon emissions in our own operations since 2015.

Our goal to be net zero by 2025 is an ambitious undertaking, but we believe in taking timely and decisive action to combat climate change. Our commitment is aligned to the Science Based Targets initiative (SBTi) and we are working in partnership with the Carbon Trust to develop a clear roadmap to underpin our goal. In 2020, we published a whitepaper 'The journey to net zero' which outlines a five-step process to create a net zero framework, and details our plans, progress, and learnings so far, with advice and support to help other businesses join us on the journey.

We believe that mobile technology can deliver environmental benefits for society that outweigh our own impacts, by helping to make it easier for our business partners, suppliers and customers to make sustainable choices. We launched a Green Savings Calculator to help businesses identify ways to reduce their carbon footprint and save money with long-term flexible working. The Green Savings Calculator finds annual savings of 534 tonnes of CO2 and £2.6m on energy, property and travel costs for an average company with 1,000 employees, and an overall estimated £53bn saving for UK PLC.

We aim to remove all possible non-renewable energy across our business and network. Our network is already powered by 100% renewable energy, wherever we directly control the energy bill. For masts and sites where we don't have operational control, we're working with our landlords to promote the switch to renewable energy. We carried out 732 site surveys in 2020 and will use the results to inform our activities in 2021 as we continue to influence the transition to renewable energy.

We are also undertaking multiple energy efficiency measures, including advanced automation, or 'turn off' technology, on our networks when demand is low; LED lighting upgrades; and enhanced free air-cooling processes, which has resulted in an 82% overall improvement in energy efficiency since 2015. Additionally, we partnered with SSE Business Energy and launched a new offer for all O2 suppliers and business partners in Great Britain, giving them the chance to buy SSE Green renewable electricity at an exclusive rate. Our carrier partners deployed 730 electric vehicles for O2 deliveries at depots across the country by the end of 2020.

In 2020 we were recertified to the environmental management system ISO 14001, celebrating our continuous improvement and reduced environmental impact. This standard supports environmental protection, pollution prevention, waste minimisation, as well as energy and materials consumption reduction. We were also recertified to the Carbon Trust Triple Standard for carbon, water and waste. Our Eco rating scheme helps customers understand the social and environmental impact of our handset range and our O2 Recycle initiative offers customers money back to recycle their old devices, thereby extending the life of mobile phones and helping to save waste from going to landfill. Through our returns / repairs and recycle partner, we've delivered a 10% year on year reduction in CO2 emissions for devices processed.

We are always looking for ways to remove or reduce our plastic use, both in our offices and in our stores. We do not use plastic bags in our shops, we have reduced the plastic used in SIM-card packaging and promoted the use of re-usable tableware in our offices as well as recycling uniforms in our stores. We have also increased the usage of e-receipts - up 40% year on year. 2020 saw the increase of single-use plastics due to the heightened safety measures because of the pandemic. We joined forces with TerraCycle to introduce a PPE (Personal Protective Equipment) recycling scheme which allows all PPE used in our stores to be recycled responsibly via TerraCycle's Zero Waste Box. In total, 112 kg of PPE waste was saved from potentially ending up in landfill or other sites such as waterways in 2020 through the scheme.

For our supply chain, we expect all our suppliers to respect our Business Principles and adhere to our supplier-facing ethical code. Risk-based due diligence is used to monitor compliance, including desk-based checks of supplier processes and policies; assessed evidence-based questionnaires via EcoVadis (a third-party provider); and full on-site audits by trained sustainability auditors. In 2020, COVID-19 restricted our ability to carry out on-site audits, but we continued to assess supplier risk through our established tools and systems. We won the Silver award at the 2020 Shared Services and Outsourcing Network (SSON) Impact Awards Asia in the Best Vendor Collaboration category. The SSON Impact awards are among the most significant and sought-after awards in our industry.

To meet our Blueprint goal of reducing supply chain emissions, we worked closely with our suppliers to help them set carbon goals: currently, over 20% of our supply chain emission sources have agreed to carbon reduction plans. We also encouraged suppliers to reduce reliance on single-use plastics, use green energy, and manage sustainability within their own supply chain. We hold BS11000 certifications and operate a formal vendor management that adopts its collaborative working principles. Full details of our approach to the management of modern slavery in our Supply Chain can be found in our annual Modern Slavery Statement on our website. We manage this risk as part of our routine supply chain management process and hold specific modern slavery risk management reviews where we identify heightened risk.

Helping society thrive

We want to keep communities connected by making our products and services accessible for everyone, and by helping people enjoy a safer and more positive experience with technology. We focus our efforts around causes that link to the social responsibilities that we face as a business. We believe that everyone should be able to safely access our products and services, and we strive to ensure that we support the most vulnerable in the communities where we operate.

Due to the pandemic digital connectivity mattered more than ever - keeping families connected, reducing loneliness, supporting online learning, and helping people to keep working. In response to the crisis, we:

- Provided free access for our customers to over 30 websites offering essential support services, including NHS and other financial, health and emotional advice support websites.
- Established a new Community Calling scheme with environmental charity Hubbub, to refurbish and gift smartphones and tablets to the most vulnerable people in six cities across the UK. Working in partnership with local community organisations and reputable charities, we distributed 2,538 devices to those most in need, plus 12 months of free connectivity including unlimited minutes, unlimited texts and 6GB of data per month. We are calling on businesses to donate devices to help those who are digitally disconnected.
- We made a £1m donation as one of the official partners of the BBC's Big Night In Appeal which saw the charitable partners, BBC Children in Need and Comic Relief come together to raise money to provide essential support to local charities and projects across the UK.
- We teamed up with a selection of local Age UK charities to provide older members of the community with a range of tech devices and support to help them stay in touch with loved ones on Christmas Day.

In 2020, we continued to focus on our ongoing commitment to keep families and children safe online through our award-winning partnership with the UK's leading child protection charity, the NSPCC. We invested £1m with the NSPCC to support the delivery of online safety initiatives including Net Aware, which offers advice and support on the most popular apps, games and websites used by children. We delivered 681,301 social impacts via our partnership with the NSPCC – which is how we describe ways in which we've helped people have a healthier, more positive relationship with technology through our tools, programmes, products and services.

Our Content Standards Policy covers our approach to content classification, age-verification, and the work we do with the Internet Watch Foundation to block illegal content. To help young people develop a better relationship with tech and the online world, we launched the #OwnYourFeed campaign with YoungMinds – a mental health charity for children and young people. The campaign encouraged young people to take control of their social media feed so they could have a more positive time online. We delivered 764,864 social impacts to young people via this campaign.

Leading By Example

We put responsibility at the heart of everything we do, championing a fair, inclusive, and ethical business, while maintaining the highest standards in our own decision making. Our people are key to helping us to deliver our responsible business goals. Everyone has an annual Blueprint objective and is encouraged to fundraise and volunteer their time to support our key causes. A few examples include supporting Telefonica's International Volunteering Week by making green pledges, donating phones or joining our People networks as well as different fund-raising events for the NSPCC. These included a static cycle challenge, and the CEOs of O2 and NSPCC virtually climbing the UK's highest peaks. In 2020 we raised a total of £297,043 for the charity.

Our ambition is to be a leading inclusive employer and to become a truly representative business by 2025. Our commitments in this area are outlined in the People section within our Strategic Report on page 19.

We're committed to ensuring the Health and Safety of all our people, contractors, partners, customers and members of the public. Our Health and Safety Policy is implemented through an externally certificated Health and Safety Management System. In July 2020, we received certification to BS ISO 45001:2018, replacing our previous OHSAS 18001 certificate. In 2020, the International Commission on Non-Ionizing Radiation Protection (ICNIRP) reissued the Guidelines on Limiting Exposure to Electromagnetic Fields (EMF). We have assessed our framework against the standards, and it continues to remain compliant.



Governance

Our Responsible Business Taskforce oversees our social, ethical and environmental impacts, identifying and prioritising the issues that matter most to our business and stakeholders. It includes senior representatives from each business area, is chaired by the Director of Corporate Affairs and reports directly into the Board.

Local risk registers are kept for all non-financial risks as part of the company-wide process. Identified risks for online safety are managed through our age verification and content classification procedures. The key environmental risks are associated with climate change - including the continued availability of renewable energy and the potential for floods to impact the delivery of our services. In 2020, new risks relating to the current global health pandemic and its effect on our supply chain have been recorded. Details of our significant non-financial risks are disclosed in the Principal Risks and Uncertainties section of the Strategic Report on page 27.


The Non-Financial Report Statement was approved by the Board on 28 April 2021.

By Order of the Board

Vivienne Aziba

For and on behalf of O2 Secretaries Limited

Company Secretary



Streamlined carbon and energy report

We are pleased to report on our energy and carbon report for the financial year ended 31 December 2020. This is the first year we are required to report on our energy and carbon footprint therefore we have not included the comparative data for the previous year.

