Registered Number: 4196996

giffgaff Limited

Annual Report and Financial Statements

Year ended 31 December 2018

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Company information

Directors

Mark Evans
Patricia Cobian
Ashley Schofield

Secretary

O2 Secretaries Limited

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Independent Auditors

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Strategic report

giffgaff Limited ("the Company" or "giffgaff") is a wholly owned subsidiary within the Telefónica Group of companies. The ultimate parent company is Telefónica S.A., a company incorporated in Spain and primarily listed on the Spanish stock exchange. giffgaff operates as a 100% owned subsidiary of Telefonica UK Limited ("T UK"), a mobile network operator trading under the O2 brand.

Our Strategy

Our purpose is to harness the power of people, to challenge the established way and improve it. To achieve this giffgaff's strategy is to grow a member-run mobile communications network that utilises and rewards the collective resources of its members. This mutuality principle, combined with a predominantly online and SIM only business model, keeps costs low and allows savings to be passed on to members.

In 2018 we achieved this through:

- **Business model**: increasing the availability of our SIMs in the retail sector and online to attract new members (page 2)
- **Propositions**: enhancing our monthly SIM only plans, or 'goodybags' to include more data and minutes and offering handsets to attract new activations and retain more members (page 2)
- **Community**: developing a core community of 'pioneers', who are members choosing to help us identify new opportunities and providing feedback on experiences, to create more engagement with our members. Engaging with our members on the community and wider, including social media, to bring maximum reach (page 3)
- **Stakeholder**: doing the right thing for all our stakeholders (page 3)
- **Experience:** developing our technology capability to allow us to provide enhanced experiences to members (page 4).

Business model

giffgaff is a mobile virtual network operator running on the O2 network, providing telecommunication services to the consumer mobile segment. giffgaff is an ancient Scottish word that means 'mutual giving' and, as such, we have 'members' rather than 'customers'. We seek to attract a different profile of members to that which would be attracted to the O2 brand. Our business model is designed to deliver against our strategic objectives.

Our core business is the provision of SIM only mobile services, but we also offer the purchase of handsets (outright or via loans) and we provide online charging platform services to other mobile virtual network operators.

Propositions

Our ambitions are to (1) optimize our mobile business, (2) adapt it so we remain relevant & (3) expand our business beyond mobile.

- **Optimise**: we remain committed to improving mobile for our audience. Our Net Promoter Score reached 69.4 (69 in 2017) and our ambition is to continue to improve this score
- **Adapt:** we are also mindful that the mobile world around us is changing. Text to Switch arrived on 1 July 2019 and the brand campaign is designed to take full advantage of it. With eSIM and 5G on the horizon giffgaff will ensure that it stays relevant for our members
- **Expand:** We have an appetite to try and create value for members beyond mobile, tapping in to new opportunities to make giffgaff more relevant to our members' lives.

Strategic report (continued)

giffgaff community

At giffgaff, we believe in listening to our members, involving them, being run by them and rewarding them with money. The idea is that "together with our members anything is possible". Members can help each other by answering one another's questions. They can recruit new members to the cause. They can come up with new ideas that improve the way we're run. They can suggest worthy causes for us to plough our money into. In essence, we seek to minimise costs by working in collaboration with our members and running a lean operation, without the need for our own retail shops or traditional call centres. By keeping our business lean we've also minimised our impact on the environment as the business has grown.

At giffgaff we keep our 3 million members at the heart of everything we do. In fact, we had an online community before we had any SIMs to send out. In 2018 we started regularly inviting our members into the office and have continued this as it has proved popular.

In addition to providing Which? and uSwitch award winning services, our members get involved in everything at giffgaff. As well as guest starring in our adverts and creating content for other members to enjoy in the form of videos, blogs and images, our members have had over 690 of their ideas implemented. That's why we're the mobile network run by you.

Results and measurement

Having a focus on our members helped us to deliver the following business impact:

- A 2018 average net promoter score of 66.9 significantly above the average for the mobile sector
- Growth of our 2018 member base by 435,995 members
- Growth of our member satisfaction index to 86.5, our highest satisfaction levels ever, and well above the sector average.

Recent awards

We were voted uSwitch Network of the Year in 2018
We were a Which? Recommended provider for the seventh year running
Best Value Network at the Mobile Choice Consumer Awards 2018
Winner at the Music and Sound Awards 2018
Best Mobile Data provider at the PC Pro Awards 2018

Our stakeholders

Our focus on mutuality and our community means that our values are aligned with our brand. Our core behaviours, expected in everything we do, are to be Positive, Curious, Collaborative and Gritty. We are a responsible business which aims to do the right thing for our members.

How we operate

Our approach to ethical conduct is reflected in our Business Principles which underpins our commitments to our stakeholders and is centred on three core values, in which we are aligned with our shareholder, T UK:

- **Integrity:** being honest and acting in accordance with non-negotiable ethical standards. Our policy states that we are committed to acting professionally, fairly, with integrity and do not tolerate any form of bribery or corruption: "we do not offer or accept gifts, entertainment or other types of incentives which may reward or influence a business decision." Any breach of either of these policies can lead to disciplinary action
- **Commitment**: the commitment we undertake with each stakeholder group is based on a commitment to always act in a responsible manner and to stand by what we pledge
- **Transparency**: we commit to clear and accessible information about our strategy and our activities, providing a platform for questions to be asked by anyone at any time.

