

Registered Number: 02604354

O2 Holdings Limited

Annual Report and Financial Statements

31 December 2016



O2 Holdings Limited

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COMPANY INFORMATION

Directors

Robert Harwood

Mark Hardman

Secretary

O2 Secretaries Limited

Registered office

260 Bath Road

Slough

Berkshire

SL1 4DX

UK

Auditor

Ernst & Young LLP

Apex Plaza

Forbury Road

Reading

RG1 1YE

O2 Holdings Limited

STRATEGIC REPORT

Strategy

O2 Holdings Limited is an intermediate holding company within the Telefónica Group. The Company's strategy is integral to that of its principal subsidiary, Telefonica UK Limited (Telefonica UK) which trades under the brand O2 ("O2") and pursues a customer-led, mobile-first strategy focused on delivering an excellent customer experience and helping customers get the most out of mobile connectivity.

The customer-led, mobile-first strategy focuses entirely on customer needs, using mobile technologies as the key enabler. Telefonica UK aspires to deliver an excellent and differentiated customer experience through a customer centric approach. Telefonica UK has built a proven track record of innovation since its inception and has been leading the market through innovations such as O2 Refresh and Business Essentials. Telefonica UK has implemented best-in-class distribution channel capabilities allowing customers to interact across online, voice and stores and also built an award-winning customer service that ensures outstanding customer satisfaction. Furthermore, Telefonica UK delivers unique experiences that matter for its customers through its market leading loyalty programme Priority and sponsorships, underpinned by its strong and trusted 'O2' brand.

Telefonica UK offers a full range of mobile services and products to consumer and business customers, including mobile voice, messaging and data services and sales of handsets and other hardware. In addition, Telefonica UK offers a wide range of value-added services and products including Wi-Fi services, security services, cloud services, digital payment services, certain fixed-line services for businesses and insurance products for handsets and automobiles. Telefonica UK has continued to develop innovative value-added services and products, including services and products relating to the internet of things, big-data & insights, advertising and digital identity & authentication services for businesses.

Other offerings seek to access additional customer groups through wholly owned digital brands, giffgaff, which aims to provide innovative and flexible mobile service solutions to the tech-savvy and self-service consumer segments and Weve which provides market-leading mobile media, consultancy, data analytics, and technology services.

In accordance with Section 400 of the Companies Act 2006 the Company is exempt from producing consolidated financial statements by virtue of being a wholly owned subsidiary of Telefónica SA, the ultimate holding company incorporated in Spain which consolidates the Company and its subsidiary undertakings. The Directors have accordingly prepared individual financial statements.

Performance and development

The operating loss for the Company in the year to 31 December 2016 was £235 million (2015: £9,791 million operating loss). During 2016 the company was not involved in any active trading.

The Company generated a profit before tax of £290 million in 2016 in comparison to a profit before tax of £12,551 million in the prior year. This profit before tax has been driven by the impairment charge of £240 million (2015: £9,778million) and the dividend income received from subsidiaries of £525million for the year ended 31 December 2016 (2015: £22,345million).

The net assets of the Company as at 31 December 2016 were £9,349 million (2015: £9,530 million). The increase is due to net profit after tax generated during the year (£344 million), partly offset by the dividend paid during the year (£525 million).

Given that the Company operates as a holding company, the performance of the Company is integral to the performance of its principal trading subsidiaries and the Directors are of the opinion that analysis using key performance indicators is not necessary for understanding the Company's business itself.

Detail about the operating performance of the Company's main subsidiary, Telefónica UK Limited, can be obtained from that company's statutory accounts and from the financial results releases of the Company's ultimate shareholder, Telefónica, S.A.

Principal risks and uncertainties

The Directors have satisfied themselves that it is not essential for the Company to have a separate risk management system since the Company's risks and uncertainties are integral to the principal risks and uncertainties of its key subsidiaries as listed in note 21.

Telefonica UK has a comprehensive risk management framework in place, which is aligned with best practice in Internal Control (COSO1 II Report and ISO31000:2009 Principles and Guidelines for Risk

STRATEGIC REPORT (continued)

Management). This framework also applies across its subsidiary companies. The framework is designed to identify, assess, manage, monitor and mitigate significant risks that could adversely affect the future success of the key subsidiaries through a well-established network of risk champions. The framework gives the respective Boards a high awareness of key risks and the capacity to assign the most effective resources at the optimal moment to control and respond to the risks and opportunities identified.

Topical risk workshops and fora are held regularly in order to discuss and evaluate key emerging and horizon risks to the key subsidiaries such as climate change and the environment, data fraud and the withdrawal of the UK from the European Union ('Brexit'). However the key subsidiaries most significant risks and uncertainties are as follows:

| Risk | Mitigation |
|---|--|
| Data Privacy | |
| <p>Telefonica UK and its subsidiaries have an obligation to manage their customer's data sensitively and within the relevant permissions, making it very clear and transparent to customers how their private data is being used and shared.</p> | <p>Telefonica UK has a Digital Confidence programme in place to address this risk. Each operating division has been asked to review their current products and services for compliance with internally set Data Governance on Customer Data Principles and permissions. The programme also reviews compliance against the EU General Data Protection Regulation, which came in to law in April 2016.</p> |
| <p>In the event that the key subsidiaries shared customer data without permission or where that permission had not been clearly understood, they would be at risk of fines, loss of reputation, loss of customer and employee trust, increased churn and loss of revenue.</p> | |
| Breach of Data Security | |
| <p>Due to the way in which data is electronically stored and transmitted, there is a risk that a breach of security could occur and lead to the accidental or unlawful destruction, loss, alteration, unauthorised disclosure of, or access to that data. This could result in fines, loss of reputation, loss of customer and employee trust, increased churn and loss of revenue.</p> | <p>A review has been carried out to identify the principal areas where data breaches could occur and mitigating controls are in place where relevant.</p> |
| Network Spectrum/Capacity | |
| <p>The key subsidiaries' mobile operations rely on the availability of spectrum and following the 2013 Spectrum auction, Telefonica UK has the lowest amount of spectrum per customer, aligned with a data growth rate of 100% year on year. To redress this, Telefonica UK needs to successfully acquire additional capacity in an upcoming auction.</p> | <p>Telefonica UK is preparing for the upcoming spectrum auction and has also taken learnings from around the World in alternative radio technology and infrastructure.</p> |

STRATEGIC REPORT (continued)

Risk

Mitigation

Network Coverage

Telefonica UK has an obligation in its 800MHz spectrum license to provide indoor coverage to 98% of the UK population (and 95% of the populations of each of England, Wales, Scotland and Northern Ireland) and an obligation in its 900/1800MHz spectrum licence to provide voice and text services to 90% of the UK landmass, both by the end of 2017, to be maintained, thereafter. Inherent with these obligations is a risk of Telefonica UK not meeting the required targets.

Telefonica UK is actively working towards mitigating the risk through the increased investment of capital expenditure in an infrastructure improvement programme, upgrading its 2G and 3G Networks and continued roll-out of our 4G Network.

Fraud Management

Fraudulent activity by customers, suppliers, and sales channels may lead to the key subsidiaries suffering financial loss due to being unable to recover revenue from products and services already provided. Examples could include identity fraud, card payment fraud and the fraudulent takeover of genuine customer accounts.

The key subsidiaries remain ever-vigilant to the constantly changing threat environment and numerous defences are in place to defend their products and services, including dynamic and technological security solutions.