The scope of the report includes our company owned stores, corporate sites, switch/datacentres and cell sites (mast/antennae sites), it does not include Franchise stores; these are separate legal entities. The calculation approach is based on invoicing (where applicable) and estimation where the scope includes emission sources outside our operational control (for example landlord supplied sites). 31% of the emissions data is based on estimates where actual data is not available. Emissions factors have been taken from the BEIS 2020 Conversion Factors published in June 2020 and our data has been externally validated by Aenor.

Emissions	2020 (tCO ₂ e)
Scope 1 - Direct emissions from activities owned or controlled by the Company.	
This is low impact and fuel used is primarily for space heating (gas) and fuel used in standby generators (diesel).	
Fuel consumption	2,167
F-gases	441
Vehicle fuel consumption	399
Total	3,007
Scope 2 - Indirect emissions into the atmosphere associated with purchased, electricity, heat, steam and cooling	
Electricity Consumed across the following site types (cells/switch sites/offices and stores)	
Total electricity consumption (includes renewables – TEF) (Location based)	135,658
Renewable energy purchase	93,325
Total electricity consumption (exc renewables – TEF) (Market based)	42,333
Scope 3 a consequence of an indirect source and not scope 2 (e.g. business travel by vehicles not owned by the Company)	
Refrigerants used in cooling systems and business travel (business mileage, flights etc.).	
Air travel domestic	100
Air travel short haul	54
Air travel long haul	63
Gasoline/oil	144
Diesel	224
Total	585
Methodology for scope data	ISO14001:2015 and GHG Protocol
Intensity ratio using the UK Gov BEIS emissions factors	121.8 tCO ₂ e/PB
Carbon offsets (tCO₂e)	Zero

We purchased 581,872,147 kWh of electricity for our own consumption (renewable/non-renewable) in our own or controlled sources. The renewable energy has a zero-emission factor using the market approach. The saving compared to location approach is 93,325 tCO₂e.

Our energy supplier and tariff is SSE Renewable 100% certified renewable energy. The carbon saving associated with the energy renewal tariff was 100% within our operational control and 70% overall emissions. From controlled and owned resources, we generated 7,300 kWh of electricity.

Some measures taken to increase our energy efficiency include the procurement and deployment of more efficient network transmission equipment. We upgraded to LED lighting in our offices, installed fresh air cooling (reducing the reliance on refrigerant gasses) for cell sites, enhanced cooling optimisation to improve operational efficiency of our switch/datacentres and we also turned down parts of our network during low traffic use.

An overview of the progress made during the period against our objectives are:

- More energy efficiency: reduce energy consumption by 90% per unit of traffic by 2025 compared to 2015. Progress: 82%.
- More renewable energy: continue to use 100% of electricity from renewable sources, promoting its development with long-term contracts and self-generation (within operational control). Progress: 100% where within our operational control.
- Achieve net zero emissions by 2025 (scopes 1 and 2). Progress: 29% reduction from baseline (2015).
- Targeting a reduction of 39% in our value chain by 2025 and reach net zero by 2040.
- Through our Eco Smart solutions, customers reduce CO₂ by at least 5 million tonnes annually by 2025.

These objectives have been validated according to the 1.5°C scenario by the Science Based Targets initiative (SBTi). Full details of our responsible business environmental commitments beyond energy consumption can be found in the Non-Financial Statement on page 36.

The Streamlined Energy and Carbon Report was approved by the Board on 28 April 2021.

By Order of the Board

Vivienne Aziba

For and on behalf of O2 Secretaries Limited

Company Secretary

Director's report

We are pleased to present the Directors' report for the year ended 31 December 2020. The report does not include matters of strategic importance which are disclosed in other parts of the Annual Report and referenced accordingly.

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

Our ultimate UK parent, Telefonica O2 Holdings Limited, 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 our governance arrangement is set out in a separate report, Corporate Governance Statement, on page 46 to 51 which forms part of this report.

Stakeholder Statement

Details of how we have fostered business relationships with suppliers, customers, and other stakeholders and the effect on principal decisions can be found throughout the integrated report. For ease of reference the key stakeholders are detailed in the Consumer and Business sections of the Strategic Report, the Non-Financial Statement and the Principle 6 Stakeholder Engagement section of the Corporate Governance Statement on page 49.

UK Employee Engagement Statement

We solely operate in the UK and our People are based in the UK apart from a handful which are seconded to other group companies from time to time. Details of our People engagement and how we have had regard to matters of concern to them can be found in the People section of the Strategic Report on page 19 and in Principle 6 of the Corporate Governance Statement on page 49.

Energy and Carbon Report

Details of our energy and carbon emissions during the financial year ended 31 December 2020 are set out in a separate report, Streamlined Energy and Carbon Statement on page 41 to 42 which forms part of this report.

Dividends

The Company paid an interim dividend of £548,620,605 during the year ended 31 December 2020 (2019: £480,000,000).

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 2020 (2019: £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 - TBC

The Strategic report sets out on page 35 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 telecommunications provider and operator. The financial position of the Company is described on page 34 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 financing and business risks successfully.

The Company prepares detailed annual budgets and forecasts as part of its planning process. These budgets and forecasts are subject to rigorous review which include sensitivity testing of key assumptions, analysis of growth rates, market guidance and macroeconomic indicators. There are processes in place to review the appropriateness of financial outlooks regularly and monitor market activity on an ongoing basis. Rate and volume assumptions are stress tested and triangulated with market insight/trading updates as well as monthly results and third party economic/other relevant sources. The Directors have reviewed the budgets, forecasts and business plan which reflects our current view of the impacts of Covid 19 on the business for the period to 31 December 2022. The Company has proved to be resilient, but not entirely immune to the effects of Covid 19. The need for connectivity by our customers has been just as strong. The Company does not anticipate that an unexpected fall in volumes and/or prices will result in sustained losses that have a material impact on its ability to continue in operation. Having considered the impact of a severe but plausible downside scenario for Covid 19, OIBDA is expected to be a significant positive number and thus causes no concern in respect of going concern considerations. The Company has demonstrated its ability to pull on sufficient levers to mitigate a significant impact on profitability and liquidity. In light of this, the Directors believe that the Company is well placed to continue to mitigate the impacts of Covid 19 during 2021 and beyond.

In anticipation of the impending JV merger transaction with Virgin Media during 2021 both Telefonica UK and Virgin Media have combined to create a joint business plan for the JV. The joint business plan brings together forward looking forecasts for both businesses, with anticipated synergies and growth opportunities. The Directors have confidence that the new JV management team will be well placed to grow the business and ensure that the new JV will be stronger as a combined organisation.

It is anticipated that intercompany loans (including £524m owed to Telfin Ireland with a maturity date of 30 June 2022) will be settled within their due date or as part of the closing transaction steps should the merger go ahead as expected. The loan repayments have been factored into the cashflow forecasts and sufficient liquidity exists to meet obligations as they fall due. The Directors do not consider the settlement of intercompany loans to pose any risks from a going concern perspective.

The Company is considered to be in a strong financial position as at 31 December 2020 and has identified no factors that cast doubt on its ability to continue as a going concern in future financial reporting periods.

The Directors have noted no significant issues causing them to believe that the going concern assumption is not appropriate for the Company for the year ended 31 December 2020. Together with the commitment received from the ultimate parent company to continue providing financial support because of the net current liabilities position, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. As a result we continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Statement as to disclosure to auditors

The auditors are aware of the necessary information to support the audit. We have taken the necessary steps to provide any relevant audit information and to establish that the auditors are aware of that information.

The Directors' Report has been approved by the Board on 28 April 2021.

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 statutory Board, supported by the Executive Leadership Team (the ELT), have continued to promote the success of our Customer Led, Mobile First strategy and to make every day better through personal experiences that count. We are committed to being a responsible business as detailed in our Blueprint and being a truly diverse and inclusive business. Our mission to do the right thing, for all our stakeholders, is embedded in our company values (Bold, Open and Trusted) and our Business Principles which form our ethical code of conduct to help guide behaviours across the organisation. Full details on the progress we have made on our various commitments are discussed throughout the Strategic Report and the Non-Financial Statement.

2020 presented two significant matters which impacted the business. The first was the COVID-19 pandemic. As a business we are not immune to the implications, but we are resilient. Secondly, the decision of our ultimate shareholder, Telefónica SA, to enter into a proposed joint venture arrangement with Liberty Global to merge their UK businesses; O2 and Virgin Media. The proposed joint venture arrangement is subject to regulatory clearance currently underway.

To keep our People informed of the business focus as we navigate through the unprecedented times, we hosted fortnightly and later monthly live streams led by the Chief Executive Officer, alongside members of the ELT at each session. On average the sessions generated audiences of about 1,500 people in addition to 4,000 on catch up and over 700 responses to feedback surveys.

The COVID-19 pandemic proved the efficacy of our Business Continuity planning and allowed us to refine and improve the detail. We are the first UK Telecommunications provider to be recommended for transition to the latest iteration of ISO 22301 certification. We operate a best practice approach to Business Continuity, and therefore no major changes were required. We did however make some tactical changes to ensure that our resilience levels were maintained. For example, we increased the capacity and geographic diversity of our VPN solution to ensure continued business resilience.

Our desired culture is embedded through our business practices, including regular updates from the Board on our commitments and the collective responsibility of our People, through the performance management process where individual objectives must demonstrate our company values and corporate responsibility commitments. In addition, we continue to listen to our People through the annual global engagement survey and regular pulse surveys. These tools gather the views of our People and enables everyone to have a voice throughout the year. We also have a Speak Up channel where our People can raise any issues and concerns and Internal Audit conducts reviews which cover adherence to the policies and procedures supporting our business activities.

Principle Two: Board composition

The statutory Board (which is comprised of the Chief Executive Officer and the Chief Financial Officer) with the support of the ELT through committees have overall accountability and oversight responsibilities for the day-to-day management of the business activities, which forms part of the governance framework to deliver the Company's purpose.

The ELT is gender diverse with nine members (five female, four male). During the period the ELT undertook the necessary professional development to discharge their duties, including briefing on specialist matters, keeping abreast with regulatory changes in particular the government guidance and national restrictions due to the COVID-19 pandemic. The formal governance framework includes a number of 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. Members of the ELT who also head the directorates across the organisation have the necessary skills and experience to make valuable contributions in promoting the success of the Company and are committed to ensuring that the Company is managed according to the highest standards of corporate governance. Full details of the Committee structure and the ELT bios can be found on the Company's website <https://www.o2.co.uk/abouto2/our-leadership-team>

Principle Three: Responsibilities

The formal governance framework consists of the statutory Board and its committees which have a defined charter of roles and responsibilities and terms of reference detailing their responsibilities and delegated authority.

- The Operating Committee consists of the ELT which has oversight of the day-to-day management of the business activities including monitoring the financial performance and the implementation of the objectives which underpin the Company's purpose.
- The Strategy Committee consists of the ELT 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 the implications of the COVID-19 pandemic on the Business plan.
- The Assurance Forum (the majority of which are ELT members) considers the internal control framework and assists the statutory Board and the Operating Committee in fulfilling certain oversight responsibilities such as COVID-19 pandemic risks, Brexit implications for the business, Contract Management Framework, implementation of regulatory change - End of Contract Notification.
- The National Security Committee consists of some ELT members and considers policy and issues in respect of the company's specific legal obligation as a communication provider.
- The Pensions Committee consists of some ELT members and 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. During the period the Company set up a new pension scheme for the defined contribution pension arrangement which is now held and managed by a third-party pension provider, Mastertrust which is authorised by the UK Pension regulator.
- The Responsible Business Taskforce is chaired by an ELT member and considers matters related to the delivery of the Company's sustainability and responsibility strategy through our Blueprint. Full details are disclosed in the Non-Financial Statement on page 36.

At the start of 2021, the Operating Committee and Strategy Committee merged their roles and responsibilities into the Executive Committee.

Principle Four: Opportunity and Risk

As risks are inherent in all business activities, an effective risk management contributes to the development of the business through an appropriate balance between growth, return and risk. We have a comprehensive Risk Management Framework, which is aligned with ISO31000:2009 Principles and Guidelines for Risk Management, including the Risk Management Policy which has been independently assessed by the BSI against the ISO31000:2009 Standard. The framework is designed to identify, assess, manage and, monitor significant risks that could adversely affect the future success of the organisation. The identified risks are assessed in a qualitative and/or quantitative way to prioritise the follow-up and response to these risks, usually through mitigation plans, or strategies to avoid or transfer these risks. 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. Details of the Principal Risks and Uncertainties facing the business are disclosed in pages 27 to 32 of the Strategic Report.

Our Risk Appetite is created through a combination of internally defined parameters and those set by our ultimate shareholder. This defined appetite enables us to deliver value creation, growth and performance whilst managing risk exposure in a measured and accountable way. When applied to our strategy decision making, this helps the Company's management to select appropriate strategies within its acceptable risk level.

The Internal Audit function supports those charged with managing the Company affairs by the provision of services related to assurance, through applying a systematic and disciplined approach in the delivery of the annual audit plan. The function reports monthly on key performance indicators, implementation of any controls and/or any identified internal audit actions. In addition, the function reports on the effectiveness of the Internal Control Framework as one of the requirements to conform with the Sarbanes-Oxley Act 2002. During 2020, the function was the subject of an External Quality Assessment Review performed by the Institute of Internal Auditors which assessed adherence to the International Standards of Internal Auditing and achieved the highest assessment rating.

Principle Five: Remuneration

The focus of our Remuneration Policy is to ensure that the organisation can attract, reward and retain the best talent, enabling us to meet our strategic targets within a highly competitive and globalised setting. The pay principles and the approach outlined below for employees also applies to executives. There is an additional level of governance for the ELT remuneration which is strictly determined and assessed by the Telefónica Group Remuneration Committee.

A significant portion of the ELT remuneration 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. Whilst the long-term variable remuneration is linked to the long-term value creation in Telefónica Group by measuring the shareholders' return on investment and key economic financial objectives. Details of the ELT remuneration are disclosed in the notes to the Financial Statement.

In general salary reviews are positioned against external benchmarking depending on grades, individual performance and the Company's overall pay budget which is determined by financial position, company performance and affordability. Despite the economic downturn we did not furlough any of our People and have awarded around 1% salary increase in 2020. All our People on a permanent contract are eligible for our Flexible Benefits programme to help improve their lifestyle, including an employee share scheme allowing our People to invest up to £1,800 or 10% of their salary (whichever is the lower) in Telefónica S.A. shares per tax year. In July 2020, we launched an incentive plan for our People called "See What You Can Do" with an opportunity to earn an award of up to £1,500 for meeting set targets which are commercially focused.

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 our Shareholder, customers, people, the regulators, government, suppliers, society and the environment. We continue to promote the Company's long-term aspirations taking into consideration the interest of the wider stakeholders and the expectations of our ultimate Shareholder. The statutory Board hold monthly meetings with the ultimate Shareholder to understand their views and regularly updates the Shareholder and the ELT to ensure alignment between the Company and the shareholder.

Stakeholder Engagement

Each of our stakeholder group has at least one member of the ELT as an Executive Sponsor to help manage the day-to-day relationship.

Customer

In addition to our customer surveys and innovation sessions, we regularly host events to engage with our customers and to understand their views and ensure we achieve our purpose. A few of the engagements during the period were:

Customer Advisory Board – a group for senior executives from our most strategic business customers where we share unique insights and collaborate to explore how we can create greater value. In 2020, the group met virtually on six occasions to share ideas and experiences around common business challenges and to provide input and advice on our strategies and direction. Members valued the opportunity to discuss challenges and to learn and share strategies as a group especially during the pandemic.

Blue Door Conference – We organised a virtual event for business clients, industry leaders and visionaries to discuss and debate how creative solutions and technology can address the complex challenges faced by organisations. We hosted more than 30 interactive sessions and exclusive networking opportunities, giving our customers the chance to hear from subject-matter experts and discuss cutting-edge technology and the key challenges facing businesses today.

People

In addition to the annual Global Engagement Survey and regular Pulse surveys, we use multiple channels to engage with our People, in particular Workplace, with a focus on daily information sharing, team collaboration and company-wide updates. We also have a People Champions Network to support our leaders and take action on the insight collected to create multi-level action plans that are reviewed regularly throughout the year. In 2020, we held company wide live events to bring our people together and update them on topics including strategic priorities, commercial performance and updates, and to celebrate success.

The Regulators

Our three main Regulators are Office of Communications (Ofcom), Information Commissioner's Office (ICO) and the Financial Conduct Authority (FCA).

We have engaged with Ofcom on a number of policy areas, spectrum issues and investigations, in particular on the implementation of the European Electronic Communications Code ("EECC"), as it relates to the linked split mobile contracts, such as our custom plan proposition. Ofcom has now implemented the consumer protection elements of the EECC and we are considering the impact of these regulatory changes. In addition, we are engaged with Ofcom on the forthcoming spectrum auction for 700 MHz and 3.6 - 3.8 GHz spectrum, our acquisition of 2.6 GHz TDD spectrum from BT, the measures to address the impact of COVID-19 pandemic and on our compliance with metering and billing obligations.

Unfortunately, in 2019 we identified a system error in relation to the calculation of the final bills for some pay monthly mobile customers which resulted in duplicate payments. We immediately notified the issue to our metering and billing auditor, proactively refunded those customers who were not automatically refunded of any overpayment, took steps to remediate the issue and further enhanced our billing protocols to ensure that the issue does not happen again.

On 12 February 2021, Ofcom announced that it had concluded its investigation into our compliance with metering and billing obligations. Ofcom found that we had not complied with those obligations in relation to the way our systems calculated the final bills for some pay monthly mobile and levied a fine of £10.5m. We have accepted Ofcom's findings.