Child Protection

The key subsidiaries provide mobile and online services and due to the ever-increasing penetration of WiFi and Smartphone use amongst young people there is a risk of corporate reputation and brand damage or regulatory intervention flowing from a failure to protect children from inappropriate content, contact or conduct.

The key subsidiaries have a robust network of 'SHIELD' controls in place to protect young people on our network from inappropriate content and contact. Telefonica UK also works with the NSPCC to raise awareness of online safety and share advice with parents and children.

Cyber Security Threat

The key subsidiaries provide consumer facing services through the internet via their online estate. Consequently, the key subsidiaries must ensure that the estate is maintained to an acceptable and secure level so that customers are protected when using its services.

The key subsidiaries are engaged in reviewing the front facing domains and have identified a number of items as needing redress to ensure provision of the best possible security against the physical estate. Mitigation elements are being introduced across systems gradually and the risk value will be reviewed at each significant step.

Significant event

On March 24, 2015, Telefónica, S.A. ("Telefónica") reached an agreement with Hutchison Whampoa Group for the acquisition of Telefónica's operations in the UK (the "Proposed Transaction").

On May 11, 2016 the European Commission made public its decision to prohibit the Proposed Transaction. Following this decision, the Board of Directors of Telefónica at its meeting on June 29, 2016 agreed that Telefónica will continue to explore different strategic alternatives for its UK operations, to be implemented when market conditions are deemed appropriate.

O2 Holdings Limited

STRATEGIC REPORT (continued)

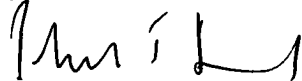
Subsequent events

On 23 February 2017, Telefonica UK Limited (O2), announced that it had signed a new agreement with Anschutz Entertainment Group (AEG) for a further ten years securing the naming rights for the world's most successful music and entertainment venue, The O2 (the "Partnership"). The Partnership reaffirms O2's commitment to its customers to provide countless benefits through Priority and unforgettable live experiences.

Approval

The Strategic Report was approved by the Board on 27 September 2017.

By Order of the Board



Robert Harwood

For and on behalf of O2 Secretaries Limited

Company Secretary

O2 Holdings Limited

DIRECTORS' REPORT

Legal form

O2 Holdings Limited (the "Company") is a private limited company registered in England and Wales under the number 2604354. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX. The immediate parent is Telefónica Europe plc and the ultimate parent is Telefónica, S.A., a company incorporated in Spain. Reference to Group means the Company and its subsidiaries.

Directors

The Directors who held office during the year and currently are as follows:

Robert Harwood

Graham Crichton (resigned on 1 of August 2016)

Enrique Medina Malo (resigned on 30 September 2016)

Mark Hardman (appointed on 1 of August 2016)

O2 Secretaries Limited served as secretary throughout the year.

Directors' liability insurance and indemnities

Telefónica Europe plc, the Company's immediate parent company, has granted an indemnity in the form permitted by UK Company Law to Directors appointed to subsidiary companies. This indemnity remains in place and continues until such time as any relevant limitation periods for bringing claims (as defined in the indemnity) against the Director has expired, or for so long as the past Director, where relevant, remains liable for any losses (as defined in the indemnity).

Dividends

During the year ended 31 December 2016 the Directors paid interim dividends totalling £525 million (2015: £6,060 million).

Political contributions

The Company made no political contributions during the year (2015: £nil).

Employees

The Directors believe that diversity of thinking is critical to a successful consumer business, as the Group aims to understand the points of view and needs of its more than 25 million customers.

The Group is committed to employment policies that follow good practice based on equal opportunities for all, and recognise diversity, including fair treatment of people with disabilities in relation to their recruitment, training and development.

The Group also invests in researching age, gender and disability diversity across the organisation, seeking to support all employees and their career development at every level.

The Group supports the health and wellbeing of its employees and, specifically, is committed to making improvements to the issue of mental health in the workplace as well as providing a range of occupational health and employee support services to employees.

To support employees the Group is a member of the Business Disability Forum which provides pragmatic support by sharing expertise, giving advice, providing training and facilitating networking opportunities. This helps organisations become fully accessible to disabled customers and employees.

The Group's policies on *Diversity & Inclusion* and *Reasonable Adjustments* detail the importance placed on providing an inclusive workplace for all, including disabled employees.

DIRECTORS' REPORT (continued)

The policies provide guidance for line managers and employees about recruitment processes and additional arrangements which can be made for any disability. They cover matters such as:

- Increasing the accessibility of our services to make them more inclusive for disabled people;
- Encouraging diversity and ensuring that discrimination does not occur;
- Encouraging a focus on what people can do rather than what they cannot and challenging stereotypes about people with disabilities; and
- Making e-learning available to all employees to highlight the legal and behavioural aspects of Diversity and Inclusion.

Employee engagement

The Group's employees are key to its business and culture. The Group aims to achieve high levels of employee engagement in order to achieve high levels of performance. The Group aims to do this in the following ways:

Engagement: the Group has a wide range of communication channels with employees, including face-to-face meetings, team briefings, digital live streaming conferences, interactive microsites and a comprehensive intranet with tailored content dependent on employee segmentation. The Group aims to ensure employees understand the Group's objectives and its operational and financial performance as well as its latest products and services. The Group conducts a biannual engagement survey, in which the Directors believe the Group consistently scores above average in comparison to other comparable UK organisations. The Group aims to maintain a constructive dialogue with unions, employee representative bodies and works councils.

Employee development: the Group is committed to the development of all employees and actively promotes this through learning and development initiatives including the provision of digital learning. The Group aims to maintain robust succession plans for senior roles and invests in developing high-potential leaders through tailored development programmes to improve stability in its leadership population. Employees are encouraged and supported in maintaining personal development plans.

Diversity: the Directors believe that diversity of thinking is critical to a successful consumer business, as the Group aims to understand the points of view and needs of its more than 25 million customers. The Group is committed to employment policies that follow good practice based on equal opportunities for all, and recognise diversity, including fair treatment of people with disabilities in relation to their recruitment, training and development. The Group has also invested in researching age, gender and disability diversity across the organisation, seeking to support all employees and their career development at every level of the organisation. The Group supports the health and wellbeing of its employees and, specifically, is committed to making improvements to the issue of mental health in the workplace as well as providing a range of occupational health and employee support services to employees.

Incentives: the Group aims to create a high performing culture by targeting and rewarding employees based on both personal and company performance, through annual bonuses and financial incentives for the Group reaching specific targets.

Financial risk management objectives, policies and exposure

Details of the Group's approach to financial risk management are set out in the financial statements in note 22 "Financial instruments".

Going concern

The Company's business activity is to act as an intermediate holding company within the Telefónica Group. The financial position of the Company is described above. In addition, notes 19 and 22 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk, liquidity risk and interest rate risk. The Directors believe that the Company is well placed to manage its business risk successfully despite the current uncertain economic outlook.

DIRECTORS' REPORT (continued)

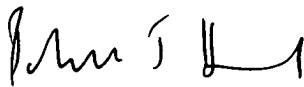
The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Statement as to disclosure to auditor

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

The Directors' Report was approved by the Board on 27 September 2017.

By Order of the Board:



Robert Harwood
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 regulations.

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

In preparing the Company financial statements, the directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF O2 HOLDINGS LIMITED

We have audited the financial statements of O2 Holdings Limited for the year ended 31 December 2016 which comprise the Statement of Financial Position, the Statement of Comprehensive Income, the Statement of Cash Flow, the Statements of Changes in Equity and the related notes 1 to 25. The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page eleven, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31st December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial reporting Standards (IFRSs) as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF O2 HOLDINGS LIMITED (continued)

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report and the directors' report.