The ICO is the UK's independent body set up to uphold information rights. During COVID-19 Pandemic we have continued to engage with the ICO in relation to our existing regulatory obligations as well as in respect of the actions we have taken to keep our customers and communities connected. We continue to engage constructively with the ICO in relation to any enquiries we may receive from the regulator under relevant protection laws. There are no material public enforcement actions against us to date, however we are aware of two ongoing investigations for which we are actively corresponding with the regulators to resolve the matters. Details of any investigations are made public on the ICO website.

We are authorised by the FCA to provide regulated consumer credit facilities, to arrange insurance contracts and to support our customers with their digital connectivity needs. We are committed to treating customers fairly and giving due regard to the FCA's objectives of protecting consumers, ensuring market integrity, and promoting effective competition. For example, the implementation of the Payment Services Directive where we put in place key controls to ensure we remain fully compliant and the Emergency Payment COVID-19 rules allowing customers to have up to a three-month payment break. In addition, we have implemented the Senior Managers and Certification Regime which replaces the Approved Persons Regime.

The government

We have continued to engage with the government to support communities across the UK to ensure we keep the nation connected and help to rebuild Britain, for example on network coverage, planning policy, regulation and our Greener Network Net Zero commitments. The pandemic has elevated an appreciation of the importance and value digital connectivity can bring. We are leveraging this to ensure that public policy in key areas (e.g. planning, regulation) reflects the increased importance people now attach to digital connectivity and reinforcing the contribution that mobile can play in supporting economic growth in a post-Brexit, coronavirus-damaged economy. For example, we have secured government backing for the Shared Rural Network, winning investment and policy support that will help us improve rural coverage.

Suppliers, Society and the environment

Full details of our engagement and relations with Suppliers, Society and the environment can be found on pages 37 to 41 respectively within the Non-Financial Statement.

The Governance Statement was approved by the Board on 28 April 2021.

By Order of the Board

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

Statement of director's responsibilities

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 accounting standards in conformity with the requirements of the Companies Act 2006.

Under company law, 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 international accounting standards in conformity with the requirements of the Companies Act 2006 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 group and company will continue in business.

The directors are also responsible for safeguarding the assets of the group and 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 group's and company's transactions, and disclose with reasonable accuracy at any time the financial position of the group and company, and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' confirmation

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 group's and 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 group's and company's auditors are aware of that information.

The Statement of Directors' responsibilities was approved by the Board on 28 April 2021.

By Order of the Board

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



Independent auditors' report to the members of Telefonica UK Limited

Report on the audit of the financial statements

Opinion

In our opinion, Telefonica UK Limited's group financial statements and company financial statements (the "financial statements"):

- give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2020 and of the group's and company's profit and the group's and company's cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; 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, which comprise: the Group and Company statement of financial position as at 31 December 2020; the statement of comprehensive income, Group and Company statement of changes in equity and the Group and Company statement of cash flows 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

Our evaluation of the directors' assessment of the group's and the company's ability to continue to adopt the going concern basis of accounting included:

- Considered the extent to which the Group's and Company's future cash flows might be adversely affected by COVID-19 - reviewing management's cash flow forecasts, assessing the existing sources of finance and considering the overall impact on liquidity, concluding that there was not a material uncertainty related to going concern; and
- Considered the adequacy of the disclosures in the financial statements, particularly in the summary of significant accounting policies - going concern; and
- Considered the cash flow forecasts of the combined O2 Holdings and Virgin Media business, as it is likely that the two businesses will merge in 2021.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

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

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

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 our work undertaken in the course of the audit, the Companies Act 2006 requires 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 2020 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 group and 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, 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 group's and 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 group or 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. Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to tax legislation, employment regulation, health and safety legislation, Ofcom regulations and other legislation specific to the industry in which the group operates, and we considered the extent to which non-compliance might have a material effect on the financial statements.

We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in determining accounting estimates. Audit procedures performed by the engagement team included:

- reviewing the financial statement disclosures and testing the supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management and those charged with governance about existing and potential litigation and claims, and known or suspected instances of non-compliance with laws and regulations and fraud;
- addressing the risk of fraud through management override of controls by testing the appropriateness of journal entries, including journal entries with unusual account combinations;
- challenging assumptions and judgements made by management in their significant accounting estimates that involved considering future events that are inherently uncertain. In particular, in relation to valuation of goodwill and investments, the completeness of commercial & legal claims against the company, the valuation of defined benefit pension assets and obligations and the valuation of property, plant & equipment and intangible assets though testing of useful economic lives; and
- communicating relevant identified laws and regulations and potential fraud risks to all engagement team members, including internal specialists, and reminding them to be alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

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 obtained 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 company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Jass Sarai (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Watford
30 April 2021

**Statement of comprehensive income
for the year ended 31 December 2020**

	Note	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Revenue	6	5,718	5,976
Operating costs	6	(4,796)	(5,046)
Net impairment losses on financial and contract assets	6	(164)	(149)
Operating profit	6	758	781
Financial income	10	24	17
Financial costs	10	(72)	(33)
Profit before taxation		710	765
Taxation	11	(129)	(163)
Profit for the year		581	602
Other comprehensive loss			
Items that will not be reclassified to profit or loss:			
Actuarial loss on retirement benefit obligations	26	(27)	(59)
Income tax related to other comprehensive loss	27	4	6
Other comprehensive loss for the year		(23)	(53)
Total comprehensive income for the year attributable to equity holders		558	549

The accompanying notes on pages 61 to 114 are an integral part of these financial statements.

**Statement of financial position
As at 31 December 2020**

	Note	31 December 2020 £m	31 December 2019 £m
Non-current assets			
Property, plant and equipment	13	2,940	2,817
Right of use assets	14	454	606
Intangible assets	15	1,237	1,356
Investments	16	14	14
Deferred tax assets	27	4	6
Trade and other receivables	18	250	342
Other financial assets	19	63	57
Retirement benefit asset	26	40	-

		5,002	5,198
Current assets			
Inventories	17	122	120
Trade and other receivables	18	1,753	1,747
Other financial assets	19	73	64
Cash and cash equivalents	20	76	138
		2,024	2,069
Current liabilities			
Borrowings	21	(167)	(2)
Lease liabilities	22	(182)	(186)
Trade and other payables	23	(2,412)	(2,577)
Current tax liabilities		(5)	(74)
Provisions	24	(30)	(37)
		(2,796)	(2,876)
Net current liabilities		(772)	(807)
Total assets less current liabilities		4,230	4,391
Non-current liabilities			
Borrowings	21	(964)	(964)
Lease liabilities	22	(280)	(411)
Trade and other payables	23	(206)	(231)
Deferred tax liabilities	27	(58)	(52)
Retirement benefit obligation	26	-	(12)
Provisions	24	(64)	(72)
		(1,572)	(1,742)
Net assets		2,658	2,649
Equity			
Ordinary share capital	28	10	10
Capital reserve	28	23	23
Retained earnings		2,625	2,616
Total equity		2,658	2,649

The accompanying notes on pages 61 to 114 are an integral part of the financial statements. The financial statements on pages 57 to 114 were approved by the Board of Directors and authorised for issue on 28 April 2021 and were signed on its behalf by:

Mark Evans
Director

**Statement of changes in equity
for the year ended 31 December 2020**

	Share capital (Note 29) £m	Capital reserve (Note 29) £m	Retained earnings £m	Total equity £m
Balance at 1 January 2019	10	23	2,547	2,580
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
Profit for the year	-	-	581	581
Other comprehensive loss	-	-	(23)	(23)
Total comprehensive income for the year	-	-	558	558
Dividends paid (Note 12)	-	-	(549)	(549)
Balance at 31 December 2020	10	23	2,625	2,658

**Statement of cash flows
for the year ended 31 December 2020**

	Note	2020 £m	2019 £m
Profit before taxation		710	765
Adjustments to reconcile profit before tax to net cash flows:			
Property, plant and equipment depreciation	13	525	533
Right of use asset depreciation	14	198	181
Intangible asset amortisation	15	273	261
Increase/(decrease) in other provisions		(14)	42
Increase in bad debt provision	24	11	4
Impairment of investment in subsidiaries		12	1
Share based payment expense		4	2
Net foreign exchange gain		-	-
Net financial expenses		47	16
Operating profit before adjustments for working capital changes		1,766	1,805
Increase in inventories		(1)	(27)
Decrease in trade and other receivables		96	157
Decrease in trade and other payables		(208)	(2)
Decrease in other provisions		(1)	(12)
Company contributions to retirement benefit obligation		(80)	(25)
Corporation tax paid		(162)	(194)
Interest received		29	13

Net cash flow generated from operating activities	1,439	1,715
Purchase of property, plant and equipment and intangible assets	(875)	(896)
Purchase of other financial assets	(15)	(35)
Share subscription in subsidiary undertaking	-	(1)
Net cash flow used in investing activities	(890)	(932)
Dividends paid	(549)	(480)
Principal elements of lease payments	(202)	(164)
Lease interest paid	(3)	(14)
Other interest paid	(22)	(21)
Proceeds from borrowings	165	-
Repayment of borrowings	-	(70)
Net cash flow used in financing activities	(611)	(749)
Net increase in cash and cash equivalents	(62)	34
Cash and cash equivalents at 1 January	138	104
Cash and cash equivalents at 31 December	76	138

The accompanying notes on pages 79 to 127 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 2020:

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 has analysed the amendment and concluded that they do not have impact on its consolidated financial statements, nor the comparative financial information however the change in definition is relevant to the user of the financial statements.