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- 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
- the Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or

ERNST & YOUNG LLP

Marcus Butler (Senior Statutory Auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor

Reading

Date 28/09/17

O2 Holdings Limited
Statement of comprehensive income
Year ended 31 December 2016

| | Note | 2016 £m | 2015 £m |
|---|----------|--------------|----------------|
| Other operating income | | 25 | 27 |
| Personnel expenses | 24 | (4) | (10) |
| Other operating expenses | | (16) | (30) |
| Impairment of investment in subsidiaries | 4 | (240) | (9,778) |
| Operating loss before depreciation and amortisation | | (235) | (9,791) |
| Depreciation and amortisation | 4 | - | (2) |
| Operating loss | 4 | (235) | (9,793) |
| Dividend income | 5 | 525 | 22,345 |
| Financial income | 5 | 4 | - |
| Financial expense | 5 | (4) | (1) |
| Profit before taxation from continuing operations | | 290 | 12,551 |
| Taxation income/(expense) | 6 | 55 | (27) |
| Profit for the year from continuing operations | | 345 | 12,524 |
| Profit for the year attributable to equity holders of the parent | | 345 | 12,524 |
| Other comprehensive loss: | | | |
| <u>Items that will not be reclassified subsequently to profit and loss</u> | | | |
| Actuarial loss on pensions | 17 | (1) | - |
| Other comprehensive loss for the period, net of tax | | (1) | - |
| Total comprehensive income for the year attributable to equity holders | | 344 | 12,524 |

The accompanying notes are an integral part of these financial statements.

There are no other gains or losses apart from the ones recognised above.

O2 Holdings Limited
Statement of financial position
As at 31 December 2016

| | Note | 2016 £m | 2015 £m |
|--|------|--------------|--------------|
| Non-current assets | | | |
| Investments in subsidiary undertakings | 7 | 9,171 | 9,411 |
| Property, plant and equipment | 9 | - | - |
| Intangible assets | 10 | - | 1 |
| Deferred tax assets | 18 | 1 | 2 |
| | | <u>9,172</u> | <u>9,414</u> |
| Current assets | | | |
| Trade and other receivables | 11 | 272 | 247 |
| Other financial assets | 12 | 241 | 241 |
| Cash and cash equivalents | 14 | 38 | 43 |
| | | <u>551</u> | <u>531</u> |
| Current liabilities | | | |
| Trade and other payables | 16 | (363) | (405) |
| Borrowings | 15 | (7) | (7) |
| | | <u>(370)</u> | <u>(412)</u> |
| Net current assets | | <u>181</u> | <u>119</u> |
| Total assets less current liabilities | | <u>9,353</u> | <u>9,533</u> |
| Non-current liabilities | | | |
| Retirement benefit liability | 17 | (4) | (3) |
| | | <u>(4)</u> | <u>(3)</u> |
| Net assets | | <u>9,349</u> | <u>9,530</u> |
| Equity | | | |
| Share capital | 19 | 12 | 12 |
| Retained earnings | | 9,337 | 9,518 |
| Total equity attributable to equity holders | | <u>9,349</u> | <u>9,530</u> |

The accompanying notes are an integral part of these financial statements.

The prior year comparatives have been restated following the review of the balances. Refer to Note 1 to the Financial Statements for further details.

These financial statements were approved by the Board of Directors and authorised for issue on 27 September 2017. They were signed on its behalf by:



Mark Hardman
Director

O2 Holdings Limited
Statement of changes in equity
As at 31 December 2016

| | Note | Share capital (note 19) £m | Retained earnings £m | Total equity £m |
|---|------|----------------------------------|----------------------------|-----------------------|
| At 1 January 2015 | | 12 | 3,054 | 3,066 |
| Dividends paid | 8 | - | (6,060) | (6,060) |
| Total comprehensive income for the year | | - | 12,524 | 12,524 |
| At 31 December 2015 | | 12 | 9,518 | 9,530 |
| Profit for the period | | - | 345 | 345 |
| Other comprehensive loss | | - | (1) | (1) |
| Total comprehensive income for the year | | - | 344 | 344 |
| Dividends paid | 8 | - | (525) | (525) |
| At 31 December 2016 | | 12 | 9,337 | 9,349 |

The accompanying notes are an integral part of these financial statements.

The prior year comparatives have been restated following the review of the balances. Refer to Note 1 to the Financial Statements for further details.

O2 Holdings Limited
Statement of cash flows
As at 31 December 2016

| | Note | 2016 £m | 2015 £m |
|---|-------------|--------------------|--------------------|
| Net cash (used in) from operating activities | 13 | (5) | 966 |
| Acquisition of subsidiaries | 7 | - | (9,013) |
| Proceeds from disposal of subsidiaries | 7 | - | 169 |
| Dividends received | 5 | 525 | 22,345 |
| Net cash inflow from investing activities | | 525 | 13,501 |
| Repayment of borrowings | | - | (8,400) |
| Dividends paid | 8 | (525) | (6,060) |
| Net cash outflow from financing activities | | (525) | (14,460) |
| Net (decrease) increase in cash and cash equivalents | | (5) | 7 |
| Cash and cash equivalents at beginning of year | | 43 | 36 |
| Cash and cash equivalents at end of year | 14 | 38 | 43 |

The accompanying notes are an integral part of these financial statements.

O2 Holdings Limited

Notes to the financial statements

For the year ended 31 December 2016

1. General information

O2 Holdings Limited (the "Company") is a private limited company registered in England and Wales under the number 2604354. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX. The immediate parent is Telefónica Europe plc and the ultimate parent is Telefónica, S.A., a company incorporated in Spain.

The Company financial statements are presented in pounds of sterling, which is also the functional currency, as this is the currency of the primary economic environment in which the Company operates.

2. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations, as adopted for use in the EU. In addition the financial statements have been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared using historical cost principles except that, as disclosed in the accounting policies below, certain items are measured at fair value.

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.

Under the provisions of section 400 of the Companies Act 2006, the company is exempt from preparing consolidated financial statements by virtue of the fact that the company is a subsidiary of Telefónica, S.A Group which prepares group financial statements. These financial statements therefore present information about the company as an individual undertaking and not as a group.

The Directors have received the commitment from the parent company to continue providing financial support and have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future, and, thus, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

3. Accounting policies

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.

Foreign currencies

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 period. Non-monetary assets and liabilities denominated in foreign currency are translated at the foreign currency exchange rate ruling at the dates the non-monetary assets and liabilities are recognised. Exchange differences arising on the translation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the translation of non-monetary items in respect of which gains and losses are recognised directly in equity.

Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation and any accumulated impairment losses, where applicable. The cost of property, plant and equipment includes directly attributable incremental costs incurred in its acquisition and installation, and also the initial estimate of costs of dismantling, removing the item and restoring the site on which it is located. Subsequent costs are included in the assets' carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. Interest and other financial expenses incurred and directly attributable to the acquisition or construction of qualifying assets are capitalised.

O2 Holdings Limited

Notes to the financial statements (continued)

3. Accounting policies (continued)

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:

| | |
|---------------------|--------------|
| Computers equipment | 2 to 6 years |
|---------------------|--------------|

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

Other intangible assets

Software

Software is capitalised and measured at the cost incurred to acquire and bring into use the specific software. These costs are amortised over their estimated useful lives of between 2 and 6 years on a straight line basis. Costs that are directly associated with the production of identifiable unique software products controlled by the Company, which are expected to generate economic benefits over a period of more than one year, are recognised as intangible assets. Computer software development costs recognised as intangible assets are amortised over their estimated useful lives not exceeding 6 years on a straight line basis.

Pension obligations

Telefonica Europe Plc, immediate parent company of O2 Holdings Limited, operates both defined benefit and defined contribution plans. A defined benefit plan is a pension plan that sets the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the Company pays fixed contributions on behalf of employees and under which there is no legal or constructive obligation to pay further contributions for employees' service in the current and prior periods.

The Company participates in the Telefónica UK Pension Plan ("Plan"), a scheme sponsored by Telefónica Europe plc that provides benefits for the majority of UK employees in the Telefónica Europe plc Group. During the period presented, the Plan had the following defined benefit and defined contribution schemes:

- 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

On 28 February 2013 the defined benefit scheme of the Plan closed to further benefit accrual. Member benefits of the defined benefit scheme of the Plan will continue to be increased in deferment by reference to the Consumer Prices Index (see note 17), 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 accrual. The assets of the Plan are held independently of the Company's finances.

In its capacity as a participating employer in the defined contribution scheme of the Plan, the Company pays contributions into the Plan on behalf of the employees. The Company has no further obligations once the contributions have been paid. The contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

As the sponsoring employer is Telefónica Europe plc, the funded defined benefit liability or asset of the Plan is not recognised on the statement of financial position of the Company. The unfunded defined benefit scheme is exclusively related to the Company and is therefore recognised in the statement of financial position. The asset or liability recognised in the statement of financial position in respect of defined benefit pension plan is the present value of the defined benefit obligation at the statement of financial position date less the fair value of the plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Accordingly all actuarial gains and losses are recognised in the statement of comprehensive income and expense in the period in which they arise.

O2 Holdings Limited

Notes to the financial statements (continued)

3. Accounting policies (continued)

Financial income and expense

Financial income principally consists of interest income on Company deposits and gains arising from foreign exchange rate hedging instruments. Financial expense principally consists of interest expense on Company borrowings 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. Increases or decreases in the value of the hedges are reported as income or expense in net financial income/expense. Hedge accounting is not applied.

Taxation

The charge for current tax is based on the results for the year 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 and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax and current tax are 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.

Cash and cash equivalents

Cash and cash equivalents are carried in the statement of financial position at cost. Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

Trade and other receivables

Trade and other receivables are carried at original invoice amount less provision for doubtful debts. A provision for doubtful debts is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Provisions are made based on an analysis of balances by age, previous losses experienced, disputes and ability to pay. The amount of the provision is the difference between the carrying amount and the present value of estimated future cash flows. Changes in the provision against receivables are recognised in the statement of comprehensive income within other operating expenses.

Other financial assets

Other financial assets are carried in the statement of financial position at amortised cost. Other financial assets pertains to loans to related parties that are considered to be non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are not considered highly liquid investments and are not held for the purpose of meeting the Group's short-term cash commitments.

Trade and other payables

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

Borrowings

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

O2 Holdings Limited

Notes to the financial statements (continued)

3. Accounting policies (continued)

Dividends

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 shareholders.

Income is recognised when the company's rights to receive the payment is established. Dividends received from subsidiary companies are recognised as finance income in the Company's financial statements in the period in which the dividends are received.

New standards and IFRIC interpretations not applied

The following IFRS and IFRIC interpretations, which may have an impact on the Company's financial information, have been issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee (IFRIC). The Company intends to adopt these standards and interpretations when they become effective:

| IAS/IFRS standards | Effective for accounting periods beginning on or after |
|---|--|
| Amendments to IAS 12 (January 2016) <i>Recognition of Deferred Tax Assets for Unrealised Losses</i> | 1 January 2017 ¹ |
| Amendment to IAS 7 <i>Disclosure Initiative</i> | 1 January 2017 ¹ |
| Annual Improvements to IFRSs: 2014-16 Cycle (Dec 2016) | See below ³ |
| IFRS 9 <i>Financial Instruments</i> | 1 January 2018 |
| IFRS 15 <i>Revenues from Contracts with Customers</i> | 1 January 2018 |
| Clarifications to IFRS 15 (Apr 2016) <i>Clarifications to IFRS 15 Revenue from Contracts with Customers</i> | 1 January 2018 ¹ |
| Amendments to IAS 40 (Dec 2016) <i>Transfers of Investment Property</i> | 1 January 2018 ¹ |
| IFRIC 22 <i>Foreign Currency Transactions and Advance Consideration</i> | 1 January 2018 ¹ |
| Amendments to IFRS 4 (Sept 2016) <i>Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts</i> | 1 January 2018 ¹ |
| Amendments to IFRS 2 (Jun 16) <i>Classification and Measurement of Share-based Payment Transactions</i> | 1 January 2018 ¹ |
| IFRS 16 <i>Leases</i> | 1 January 2019 ¹ |
| Amendments to IFRS 10 and IAS 28 (September 2014) <i>Sales or Contribution of Assets between an Investor and its Associate or Joint Venture</i> | See below ² |

¹ The mandatory adoption under EU applying regulations has not yet been confirmed.

² The IASB has acknowledged a conflict between these amendments and IAS 28 Investments in Associates and Joint Ventures. In December 2015 the IASB published an amendment to IFRS 10 and IAS 28, deferring the effective date of these amendments indefinitely.

³ Amendments to IFRS 12 are effective for periods commencing on or after 1 January 2017. Amendments to IFRS 1 and IAS 28 are effective for periods commencing on or after 1 January 2018.

The Company does not anticipate the adoption of these other standards will have a material impact on the Company's accounts in the period of initial application other than the following:

IFRS 9 may impact the measurement and disclosure of the Company's financial instruments.

IFRS 15 will not impact the Company as it does not trade.

IFRS 16 will not impact the Company as it does not have any operating leases.

O2 Holdings Limited

Notes to the financial statements (continued)

3. Accounting policies (continued)

Adoption of new and revised standards

The accounting policies adopted are consistent with those of the previous financial year except for a number of new and revised Standards and Interpretations which have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported.

Critical 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 significant 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.

Impairment of investments

An impairment exists when the carrying value of an investment exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from forecasts. The recoverable amount is most sensitive to the discount rate used in the discounted cash flow model as well as the expected cash inflows and the growth rate used for extrapolation purposes.

Restatements

Certain amounts in 2015 financial statements have been reclassified to conform to the current period presentation. This relates to the following:

1. Reclassification Trade and other payables amounting to £169m to Trade and other receivables to present intercompany balances relating to group tax relief on a gross basis rather than presenting on a net basis; and
2. Presentation of short-term loans amounting to £241m as a separate financial line item which was previously presented under Trade and Other Receivables.

The Company has also corrected its note disclosure on the investment in subsidiary undertakings to present the disposal of investments at gross basis rather than at net book value. Gross cost and provision for impairment at January 1, 2015 have been reduced by £2,015m to remove amounts not pertaining to investments of the Company. Gross cost and provision for impairment relating to disposals in 2015 have been increased by £4,335m to present disposals of fully provisioned investments on a gross basis rather than net basis.

The above reclassifications and restatements have no impact on the 'Total assets less current liabilities' line as well as 'Net Assets' and 'Total equity attributable to equity holders' lines within the Statement of Financial position. There is also no impact in the Profit after tax in the Statement of Comprehensive Income and on net cash from operating activities within the Statement of Cash Flows.

The Company has also restated its 2015 Trade and other payables and Retained Earnings to derecognize £25m liabilities that is no longer expected to be realized. This restatement has as an impact to Trade and other payables as well as Equity within the Statement of Financial Position. There are no impact in the Profit after tax in the Statement of Comprehensive Income.