Other standards

The following amended standards and interpretations were also effective during the year, however, they have not had a significant impact on the financial statements.

- Amendments to references to Conceptual Framework in IFRS standards.
- Interest rate benchmark reform (Amendments to IFRS 9, IAS 39 and IFRS 7).
- Amendment to IFRS 3 – Definition of a business

2.2 New standards and interpretations not yet adopted

Certain new accounting standards and amendments have been published that are not mandatory for the current reporting period and have not been early adopted by the Group as the adoption as the adoption of the following standards is not expected to have a material impact.

	Annual periods beginning on or after
Amendment to IFRS 16 leases - Covid 19-related rent concessions	1 June 2020
Amendments to IFRS 4 Insurance Contracts – deferral of IFRS19	31 January 2021
Amendments to IFRS 3: Business Combinations	31 January 2022
Amendments to IAS 16: Property, Plant and Equipment	31 January 2022
Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets	31 January 2022
Annual Improvements 2018-2020	31 January 2022
IFRS 17: Insurance Contracts	31 January 2023
Amendments to IAS 1 Presentation of Financial Statements: Classification of Liabilities as current or non-current	31 January 2023
Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	To Be Determined

3. Significant accounting policies

3.1 Basis of preparation

These financial statements have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006.

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 2020.

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 2020.

3.4 Going concern

The Company's business activity is that of a mobile cellular telecommunications provider and operator. The financial position of the Company is described on page 35 of the strategic report. In addition, Note 34 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 financing and business risks successfully.

The Company prepares detailed annual budgets and forecasts as part of its planning process. These budgets and forecasts are subject to rigorous review which include sensitivity testing of key assumptions, analysis of growth rates, market guidance and macroeconomic indicators. There are processes in place to review the appropriateness of financial outlooks regularly and monitor market activity on an ongoing basis. Rate and volume assumptions are stress tested and triangulated with market insight/trading updates as well as monthly results and third party economic/other relevant sources. The Directors have reviewed the budgets, forecasts and business plan which reflects our current view of the impacts of Covid 19 on the business for the period to 31 December 2022. The Company has proved to be resilient, but not entirely immune to the effects of Covid 19. The need for connectivity by our customers has been just as strong. The Company does not anticipate that an unexpected fall in volumes and/or prices will result in sustained losses that have a material impact on its ability to continue in operation. Having considered the impact of a severe but plausible downside scenario for Covid 19, OIBDA is expected to be a significant positive number and thus causes no concern in respect of going concern considerations. The Company has demonstrated its ability to pull on sufficient levers to mitigate a significant impact on profitability and liquidity. In light of this, the Directors believe that the Company is well placed to continue to mitigate the impacts of Covid 19 during 2021 and beyond.

In anticipation of the impending JV merger transaction with Virgin Media during 2021 both Telefonica UK and Virgin Media have combined to create a joint business plan for the JV. The joint business plan brings together forward looking forecasts for both businesses, with anticipated synergies and growth opportunities. The Directors have confidence that the new JV management team will be well placed to grow the business and ensure that the new JV will be stronger as a combined organisation.

It is anticipated that intercompany loans (including £524m owed to Telfin Ireland with a maturity date of 30 June 2022) will be settled within their due date or as part of the closing transaction steps should the merger go ahead as expected. The loan repayments have been factored into the cashflow forecasts and sufficient liquidity exists to meet obligations as they fall due. The Directors do not consider the settlement of intercompany loans to pose any risks from a going concern perspective.

The Company is considered to be in a strong financial position as at 31 December 2020 and has identified no factors that cast doubt on its ability to continue as a going concern in future financial reporting periods. The Directors have noted no significant issues causing them to believe that the going concern assumption is not appropriate for the Company for the year ended 31 December 2020. Together with the commitment received from the ultimate parent company to continue providing financial support because of the net current liabilities position, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. As a result we continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Operating items in the statement of comprehensive income are derived from the primary operations of the Group 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.

3.5 Joint arrangements

IFRS 11 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 a joint venture are accounted for using the equity method, while 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.

Joint operations

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.

Joint venture

The Group determined its interests in Tesco Mobile Limited to be classified as a joint venture. Under the equity method, the investment in an associate or a joint venture is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate or joint venture since the acquisition date. The statement of comprehensive income reflects the Group's share of the results of operations of the associate or joint venture. Note 19 includes details of the Group's joint ventures.

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). Subscription fees are recognised over the life of the contract. Roaming and Interconnect revenues are recognised over time on usage by the customer.

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 Custom Plans 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, insurance sales and provision of services in respect of smart metering programme. 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.

Payment terms are generally standardised with 14 day terms for Consumers and 30 days for Business customers. No specific provision adjustments are made for payment terms.

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 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 (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 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 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 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 Lease

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 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.

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 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 the shorter
Plant and equipment	
Network assets	5 to 20 years
Computers and office equipment	2 to 5 years

The assets’ useful lives and residual values are reviewed, and adjusted if appropriate, at each statement of financial position date. No depreciation is provided on freehold land or assets in the course of construction.

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

de-recognition 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 less impairment losses 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
4G – 2.6 GHz	13 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 Group, 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 not exceeding 6 years on a straight line basis.

Development costs are only capitalised if the Group 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 asset; 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 ("cash-generating units").

3.18 Investments

Investments are stated at cost less provision for impairment. 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 on a 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 Company 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.

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.

Revenue

Key judgements include revenue recognition and in particular the determination of stand-alone selling price for handsets by reviewing prices against external market conditions and handset airtime based on SIM only airtime pricing averaged over a rolling six month period when applying IFRS 15.

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.

Litigation

Where the Group has identified the existence of a legal dispute, there is often a significant amount of judgement required when determining the likelihood, value and/or timing of any obligation that may exist.

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 Group 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 Group 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 Group 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 Group. The carrying amount of property, plant and equipment and licences for each reporting period is set out in Notes 13 and 15 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 16 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 2020 and 31 December 2019, 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:

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Revenue		
Mobile service revenue	3,743	4,026
Hardware and other revenue	1,975	1,950
Total revenue	5,718	5,976
Operating costs (excluding depreciation, amortisation and management fees)	(3,760)	(4,031)
Impairment losses on financial and contract assets	(164)	(159)
Reversal of impairment losses on financial and contract assets	-	10
Operating profit before depreciation, amortisation and management fees	1,794	1,796
Management fees*	(40)	(40)
Operating profit before depreciation and amortisation (OIBDA)	1,754	1,756
Property, plant and equipment depreciation	(525)	(533)
Right of use asset depreciation	(198)	(181)
Intangible asset amortisation	(273)	(261)
Operating profit	758	781

*Management fees include payables to other Telefónica Group companies outside of the UK Group.

Operating costs included:	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Staff costs (Note 7)	394	399
Capitalised development costs - permanent staff	(52)	(53)
Capitalised development costs - third party labour	(95)	(80)
Auditors' remuneration	1	1
Cost of inventories recognised as an expense	1,466	1,402
Net write downs of inventories recognised in the year	4	1
Restructuring costs (Note 24)	-	27
Impairment of investments in subsidiary undertakings	-	1
Joint operation operating costs	30	45
Other operating expenditure	2,012	2,288

7. Employees

The costs incurred in respect of employees were:

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Wages and salaries	314	323
Social security costs	38	37
Other pension costs (Note 26)	39	37
Share based payments (Note 32)	3	2
Total staff costs	394	399

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

	People in post		Full time equivalent	
	2020	2019	2020	2019
	No.	No.	No.	No.
Sales and marketing	4,097	4,577	3,583	3,985
Operations	1,387	1,407	1,374	1,392
Administration	831	831	812	812
Total monthly average employees	6,315	6,815	5,769	6,189

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 (2019: None). One director (2019: One) 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 (2019: 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:

	Year ended 31 December 2020 £000	Year ended 31 December 2019 £000
Salaries and short-term employee benefits	7,272	6,370
Post-employment benefits	22	50
Share-based payments	3	2
Total key management compensation	7,297	6,422

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

	Year ended 31 December 2020 £000	Year ended 31 December 2019 £000
Aggregate emoluments in respect of qualifying services	2,962	2,560
Aggregate amount of company contributions paid to a pension scheme	6	11
Total directors' remuneration	2,968	2,571

In respect of the highest-paid director during the period:

	Year ended 31 December 2020 £000	Year ended 31 December 2019 £000
Aggregate emoluments in respect of qualifying services	2,193	1,796
Aggregate amount of company contributions paid to a pension scheme	-	-
Total highest-paid director compensation	2,193	1,796

9. Auditors' remuneration

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

	Year ended 31 December 2020 £000	Year ended 31 December 2019 £000
Audit services:		
UK audit fees in respect of current year	883	709
UK audit fees in respect of prior years	193	35
Audit-related assurance services	51	50
Total audit and audit-related fees	1,127	794

The fees in 2020 and 2019 were paid to PricewaterhouseCoopers LLP.

10. Financial income and financial costs

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Financial income	22	15
Interest income on cash, cash equivalents and other financial assets	2	2
Interest income from other group companies	24	17
Total financial income		
	(16)	(18)
Interest payable to other group companies	(9)	(14)
Lease interest	(47)	(1)

Other financial costs	(72)	(33)
Total financial costs		
	(48)	(16)
Net financial costs	(16)	

11. Taxation

The analysis of the tax charge for the period is as follows:

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Current tax - current year	122	153
Current tax - adjustment in respect of prior years	(5)	-
Deferred tax - current year (Note 27)	29	12
Deferred tax - adjustment in respect of prior years (Note 27)	(17)	(2)
Taxation	129	163

The tax assessed for the period varied from the amount computed by applying the UK statutory tax rate to profit or loss on ordinary activities before taxation. The difference was attributable to the following factors:

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Profit before taxation	710	765
Profit before taxation multiplied by rate of corporation tax in the UK of 19% (2019: 19%)	135	145
Effects of:		
Expenses not deductible for tax purposes	12	19
Effect of change in tax rate	3	1
Adjustments in respect of prior years	(21)	(2)
Taxation – total charge for the year	129	163

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase to 25%. As the proposal to increase the rate to 25% 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 £17m, and to increase the deferred tax liability to £71m.

12. Dividends paid

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Interim dividend for the year of £10.98 (2019: £9.60) per share	549	480
Total dividend paid	549	480

13. Property, plant and equipment

Group	Land and Buildings	Plant and equipment	Assets in course of construction	Total
Cost	£m	£m	£m	£m
At 1 January 2019	384	7,264	369	8,017
Additions	-	-	683	683
Reclassifications	26	684	(710)	-
Disposals	(85)	(1,859)	-	(1,944)
At 31 December 2019	325	6,089	342	6,756
Additions	-	11	651	662
Reclassifications	27	593	(620)	-
Disposals	(12)	(602)	-	(614)
At 31 December 2020	340	6,091	373	6,804
Accumulated depreciation				
At 1 January 2019	285	5,062	-	5,347
Charge for the period	25	508	-	533
Disposals	(85)	(1,856)	-	(1,941)
At 31 December 2019	225	3,714	-	3,939
Charge for the period	25	500	-	525
Disposals	(12)	(588)	-	(600)
At 31 December 2020	238	3,626	-	3,864
Net book amount				
At 31 December 2020	102	2,465	373	2,940
At 31 December 2019	100	2,375	342	2,817

During the year ended 31 December 2020 amounts of £531 million (2019: £1,503 million) cost and £531 million (2019: £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

Group	Land and buildings	Plant and equipment	Total
	£m	£m	£m
Cost			
At 1 January 2019	541	193	734
Additions	101	41	142
Disposals	(67)	(32)	(99)
At 31 December 2019	575	202	777
Additions	43	62	105
Disposals	(33)	(39)	(72)
At 31 December 2020	585	225	810
Accumulated depreciation			
At 1 January 2019	-	-	-
Charge for the period	122	59	181
Disposals	(7)	(3)	(10)
At 31 December 2019	115	56	171
Charge for the period	141	57	198
Disposals	(2)	(11)	(13)
At 31 December 2020	254	102	356
Net book amount			
At 31 December 2020	331	123	454
At 31 December 2019	460	146	606

Right of use assets have been recognised from 1 January 2019.

15. Intangible assets

Group	Licences	Software	Assets in course of construction	Total
Cost	£m	£m	£m	£m
At 1 January 2019	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
Additions	-	2	153	155
Reclassifications	83	47	(130)	-
Disposals	-	(106)	-	(106)
At 31 December 2020	5,248	1,403	31	6,682
Accumulated amortisation				
At 1 January 2019	3,863	1,593	-	5,456
Charge for the period	158	103	-	261
Disposals	-	(440)	-	(440)
At 31 December 2019	4,021	1,256	-	5,277
Charge for the period	171	102	-	273
Disposals	-	(105)	-	(105)
At 31 December 2020	4,192	1,253	-	5,445
Net book amount				
At 31 December 2020	1,056	150	31	1,237
At 31 December 2019	1,144	204	8	1,356

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

During the year ended 2018 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 2020 amounts of £102 million (2019: £392 million) cost and £102 million (2019: £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 2020, the Company purchased unpaired 2.6GHz of 4G spectrum from EE Limited at a cost £83.5 million. This was immediately useable, therefore this was charged immediately to licences in December 2020 with amortisation commencing January 2021.

16. Investments

Cost and net book value	Shares in subsidiary undertakings £m
At 1 January 2020	14
Additions	-
Impairment	-
At 31 December 2020	14

17. Subsidiary undertakings and joint arrangements

The subsidiary undertakings as at 31 December 2020 are detailed below, all of which are included in the Group financial statements.

Name / (Registered number)	Registered office	Country of incorporation and operation	Activity	Portion of ordinary shares held %
O2 Unify Limited	260 Bath Road, Slough, Berkshire, SL1 4DX	England and Wales	IT and communications solutions	100%
giffgaff Limited	260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Mobile communications network	100%
Weve Ltd	260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Mobile marketing and commerce services	100%
Statiq Limited	260 Bath Road Slough Berkshire SL1 4DX	England and 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 and Wales	Dormant entity	100%
Telefonica Cybersecurity Tech UK Limited	260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Dormant entity	100%
Cornerstone Telecommunications Infrastructure Limited	Hive 2, 1530 Arlington Business Park. Theale Reading Berkshire RG7 4SA	England and 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 and Wales	Provision of services in relation to spectrum auction obligations	25%

All share holding portions remain the same as at 31 December 2019 with the exception of Telefonica Cybersecurity Tech UK Limited which was incorporated on 2 March 2020.

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.

CTIL had a loss for the year ended 31 December 2020 of £40m (2019: loss of £47m) and total equity of £134m (2019: £175m).

17. Inventories

Inventory primarily consists of mobile devices and is presented net of provisions for obsolescence:

Group	31 December 2020 £m	31 December 2019 £m
Mobile devices and other equipment	122	120

In the opinion of the Directors there is no material difference between the balance sheet value of inventories and their replacement cost.

18. Trade and other receivables

non-current	2020 £m	2019 £m
Trade receivables	120	155
Contract assets (Note 25)	110	103
Costs of obtaining a contract (Note 25)	4	25
Prepayments	16	59
	250	342
Current:		
Trade receivables	999	866
Other receivables	32	3
Amounts owed by ultimate parent	1	1
Amounts owed by subsidiaries	-	56
Amounts owed by other group and related undertakings	74	26
Amounts owed by associates	20	21
Contract assets (Note 25)	177	166
Costs of obtaining a contract (Note 25)	54	97
Prepayments	255	359
Accrued income	141	152
	1,753	1,747

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 2020, the Company had no provisions relating to amounts owed by other group companies (2019: £nil). This assessment is undertaken each financial year through an examination of the financial position of the related party.

19. Other financial assets

	31 December 2020 £m	31 December 2019 £m
Current other financial assets		
Other financial assets	73	64
	73	64

	31 December 2020 £m	31 December 2019 £m
Non-current other financial assets		
Other financial assets	63	57
	63	57

Included within total other financial assets of £136 million (2019: £121 million) is £117 million (2019: £112 million) of loan notes issued upon factoring of trade receivables; £55 million (2019: £57 million) of which is due within one year.

20. Cash and cash equivalents

	31 December 2020 £m	31 December 2019 £m
Cash and cash equivalents	76	138
Short term deposits		
Other financial assets	76	138

21. Borrowings

	31 December 2020 £m	31 December 2019 £m
Current unsecured borrowings		
Amounts owed to other group companies		
Amounts owed to other group companies	167	2
	167	2

	31 December 2020 £m	31 December 2019 £m
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 and repayable on demand. On 17 December 2020, a loan of £165,000,000 was received from the Company's subsidiary, giffgaff Limited. The terms of the facility allow for further advances up to a total value of £200,000,000 subject to agreement between both parties. The loan is repayable upon the demand. Interest is payable on the loan at the rate of 100 basis points plus 3 month LIBOR. The effective rate of interest on the loan for 2020 was 1.05%.

Non-current amounts owed relate to two loans of £440 million (2019: £440 million) and £524 million (2019: £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 2020 was 1.44% (2019: 1.87%).