O2 Holdings Limited
Notes to the financial statements (continued)

4. Operating profit/(loss)

Company operating profit/ (loss) from continuing activities is stated after charging/(crediting):

| | Note | 2016 £m | 2015 £m |
|---|-------------|--------------------|--------------------|
| Total depreciation and amortisation | 9, 10 | - | 2 |
| Management charges to Group undertakings | | (17) | (27) |
| Employee benefit expense | 24 | 4 | 10 |
| Loss on disposal of financial investments | | - | 17 |
| Impairment of investments | 7 | 240 | 9,778 |
| | | <u>240</u> | <u>9,778</u> |

Management charges to Group undertakings represent recharges for services provided to other companies within the Group. A. Further details of intercompany loans and trading balances are included within note 20.

5. Investment income and finance cost

| | 2016 £m | 2015 £m |
|--------------------------------------|--------------------|--------------------|
| Dividends received from subsidiaries | 525 | 22,345 |
| Foreign exchange gains | 4 | - |
| Investment income | <u>529</u> | <u>22,345</u> |
| Foreign exchange losses | (4) | (1) |
| Finance costs | <u>(4)</u> | <u>(1)</u> |
| Net finance income | <u>525</u> | <u>22,344</u> |

O2 Holdings Limited

Notes to the financial statements (continued)

6. Taxation

The analysis of the (credit)/charge for the year is as follows:

| | 2016 £m | 2015 £m |
|--|-------------|------------|
| Current tax - UK tax | 4 | 1 |
| Current tax - adjustments in respect of prior periods | (60) | 25 |
| Deferred tax - origination and reversal of temporary differences | 1 | 1 |
| Taxation (credit)/charge for the year | (55) | 27 |

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

| | 2016 £m | 2015 £m |
|---|-------------|---------------|
| Profit before tax from continuing operations | 290 | 12,551 |
| Profit before taxation | 290 | 12,551 |
| Profit on ordinary activities multiplied by the rate of UK corporation tax of 20% (2015: 20.25%) | 58 | 2,542 |
| Adjustments to tax in respect of prior periods | (60) | 25 |
| Expenses not deductible for tax purposes | 51 | 1,985 |
| UK – UK transfer pricing adjustment | 1 | - |
| Income not taxable for tax purposes | (105) | (4,525) |
| Taxation— total (credit)/charge for the year | (55) | 27 |

Finance Act 2013 provided that the main rate of corporation tax would be reduced to 21% with effect from 1 April 2014, with a further reduction to 20%, effective from 1 April 2015. The tax disclosure has been adjusted to reflect this, though the enactment had no significant impact on the Company's financial statements.

Finance Act 2016 provides that the rate of corporation tax from 1 April 2017 will be 19%. On 15 September 2016 the UK Government enacted legislation to further reduce the main rate of UK corporation tax from 18% to 17% with effect from 1 April 2020. The enactment of this Act had no impact on these financial statements.

O2 Holdings Limited

Notes to the financial statements (continued)

7. Investments in subsidiary undertakings

| | £m |
|---|----------------|
| Cost | |
| At 1 January 2015 | 12,378 |
| Additions | 9,013 |
| Disposals | (4,504) |
| At 31 December 2015 and at 31 December 2016 | <u>16,887</u> |
| Provision for impairment | |
| At 1 January 2015 | (2,031) |
| Impairment | (9,778) |
| Disposals | 4,333 |
| At 31 December 2015 | (7,476) |
| Impairment | (240) |
| At 31 December 2016 | <u>(7,716)</u> |
| Net book value | |
| At 31 December 2016 | <u>9,171</u> |
| At 31 December 2015 | <u>9,411</u> |
| At 31 December 2014 | <u>10,347</u> |

For the year ended 31 December 2016 the Company has not acquired any entities (2015: £9,013 million comprising a cash consideration of £9,013 million in relation to the acquisition of Telefónica UK Limited from O2 Networks Limited and the acquisition of Cellular Radio Limited from O2 Networks Limited and O2 Cedar Limited at £nil consideration).

Investments in subsidiary undertakings is tested for impairment annually or more frequently if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable. The potential impairment loss is determined by assessing the recoverable amount of the investments in subsidiary undertakings. If this recoverable amount is less than the carrying amount, an impairment loss is recognised.

In the year ended 31 December 2016 the Company recognised an impairment loss in relation to its investments in Telefonica UK Limited and O2 Networks of £240 million (2015: £9,778 million in relation to investments in O2 Networks Limited and O2 Investments Ireland; the Company had also acquired the entire shareholding of O2 Cedar Limited from subsidiary companies). The recoverable amount, being the value in use of the investments in Telefónica UK Limited and O2 Networks Limited, is £9,171 million (2015: £9,411 million).

The recoverable amount of the investments in subsidiary undertakings has been determined based on a value in use calculation using cash flow projections from financial budgets covering a five-year period. The impairment loss was determined by performing a value in use assessment of its principal trading subsidiaries, applying a pre-tax discount rate of 8% (2015: 7%) and a perpetuity growth rate of 1% (2015: 1%) to its trading forecasts.

Main assumptions used in calculating value in use

Value in use is calculated based on the approved business plan and taking into account certain variables such as operating profit before depreciation and amortisation (OIBDA) margin, capital expenditure (CAPEX) ratio for non-current assets, expressed as a percentage of revenue, and discount and perpetuity growth rates.

OIBDA margin and long-term CAPEX

The OIBDA margin and long-term CAPEX ratio used to calculate terminal value, expressed as a percentage of revenue, are based on the business plan approved for the investment, as well as external estimates of trends in operating indicators, and the outlook for the various businesses and markets.

Discount rate

The discount rate used by management, applied to measure free cash flow, is the weighted average cost of capital (WACC), determined by the weighted average cost of equity and debt according to the finance structure established for each investment.

Perpetuity growth rate

Cash flow projections to the end of the asset's useful life are estimated using a rate of growth for the future years.

O2 Holdings Limited

Notes to the financial statements (continued)

7. Investments in subsidiary undertakings (continued)

Terminal value is calculated from the projected cash flows in the period, taking as the perpetuity growth rate consensus estimates among analysts for the business and the country based on the maturity of the industry depending on technology and the degree of development. Each indicator is compared to the forecasted long-term GDP growth adjusted for any specific characteristics of the business.

Sensitivity to changes in assumptions

The Group carries out its sensitivity analysis of the impairment test by considering reasonable changes in the main assumptions used in calculating value in use assuming the following increases or decreases in the assumptions, expressed in percentage points.

Key DCF assumption sensitivity analysis and impact:

| | | |
|---------------------------|-------------------------------------|-------------------------------------|
| Discount rate | -1.0 p.p - no impairment | + 1.0 p.p - increased impairment |
| Perpetuity growth rates | -0.5 p.p - increased impairment | + 0.5 p.p – reduction in impairment |
| OIBDA margin | -0.25 p.p - increased impairment | +0.25 p.p - reduction in impairment |
| Ratio of CAPEX / revenues | -0.25 p.p - reduction in impairment | +0.25 p.p - increased impairment |

During the year ended 31 December 2015 the Company transferred its entire shareholdings in O2 International Holdings Limited and Kilmaine Limited to O2 Europe Limited for a cash consideration of £169 million. The Company also transferred the ownership of O2 Oak Limited (formerly TU Products Limited), O2 Credit Vouchers Limited, Movistar Limited, Telefónica O2 UK Limited, O2 Pine Limited, O2 Communications (Ireland), O2 Investments Ireland, O2 Mobiles Limited, and its membership interest in O2 Willow Limited.