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 2020 was 1.29% (2019: 1.72%). The purpose of this loan was to assist with the acquisition of 2.3GHz 4G and 3.4GHz 5G spectrum.

22. Lease liabilities

	2020	2019
	£m	£m
Current lease liabilities	182	186
	2020	2019
	£m	£m
Non-current lease liabilities	280	411

Maturity of lease liabilities

	2020 £m	2019 £m
Within one year	182	186
Later than one year but not later than five years	222	328
Later than five years	58	83
Total lease liabilities	462	597

The movement in deferred tax liabilities and assets during the period, without taking into consideration the off-setting balances within the same tax jurisdiction, is as follows:

23. Trade and other payables

	31 December 2020 £m	31 December 2019 £m
Trade payables	720	787
Amounts owed to immediate parent	4	1
Amounts owed to ultimate parent	16	8
Amounts owed to subsidiaries	50	75
Amounts owed to other group and related undertakings	72	96
Amounts owed to associates	120	107
Other taxation and social security	482	336
Other payables	134	174
Accrued expenses	568	722

Contract liabilities (Note 25)	244	270
Deferred income	2	1
Total current trade and other payables	2,412	2,577

	31 December 2020 £m	31 December 2019 £m
Non-current trade and other payables		
Contract liabilities (Note 25)	202	229
Amounts owed to group and related undertakings	4	2
Total non-current trade and other payables	206	231

24. Provisions

Group		31 December 2020 £m	31 December 2019 £m
Current			
Restructuring provisions		2	26
Asset retirement provisions		12	3
Other provisions		16	8
Total current provisions		30	37
Non-current			
Restructuring provisions		-	-
Asset retirement provisions		64	72
Total non-current provisions		64	72

	Restructuring	Asset retirement	Other	Total
	£m	£m	£m	£m
At 1 January 2019	4	75	-	79
Charge for the period	27	10	8	45
Utilised in the period	(2)	(10)	-	(12)
Amounts released to the income statement	(3)	-	-	(3)
At 31 December 2019	26	75	8	109
Charge for the period	-	7	9	16
Utilised in the period	(24)	(6)	(1)	(31)
Amounts released to the income statement	-	-	-	-
At 31 December 2020	2	76	16	94

Restructuring provisions

Restructuring provisions include the full costs of planned business restructuring programmes, entered into during prior years. No programmes were entered into in 2020 and all programmes are expected to complete in 2021.

Asset retirement provisions

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 16 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 2020 using rates in the range of 0.59% - 1.55% (2019: 1.26% - 1.67%) 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. Contract assets and liabilities and capitalised costs

The movement of contract assets and capitalised costs during the year ended 31 December 2020 and 31 December are as follows:

	At 1 January 2020 £m	Additions £m	Amortisation £m	Reclassifications £m	At 31 December 2020 £m
Non-current contract assets (Note 18)	103	137	(11)	(119)	110
Contract assets	108	139	(11)	(119)	117
Impairment losses	(5)	(2)	-	-	(7)
Current contract assets (Note 18)	166	238	(346)	119	177
Contract assets	177	237	(346)	119	187
Impairment losses	(11)	1	-	-	(10)
Total	269	375	(357)	-	287

	At 1 January 2019 £m	Additions £m	Amortisation £m	Reclassifications £m	At 31 December 2019 £m
Non-current contract assets (Note 21)	74	137	-	(108)	103
Contract assets	79	137	-	(108)	108
Impairment losses	(5)	-	-	-	(5)
Current contract assets (Note 21)	137	329	(408)	108	166
Contract 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 which are due over the duration of the service contract period. The amounts recognised as contract assets are amortised over the contractual period. Included within contract assets is £18 million (2019: £23 million) of right of return assets

related to stock provided to franchise retail stores. A corresponding £18 million (2019: £23 million) right of return obligation is included within contract liabilities.

	At 1 January 2019 £m	Additions £m	Amortisation £m	Reclassifications £m	At 31 December 2019 £m
Non-current capitalised costs (Note 21)	39	50	-	(64)	25
Of obtaining a contract	39	50	-	(64)	25
Impairment losses	-	-	-	-	-
Current capitalised costs (Note 21)	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 2020 and 31 December 2019 are as follows:

	At 1 January 2020 £m	Additions £m	Amortisation £m	Reclassifications £m	At 31 December 2020 £m
Non-current contract liabilities (Note 26)	229	12	(2)	(37)	202
Current contract liabilities (Note 26)	270	1,563	(1,626)	37	244
Total	499	1,575	(1,628)	-	446

	At 1 January 2019 £m	Additions £m	Amortisation £m	Reclassifications £m	At 31 December 2019 £m
Non-current contract liabilities (Note 26)	203	17	(3)	12	229
Current contract liabilities (Note 26)	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 2020 is as follows:

	2021 £m	2022 £m	2023 £m	Subsequent years £m	Total £m
Contract liabilities – activation fees	123	-	-	-	123
Contract liabilities – sale of prepay cards	30	-	-	-	30
Other contract liabilities	91	36	31	135	293
Maturity of performance obligations	244	36	31	135	446

26. Retirement benefit schemes

Telefonica O2 Holdings Limited 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 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 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 are 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 statement of comprehensive income for the Group’s entire pension schemes are as follows:

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Telefónica UK Pension Plan cost	39	37
Total operating charge	39	37

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 2020 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 £80 million contribution was paid to the defined benefit scheme by the Company during the year ended 31 December 2020 (2019: £25 million).

The amounts included in the consolidated statement of financial position at 31 December 2020 arising from obligations in respect of the defined benefit scheme of the Plan are as follows:

	As at 31 December 2020	As at 31 December 2019
	Funded	Funded
	£m	£m
Fair value of assets	1,813	1,565
- Present value of defined benefit obligations	(1,773)	(1,577)
- Net (obligation)/asset recognised in statement of financial position	40	(12)

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

	Year ended 31 December 2020	Year ended 31 December 2019
	Funded	Funded
	£m	£m
At start of the year	1,577	1,381
Interest cost	32	39

Actuarial loss on demographic assumptions	5	2
Actuarial loss on financial assumptions	227	199
Actuarial gain on expectation adjustments	(26)	(4)
Benefits paid	(42)	(40)
At the end of the year	1,773	1,577

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

	Year ended 31 December 2020	Year ended 31 December 2019
	Funded	Funded
	£m	£m
At start of the year	1,565	1,404
Interest income	32	40
Return on plan assets in excess of interest income	180	138
Company contributions	80	25
Scheme expenses paid	(2)	(2)
Benefits paid	(42)	(40)
At the end of the year	1,813	1,565

The Group expects to contribute £158 million to the defined benefit scheme during the year ended 31 December 2021. The increased payment is in line with the agreed schedule of contributions from the September 2020 actuarial valuation

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

	As at 31 December 2020	As at 31 December 2019
	Funded	Funded
	£m	£m
Return on plan assets in excess of interest income	(181)	(138)
Actuarial loss on demographic assumptions	6	2
Actuarial loss on financial assumptions	229	199
Actuarial gain on experience adjustments	(27)	(4)
Total loss/(gain) recognised in other comprehensive income	27	59

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

			As at 31 December 2020	As at 31 December 2019
- Life expectancy (male currently age 40 / 60) in years			88.1/87.0	88.0/86.8
- Life expectancy (female currently age 40 / 60) in years			90.4/89.2	90.2/88.9
- Nominal rate of increase of pensions in payment (RPI max 5%)			2.75%	2.90%
- Discount rate			1.35%	2.05%
- Inflation assumption				
- - CPI			2.00%	1.95%
- - RPI			2.80%	2.95%

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

At 31 December 2020, the weighted average duration of the defined benefit obligation of the funded plan was 22 years (2019: 22 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:

Change of assumption:	Liabilities increase by:
Decrease discount rate by 0.25%	£104 million
Increase inflation rate by 0.25%	£100 million
Increase life expectancy by 1 year	£64 million

Investment commentary

As at 31 December 2020, 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:

	2020	2019
Equities		
Equity instrument funds	0%	0%
Credit instruments		
AAA rated		3%
AA rated	68%	67%
A rated	5%	8%
BBB and lower	32%	28%
Not rated	20%	25%
Cash/other	10%	10%
Liabilities	(35%)	(41%)

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 Group are exposed in relation to the Plan are:

Longevity risk

The assumptions adopted by the Group 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 Group 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. The Plan hedges a large part of this risk but still has some exposure to changes in yields. 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, creating a 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.

Expected benefit payments from the Plan

	2020 Funded	2020 Unfunded
- Year	Expected benefit payments (£m)	
- 2021	33	-
- 2022	35	-
- 2023	41	-
- 2024	44	-
- 2025	47	-
- Rest of time	3,009	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 £39 million for the year ended 31 December 2020 (2019: £37 million).

27. Deferred taxation

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

	£m
At 1 January 2019	(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)
Prior year credit to statement of comprehensive income	17
Current year charge to statement of comprehensive income	(24)
Current year credit to other comprehensive income	4
Effect of change in tax rate	(5)
At 31 December 2020	(54)

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	Pensions	Property, plant and equipment £m	Intangible assets £m	Intangible assets £m
At 1 January 2019		(33)	(12)	(45)
Prior year credit/(charge) to statement of comprehensive income		Property, plant and equipment	Intangible assets	Total
Current year charge to statement of comprehensive income	-	(6)	(2)	(8)
At 31 December 2019	-	(37)	(15)	(52)
Prior year credit to statement of comprehensive income	-	5	12	17
Current year (charge)/credit to statement of comprehensive income	-	(13)	2	(11)
Effect of change in tax rate	-	(5)	(1)	(6)
Transfer from assets	(6)	-	-	(6)
At 31 December 2020	(6)	(50)	(2)	(58)

Deferred tax assets	Pensions £m	Provisions £m	Total £m
At 1 January 2019	-	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
Current year charge to statement of comprehensive income	(13)	-	(13)
Current year credit to other comprehensive income	4	-	4
Transfer to liabilities	7	-	7
At 31 December 2020	-	4	4

Net deferred tax liability	
At 31 December 2020	(54)
At 31 December 2019	(46)

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase to 25%. As the proposal to increase the rate to 25% 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 £17m, and to increase the deferred tax liability to £71m.

28. Ordinary share capital and capital reserve

		Property, plant and equipment £m	Intangible assets £m	Intangible assets £m
Ordinary share capital and capital reserve	Pensions			
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				
At end of year	40,004,400	8,000,880	40,004,400	8,000,880
	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 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

From 1 January 2019 the Company has recognised right of use assets and lease liabilities in respect of its total future operating lease payments. See Notes 14 and 22 for further information.

Capital commitments

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

Deferred tax assets	Pensions £m	Provisions £m
Contractual commitments placed for expenditure not provided in the accounts:		
- Property, plant and equipment	160	192
- Intangible assets	402	490
- Operating expenditure (excluding operating leases)	1,468	1,579
At 31 December 2019	2,030	2,261

To support the Company's journey to Net Zero, the Company has committed £0.1m in 2021 to ensure 500 cell sites are powered by renewable energy.

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 the Company's financial position.

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:

	2020 £m	2019 £m
Income		
Subsidiaries	257	232
Other group undertakings	37	36
Joint operations/ventures	206	209
Expenses		
Ultimate parent	(27)	(25)
Other group undertakings	(69)	(97)
Joint operations/ventures	(93)	(86)
Dividends		
Parent	549	480

Outstanding balances as at 31 December 2020 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.

All related party transactions relate to regular trading activities of the Company on an arm's length basis.

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

31. Financial instruments and capital 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 2020, if Sterling had strengthened by 5% against the Euro, the recalculated profit before tax would have been £1.5 million higher (2019: £0.6 million). At 31 December 2020, if Sterling had weakened by 5% against the Euro, the recalculated profit before tax would have been £1.6million lower (2019: 0.7 million). At 31 December 2020, if Sterling had strengthened by 5% against the US dollar, the recalculated profit before tax would have been £0.7 million higher (2019: £1.1 million). At 31 December 2020, if Sterling had weakened by 5% against the US dollar, the recalculated profit before tax would have been £0.8 million lower (2019: £1.2 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 2020 and 31 December 2019 as follows:

	Contract assets		Trade receivables	
	31 December 2020 £m	31 December 2019 £m	31 December 2020 £m	31 December 2019 £m
Current amounts	304	285	1,179	1,014
Amounts past due:				
- Less than 90 days	-	-	49	59
- Between 90 and 180 days	-	-	16	23
- Between 180 and 360 days	-	-	5	30
- Over 360 days	-	-	41	55
Loss allowance	(17)	(16)	(171)	(160)
Total	287	269	1,119	1,021

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:

	Contract assets £m	Trade receivables £m
Loss allowance at 1 January 2020	16	160
Increase in loss allowance recognised in profit or loss during the year	2	184
Receivables written off during the year as uncollectable	(1)	(164)
Unused amount reversed	-	(9)
Loss allowance at 31 December 2020	17	171

Trade receivables and contract assets are written off where there is no reasonable expectation of recovery. Impairment losses on trade receivables and contract assets are presented as net impairment losses within operating profit in the statement of comprehensive income. Subsequent recoveries of amounts previously written off are credited against the same line item.

(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:

	As at 31 December 2020		
	Greater than one year	One year or less	Total
	£m	£m	£m
Borrowings	989	19	1,008
Trade and other payables	4	2,168	2,172
Total financial liabilities	993	2,187	3,180

	As at 31 December 2019		
	Greater than one year	One year or less	Total
	£m	£m	£m
Borrowings	997	19	1,016
Trade and other payables	3	2,306	2,309
Total financial liabilities	1,000	2,325	3,325

The following tables set out the maturity analysis of financial assets that are held to manage liquidity risk:

Supplier financing arrangements

The Company utilises a bill of exchange facility offered by Apple through two programme leads, Citi & Macquarie. The objective of the facility is to improve the capital efficiency of the Company and better manage the working capital of inventory by aligning payment terms with similar types of suppliers. Under the facility, the Company extends payment terms on Apple devices, from 30 days to 90 days for a fee. The facility is an important part of the Company's management of working capital. The total size of the facility is £380 million but can be increased if required. On average, £200 million is used on the facility at any point in time. This can fluctuate based on supply, demand, seasonality, device launches, sales and customer demand. Further details about our accounting policy for financial assets can be found on page 69.

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 Group's total capital and gearing is as follows:

	31 December 2020	31 December 2019
	£m	£m
Total borrowings (Note 21)	1,131	966
Less: cash and cash equivalents (Note 20)	(76)	(138)
Net debt	1,055	828
Total equity	2,658	2,649
Total capital	3,713	3,477
Gearing ratio	28%	24%

34.3 Financial assets

The classification of financial assets for the year ended 31 December 2020 is as follows:

	Fair value through profit or loss Held to sell £m	Amortised cost £m	Total carrying amount £m
Trade receivables	-	120	120
Contract assets	-	110	110
Other financial assets	-	63	63
Non-current financial assets	-	293	293
Trade receivables	677	418	418
Contract assets	-	177	177
Other financial assets	-	73	73
Accrued income	-	141	141
Cash and cash equivalents	-	76	76
Current financial assets	677	885	885
Total financial assets	677	1,178	1,178

For the years ended 31 December 2020 and 31 December 2019 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).

The Company undertakes factoring of trade receivables through a scheme provided by HSBC, Bank of America & MUFG. The objective of the scheme is to improve the capital efficiency and working capital management of the Company by monetising handsets sold to customers who have taken out a Refresh CCA by selling the receivable. Under the scheme, the Company is able to bring forward and capitalise on 36 months of customer cash flow. The scheme is an important part of the Company's management of working capital. The balance drawn down on the facility is £720m as at 31 December 2020 (2019: £669m). The total size of the facility is £888m. Further details about our accounting policy for financial assets can be found on page 69.

31.4 Financial liabilities

For the years ended 31 December 2020 and 31 December 2019 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 Telefonica, 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 Telefonica 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 Telefonica 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.

307,259 shares were assigned in the third phase with a fair value of €3.21 per share for the FCF linked options and €1.64 per share for TSR linked options.

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 Telefonica 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 Telefonica 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 Telefonica 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 Telefonica 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.

62,000 shares were assigned in the third phase with a fair value of €3.21 per share for the FCF linked options and €1.64 per share for TSR linked options.

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 Telefonica 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 Telefonica 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.

The total share based payment expense booked to the profit and loss statement is included in Note 8 Key management and Directors' compensation.

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 2020 (31 December 2019 : an accrual was made). Additional disclosures of the matters required by IAS 37 have 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

In January 2021, we announced a new Master Services Agreements for Cornerstone Telecommunications Infrastructure Limited (CTIL), the jointly owned and managed venture between us and Vodafone. The new arrangement will provide operational simplicity and efficiency, in addition it will enable CTIL to generate revenue by offering space on infrastructure to third parties.

In March 2021 we announced an investment of £448m in Ofcom's spectrum auction to secure the right spectrum for our business needs. We obtained 8 x 3.6 GHz lots and 2 x 700 MHz paired frequency lots. This 35. Subsequent events (continued) additional spectrum will allow for further coverage and capacity improvements in our network, demonstrating our continued commitment to the UK Market and the very best connectivity for our customers.

On 8 April 2021 Telefonica SA and Liberty Global announced the appointment of Lutz Schüler as CEO and Patricia Cobian as CFO of the proposed joint venture company if approved by the Regulatory authorities. Consequently, Mark Evans will step down as CEO of the Telefonica UK Group upon the completion of the proposed joint venture arrangement.

On 14 April 2021 the Competition and Markets Authority made an announcement that it has provisionally cleared the proposed merger of Virgin Media, and Virgin Mobile with O2.

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 Vía 28, Madrid, Spain.