Details of the Company's subsidiaries are provided in note 21.

8. Dividends paid

| | 2016 £m | 2015 £m |
|--|------------|------------|
| Interim dividend for year ended 31 December 2016: £44 per share | 525 | - |
| Interim dividend for year ended 31 December 2015: £505 per share | - | 6,060 |

O2 Holdings Limited
Notes to the financial statements (continued)

9. Property, plant and equipment

| £millions | Computer Equipment |
|---------------------------------|-------------------------------|
| Cost | |
| At 1 January 2015 | 5 |
| At 31 December 2015 | 5 |
| Write-offs | (5) |
| At 31 December 2016 | - |
| Accumulated depreciation | |
| At 1 January 2015 | 5 |
| At 31 December 2015 | 5 |
| Write-offs | (5) |
| At 31 December 2016 | - |
| Net book value | |
| At 31 December 2016 | - |
| At 31 December 2015 | - |
| At 1 January 2015 | - |

The Company has fully written-off their tangible assets during the year ended 31 December 2016 as these were no longer in use.

O2 Holdings Limited
Notes to the financial statements (continued)

10. Intangible assets

| £ millions | Software | Other | Total |
|-----------------------|----------|-------|-------|
| Cost | | | |
| At 1 January 2015 | 64 | 2 | 66 |
| At 31 December 2015 | 64 | 2 | 66 |
| Write-offs | (64) | (2) | (66) |
| At 31 December 2016 | - | - | - |
| Amortisation | | | |
| At 1 January 2015 | 61 | 2 | 63 |
| Charge for the year | 2 | - | 2 |
| At 31 December 2015 | 63 | 2 | 65 |
| Write-off | (63) | (2) | (65) |
| At 31 December 2016 | - | - | - |
| Net book value | | | |
| At 31 December 2016 | - | - | - |
| At 31 December 2015 | 1 | - | 1 |
| At 1 January 2015 | 3 | - | 3 |

The Company has fully written-off their intangible assets during the year ended 31 December 2016 as these were no longer in use.

11. Trade and other receivables

| | Note | 2016 £m | 2015 £m |
|---|------|------------|------------|
| Trade receivables | | - | - |
| Other receivables | | 27 | 25 |
| Amounts owed by ultimate parent company | 20 | 1 | 4 |
| Amounts owed by subsidiaries | 20 | 210 | 177 |
| Amounts owed by other related parties | 20 | 34 | 28 |
| Prepayments | | - | 13 |
| | | 272 | 247 |

Principal amounts owed by subsidiaries mainly include group tax receivables. All intercompany balances are interest free and repayable on demand.

Refer to Note 1 for further understanding of the restatement in the 2015 disclosure.

O2 Holdings Limited
Notes to the financial statements (continued)

12. Other financial assets

| | Note | 2016 £m | 2015 £m |
|------------------------|-------------|--------------------|--------------------|
| Current assets | | | |
| Other financial assets | 20 | <u>241</u> | <u>241</u> |

Other financial assets include the loan principal for short-term loans to Telefónica UK Limited and O2 Communications Limited. Due to the group reorganisation undertaken in 2015 all interest on intercompany loans were waived and therefore no accruals for interest were reported during the year.

Refer to Note 1 for further understanding of the restatement in the 2015 disclosure.

13. Notes to the cash flow statement

| | 2016 £m | 2015 £m |
|---|--------------------|--------------------|
| Profit before taxation | <u>290</u> | <u>12,551</u> |
| <i>Adjustment for:</i> | | |
| Impairment for investment in subsidiaries | 240 | 9,778 |
| Depreciation and amortisation charges | - | 2 |
| Net financial income | (525) | (22,344) |
| Other non-cash movements | 1 | (7) |
| Operating cash flows before movements in working capital | <u>6</u> | <u>(20)</u> |
| *(Increase)/decrease in trade and other receivables | (25) | 757 |
| *Increase in trade and other payables | 14 | 229 |
| Cash generated by operations | <u>(5)</u> | <u>966</u> |
| Net cash from operating activities | <u>(5)</u> | <u>966</u> |

14. Cash and cash equivalents

| | 2016 £m | 2015 £m |
|----------------------------------|--------------------|--------------------|
| Cash and cash equivalents | | |
| Cash at bank and in hand | <u>38</u> | <u>43</u> |

The Company's short-term deposits are funds deposited with Telfisa BV, a related party.

O2 Holdings Limited

Notes to the financial statements (continued)

15. Borrowings

| | Note | 2016 £m | 2015 £m |
|-------------------------------------|------|------------|------------|
| Current unsecured borrowings | | | |
| Amounts owed to subsidiaries | 20 | <u>7</u> | <u>7</u> |

Current borrowings at 31 December 2016 and 2015 represent a loan payable to Cellular Radio Limited, a subsidiary company, and the purpose of the loan is the provision of general trading activities. The loan is repayable on demand and bears an effective rate of interest of 1.49% (2015: 1.40%). The interest rate is based on LIBOR plus 42 basis points.

16. Trade and other payables

| | Note | 2016 £m | 2015 £m |
|--|------|-------------------|-------------------|
| Trade payables | | - | 2 |
| Other payables | | - | 4 |
| Amounts owed to ultimate parent company | 20 | 1 | - |
| Amounts owed to immediate parent company | 20 | 259 | 259 |
| Amounts owed to subsidiaries | 20 | 2 | 25 |
| Amounts owed to other related parties | 20 | 97 | 105 |
| Accrued expenses | | <u>4</u> | <u>10</u> |
| | | <u>363</u> | <u>405</u> |

Principal amounts owed to the immediate parent company, Telefonica Europe plc, and other related parties mainly relate to group tax payables. All intercompany balances are interest free and repayable on demand.

Refer to Note 1 for further understanding of the restatement in the 2015 disclosure.

17. Pension costs

Telefonica Europe plc, its ultimate UK parent company, acts as the Sponsor of the Telefónica UK Pension Plan ("the Plan"), this 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 Plan provides the pension benefits for the majority of Telefónica's UK employees. The retirement benefit obligation of the Plan is therefore recognised on the statement of financial position of Telefónica Europe plc. The Company only recognises the unfunded defined benefit scheme.

The net defined benefit cost 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, is recognised by the sponsoring employer, Telefónica Europe plc.

With effect from 28 February 2013 the defined benefit scheme of the Plan were 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 described below. 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. The assets of the Plan are held independently of Telefonica Europe plc's finances.

O2 Holdings Limited

Notes to the financial statements (continued)

17. Pension costs (continued)

The total charge included in the statement of comprehensive income for the Company's entire pension schemes are as follows:

| | Year ended 31 December 2016 £m | Year ended 31 December 2015 £m |
|------------------------------|--|--|
| Telefónica Pension Plan cost | - | - |
| Total operating charge | - | - |

Actuarial valuation

A full valuation of the defined benefit scheme of the Plan was undertaken as at 30 September 2014 by a suitably qualified independent actuary. The valuation used the projected unit method.

The full valuation was completed in line with the current investment strategy of the Plan which is predominantly a corporate bond basis initiated following the 2008 valuation.

No payment was made to the defined benefit scheme in the year ended 31 December 2016 (2015: £80 million).

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

| | Year ended 31 December 2016 £m | Year ended 31 December 2015 £m |
|--|---|---|
| Life expectancy (male currently age 40/60) | 88.7/87.2 years | 88.6/87.1 years |
| Nominal rate of increase of pensions in payment (RPI max 5%) | 3.15% | 3.15% |
| Discount rate | 2.60% | 3.80% |
| Inflation assumption (RPI/CPI) | 3.35% / 2.35% | 3.35% / 2.35% |

The initial results of the actuarial valuation of the Plan as at 30 September 2014 have been updated to 31 December 2016 by 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.

80% of the assets are invested in sterling-denominated bonds with 20% invested in synthetic global equities

Plan assets are valued by reference to quoted market prices in active markets. No assets of Telefónica Europe plc are held by the Plan.

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

| | Year ended 31 December 2016 £m | Year ended 31 December 2015 £m |
|---|---|---|
| Analysis of the amount recognised in other comprehensive income: | | |
| Return on plan assets in excess of interest income/(expense) | - | - |
| Actuarial (gains)/losses on demographic assumptions | - | - |
| Actuarial losses on financial assumptions | 1 | - |
| Actuarial (gains)/losses on experience adjustments | - | - |
| Actuarial loss recognised | 1 | - |

O2 Holdings Limited
Notes to the financial statements (continued)

17. Pension costs (continued)

The main assumptions adopted for the Plan (funded and unfunded) under IAS 19 are as follows:

| | Year ended 31 December 2016 | Year ended 31 December 2015 |
|---|-----------------------------------|-----------------------------------|
| | £m | £m |
| Funded and unfunded | | |
| Nominal rate of increase in salaries | N/A | N/A |
| Nominal rate of increase of pensions in payment: | | |
| Pension increases with inflation | 3.35% | 3.35% |
| Pension increases with inflation limited to 5% p.a. | 3.15% | 3.15% |
| Discount rate | 2.60% | 3.80% |
| Inflation assumption: | | |
| RPI | 3.35% | 3.35% |
| CPI | 2.35% | 2.35% |
| Life expectancy: | | |
| Male (current age 40) | 88.7 years | 88.6 years |
| Male (current age 60) | 87.2 years | 87.1 years |
| Female (current age 40) | 91.0 years | 90.9 years |
| Female (current age 60) | 89.5 years | 89.4 years |

At 31 December 2016, the weighted average duration of the defined benefit obligation of the funded plan was 23 years (2015: 23 years).

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

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

| | Year ended 31 December 2016 | | Year ended 31 December 2015 | |
|--|--------------------------------|----------------|--------------------------------|----------------|
| | Funded £m | Unfunded £m | Funded £m | Unfunded £m |
| At start of year | 1,180 | 3 | 1,183 | 7 |
| Interest expense | 44 | - | 44 | - |
| Actuarial gains on demographic assumptions | - | - | (8) | - |
| Actuarial losses on financial assumptions | 382 | 1 | 8 | - |
| Actuarial gains on experience adjustments | (20) | - | (28) | - |
| Benefits paid | (21) | - | (19) | (4) |
| At end of year | 1,565 | 4 | 1,180 | 3 |

O2 Holdings Limited

Notes to the financial statements (continued)

17. Pension costs (continued)

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

| | Year ended 31 December 2016 | | Year ended 31 December 2015 | |
|--|--------------------------------|----------------|--------------------------------|----------------|
| | Funded £m | Unfunded £m | Funded £m | Unfunded £m |
| At start of year | 1,286 | - | 1,220 | - |
| Interest income | 48 | - | 45 | - |
| Return on plan assets in excess of interest income | 110 | - | (38) | - |
| Employer contributions | - | - | 80 | - |
| Scheme expenses paid | (1) | - | (2) | - |
| Benefits paid | (21) | - | (19) | - |
| At end of year | 1,422 | - | 1,286 | - |

The amount included in the consolidated statement of financial position arising from obligations in respect of the defined benefit scheme of the Plan, as well as the analysis of the Plan's assets, is as follows:

| | Year ended 31 December 2016 | | Year ended 31 December 2015 | |
|---|--------------------------------|----------------|--------------------------------|----------------|
| | Funded £m | Unfunded £m | Funded £m | Unfunded £m |
| Fair value of assets comprises: | | | | |
| Equities | 306 | - | 257 | - |
| Corporate bonds | 1,117 | - | 949 | - |
| Cash and net current assets | (1) | - | 80 | - |
| Fair value of assets | 1,442 | - | 1,286 | - |
| Present value of defined benefit obligations | (1,565) | (4) | (1,180) | (3) |
| Net (obligation)/asset recognised in statement of financial position | (143) | (4) | 106 | (3) |

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

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

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

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

| Charge by assumption | Liabilities increase by: |
|------------------------------------|--------------------------|
| Decrease discount rate by 0.25% | £105m |
| Increase inflation rate by 0.25% | £90m |
| Increase life expectancy by 1 year | £37m |

O2 Holdings Limited

Notes to the financial statements (continued)

17. Pension costs (continued)

The expected benefit payments from the Plan are as follows:

| Year | 2016 | 2016 |
|--------------|---------|----------|
| | Funded | Unfunded |
| | £m | £m |
| 2017 | 24.6 | 0.1 |
| 2018 | 26.9 | 0.1 |
| 2019 | 30.5 | 0.1 |
| 2020 | 33.3 | 0.1 |
| 2021 | 35.6 | 0.1 |
| Rest of time | 3,430.8 | 6.9 |

18. Deferred taxation

Deferred tax assets and liabilities are offset only where they can be offset and arise in the same fiscal authority.

The total movement in deferred tax assets/liabilities during the period, before taking into consideration the offsetting balances within the same tax jurisdiction, is as follows:

| | 2016 |
|---|----------|
| | £m |
| Provision for deferred tax | |
| Pension provision | 1 |
| Total provision for deferred tax | 1 |

Deferred tax assets have been offset against deferred tax liabilities where there is a legally enforceable right to do so and they relate to income taxes levied by the same taxation authority on either the same taxable entity or different entities which intend to settle current tax assets and liabilities on a net basis. Deferred tax assets totalling £nil have been offset against deferred tax liabilities.

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

| | 2016 |
|--|----------|
| | £m |
| Deferred tax assets | |
| At 31 December 2014 | 3 |
| Charge to the comprehensive income statement | (1) |
| At 31 December 2015 | 2 |
| Charge to the comprehensive income statement | (1) |
| At 31 December 2016 | 1 |

There were no unrecognised deferred tax assets or liabilities at 31 December 2016 (2015: £nil).

Finance (No.2) Act 2015 provides that the rate of corporation tax from 1 April 2017 will be 19% and that the rate from 1 April 2020 will be 17%. As a result the estimate of deferred tax has been calculated at a blended rate of 18%, with no significant impact on the Company's financial statements.

O2 Holdings Limited
Notes to the financial statements (continued)

19. Share capital and reserves

| | 2016 | | 2015 | |
|---|------------------|-----------|------------------|-----------|
| | Number of | | Number of | |
| Share capital | shares | £m | shares | £m |
| Called up, allotted and fully paid | | | | |
| Ordinary shares of 0.1 pence each | 12,000,600 | 12 | 12,000,600 | 12 |

The Company has a single class of share capital, comprising ordinary shares of £1 each. Subject to the Company's articles of association and the applicable law, the Company's ordinary shares confer on the holder the right to receive notice and vote at general meetings of the Company, the right to receive any surplus assets on a winding up of the Company and an entitlement to receive any dividend declared on ordinary shares, but not the right of redemption of shares.

20. Related party disclosures

During the year ended 31 December, the Company entered into transactions with related parties as follows:

| | 2016 | 2015 |
|-----------------------|-------------|---------------|
| | £m | £m |
| Income | | |
| Subsidiary companies | 542 | 22,375 |
| Other related parties | 10 | 39 |
| | 552 | 22,414 |
| Expenses | | |
| Subsidiary companies | - | (7,499) |
| Other related parties | (17) | (2,314) |
| | 535 | 12,601 |

At 31 December 2016 the Company had the following balances arising from transactions with related parties:

| | 2016 | 2015 |
|----------------------|--------------|--------------|
| | £m | £m |
| Receivables | | |
| Subsidiary companies | 451 | 418 |
| Related parties | 35 | 32 |
| | 486 | 450 |
| Payables | | |
| Subsidiary companies | (9) | (32) |
| Related parties | (357) | (364) |
| | (366) | (396) |

O2 Holdings Limited
Notes to the financial statements (continued)

21. Subsidiary undertakings and joint arrangements

The investments held in subsidiary undertakings at 31 December 2016 are detailed below, all of which are included in the Company financial statements.

| Name | Registered number | Country of incorporation and operation | Registered office | Activity | Portion of ordinary shares held (%) |
|---|--------------------------|---|--|---|--|
| Telefónica UK Ltd* | 01743099 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Mobile cellular telephone system provider and operator | 100 |
| Tesco Mobile Ltd | 04780736 | England and Wales | Shire Park, Welwyn Garden City, AL7 1GA | Mobile cellular telephone distributor JV with Tesco | 50 |
| Weve Ltd | 08178832 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Mobile marketing and commerce services | 100 |
| O2 Networks Ltd* | 02604351 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Intermediate holding company | 100 |
| Cornerstone Telecommunications Infrastructure Ltd | 08087551 | England and Wales | The Exchange Building 1330, Arlington Busin, Berkshire RG7 4SA | Mobile infrastructure network JV with Vodafone | 50 |
| giffgaff Ltd | 04196996 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Mobile communications network | 100 |
| Telefónica UK Pension Trustee Ltd* | 04267552 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Corporate trustee of the Telefónica UK Pension Plan | 100 |
| Cellular Radio Ltd | 01612599 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Active non trading | 100 |
| O2 Secretaries Ltd* | 04272689 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Corporate Secretary | 100 |
| O2 Communications Ltd* | 04271548 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Intermediate holding company | 100 |
| O2 Redwood Limited | 02383186 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Dormant entity | 100 |
| O2 Cedar Ltd* | 04678681 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Active non trading | 100 |
| O2 Unify Ltd | 07999361 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | IT and Communication solutions | 100 |
| Digital Mobile Spectrum Ltd | 08247385 | England and Wales | 83 Baker Street, London, W1U 6AG | Provision of services in relation to spectrum auction obligations | 25 |
| Telefónica Europe People Services Ltd* | 486438 | Ireland | Hanover Court, Erne Street Lower, Dublin 2. Dublin | European HR services, support functions and administration provider | 100 |

O2 Holdings Limited

Notes to the financial statements (continued)

21. Subsidiary undertakings and joint arrangements (continued)

| Name | Registered number | Country of incorporation and operation | Registered address | Activity | Portion of ordinary shares held (%) |
|--------------------------------|-------------------|--|--|----------------|-------------------------------------|
| The Mobile Phone Store Limited | 02837875 | England and Wales | 260 Bath Road, Slough, Berkshire, Slough SL1 4DX | Dormant entity | 100 |
| DX Communications Limited | SC133682 | Scotland | The Ca'D'Oro 45 Gordon Street, Glasgow, G1 3PE | Dormant entity | 100 |

*The shares are held directly by the Company.

The shares in the other companies are held indirectly through wholly owned subsidiaries.

22. Financial instruments

Financial risk factors and management

The Company's operations expose it to a variety of financial risks including foreign currency risk, fair value risk, interest rate risk, credit risk and liquidity risk.

The principal financial risks of the Company and how the Company managed these risks are discussed below:

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 credit balances held with group companies within the Telefónica, S.A. Group. The Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

The Company does not require collateral in respect of financial assets.

The Company does not have a significant exposure to credit risk.

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 reduced through being a part of the larger Telefónica Group. The Company also maintains its own committed borrowing facilities, and holds financial assets primarily in short-term deposits with Telefónica Group companies that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

Foreign currency risk

The Company operates primarily in the United Kingdom and therefore there is low exposure to transactional foreign currency risk. The Company has foreign currency assets and liabilities held with group companies which expose it to translation risk. This risk is managed through being part of the larger Telefónica Group, which operates group wide policies in this area. If the pound sterling lost 10 percent against the euro at 31 December 2016, this would have no material impact on the statement of comprehensive income of the Company.

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 interest received on cash and cash equivalents. 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.

O2 Holdings Limited
Notes to the financial statements (continued)

23. Auditors' remuneration

The aggregate fees incurred during the year for audit and other services are analysed below.

| | 2016 | 2015 |
|---|-------|-------|
| | £'000 | £'000 |
| Audit of the Company financial statements | 41 | 42 |

The fees in the current and previous year were paid to Ernst & Young LLP.

24. Wages and salaries

The directors of the company are also directors of other companies within Telefónica Group. The directors received total remuneration for the year of £990,000.

The directors do not believe that it is practicable to apportion this amount between their services as directors of the Company and their services as directors of the holding and fellow subsidiary companies.

On 1 August 2016, Graham Crichton resigned as Director and Mark Hardman was appointed a Director of the Company.

During the year, four directors accrued retirement benefits under a defined contribution pension plan.

| | 2016 | 2015 |
|---|------------|--------------|
| | £'000 | £'000 |
| Aggregate emoluments | | |
| Remuneration in respect qualifying services | 942 | 802 |
| Contributions to pensions schemes | 48 | 92 |
| Amounts paid under long term incentive plan | - | 143 |
| | 990 | 1,037 |

| | £'000 | £'000 |
|--|------------|------------|
| Aggregate emoluments of highest paid director | | |
| Remuneration in respect qualifying services | 444 | 342 |
| Contributions to pensions schemes | 4 | 47 |
| Amounts paid under long term incentive plan | - | 95 |
| | 448 | 484 |

O2 Holdings Limited

Notes to the financial statements (continued)

24. Wages and salaries (continued)

| | 2016 | 2015 |
|--|-----------|-----------|
| | No. | No. |
| Average monthly number of full time employee equivalents (including Directors) | | |
| by class of business: | | |
| Finance | - | 14 |
| Other businesses and administration | 18 | 84 |
| Total employees | 18 | 98 |

The benefit expenses incurred in respect of these employees were:

| | 2016 | 2015 |
|---------------------------------------|----------|-----------|
| | £m | £m |
| Wages and salaries | 2 | 8 |
| Social security costs | 1 | 2 |
| Pension costs | 1 | - |
| Total employee benefit expense | 4 | 10 |

As part of restructuring in 2016, a number of employees migrated from O2 Holdings Limited to Telefonica Digital Limited in May 2016.

25. Parent company and controlling party

At 31 December 2016, the immediate parent company was Telefonica Europe plc, a company incorporated in England and Wales. Copies of the financial statements of Telefonica Europe plc may be obtained from 260 Bath Road, Slough, Berkshire, SL1 4DX.

The ultimate parent company and controlling party at 31 December 2016 was Telefónica, S.A., a company incorporated in Spain, which prepares consolidated financial statements. Consolidated financial statements of Telefónica, S.A. may be obtained from Gran Via 28, Madrid, Spain.