Strategic report (continued)

Our members

We focus on the member experience in everything we do. We engage with members through the community, through our pioneer's engagement panel and through social media dialogue in order to build trust and understand what our members value.

Our people

Our people are our most valuable asset and their enthusiasm and commitment to giffgaff is what makes it possible for us to live our purpose: to harness the power of people, challenge the established way and improve it. All of our people are employed by our Parent and as such we benefit from their support including operating the same employee related policies and procedures.

Being a community centred business, everyone plays a big part. Our people strategy is simple: spend time hiring the right people, trust them, throw them into the big challenges, grow and develop them, and don't take ourselves too seriously. We have a handful of values - gritty, collaborative, curious, positive - and as we have grown they have kept us grounded and helped us deliver some amazing things in the 'giffgaff' way. It's all underpinned by our central belief, or mission if you like, that 'together with our members anything is possible'.

We support our people's professional development and encourage the improvement of their skills and abilities. We promote awareness of how people's contributions are evaluated in the process of achieving our goals. We promote active participation in the evaluation process so that together we can all continue improving in our jobs. We also want to contribute to our people's personal development through training and information resources and tools, so they can achieve a balance between their professional and personal lives.

Fair treatment of our people and high satisfaction within the working environment are especially important to us. Our aim is to provide our people with optimum working conditions, excellent career opportunities, training, and wellbeing.

Our employee engagement survey for the second half of 2018, gave us an average score of 4.14/5 (82.8%) up from the first half survey in 2018 which gave us scores of 4.07/5 (81.4%). An improvement during the year.

Our suppliers

Being part of the Telefónica Group of companies affords benefits such as scale efficiencies in procurement and access to products and services. We benefit from the scale of the supplier base of our parent company, but have also developed strong supplier relationships in the SME environment, and remain committed to sustainable procurement and supplier management throughout the value chain.

Our engagement with our direct and indirect supply chain has led us in 2018 to focus on the areas outlined below:

- Maintaining leadership practices in the management of supply chain carbon
- Reducing waste to landfill and the use of single use plastics in our supply chains
- Strengthen our management of security in the supply chain
- Driving H&S with vendors involved in construction and other high risk activities
- Reviewing modern slavery risks with vendors in at risk categories and with franchisee partners
- Managing sustainability in new tenders
- Maintain a view of suppliers operating in high sustainability risk categories and ensuring they all hold a current EcoVadis assessment above 44 and do not present business ethics risks.

Details of our supply chain management can be found in our Modern Slavery Act Statement published on our website.

Strategic report (continued)

Our suppliers (continued)

Our standard payment terms range from 30 days to 180 days, determined by category of spend. For example, 180 day payment terms are standard for capital expenditure associated with platform development and other long term asset improvement costs; and 30 day payment terms are standard for media advertising spend. In addition, where a supplier is deemed to be a Small or Medium sized Entity (SME), 30 day payment terms are available upon request.

Parent

giffgaff operates as a 100% owned subsidiary of T UK, a mobile network operator trading under the O2 brand. We share their platform including their policies and procedures. giffgaff has a mutual business relationship with T UK gaining by using their structure for supply chain, suppliers, and warehousing.

Regulators and government

Network Outage

On 6 December 2018, the Company experienced a network issue caused by an expired hard coded certificate in Ericsson (a third party supplier) software release which had not been communicated to any of the global operators which all experienced disturbance to their respective network. The software version was current and in support at the time of the incident. T UK's Network Team in collaboration with Ericsson overcame unprecedented technical obstacles and our network was restored to full capacity within 24 hours. Whilst we deeply regret the incident, during the network outage we continually engaged with our members and the wider stakeholders to manage expectations as far as possible.

Without the benefit of hindsight it is hard to see how we could have avoided the incident as none of the software release documents mentioned certificates or changes in internal communication in the software which caused the outage. Also none of the other impacted operators knew this, if they had known Ericsson would have been aware in advance and prevented this multi-operator outage. It could only have been avoided had Ericsson's software worked as designed, or had T UK known of the existence of an expiry date and time for the hard coded certificate. As a result T UK have now included in their standard Acceptance Test Procedures (ATPs) the setting of the system time on the node being tested to a future day and time, to attempt to mitigate the existence of a time/date triggered bug, regardless of what the equipment or software documents say.

In February 2019, Ofcom decided to open an investigation into whether T UK has complied with its obligations under section 105A(4) of the Communications Act 2003. This requires a network provider to "take all appropriate steps to protect, so far as possible, the availability of the provider's public electronic communications network". Opening an investigation does not imply that Ofcom has formed any view about whether or not T UK has breached any regulatory or legal provisions.

Financial Conduct Authority

We are committed to delivering good member journeys and being aligned with the principles of the Financial Conduct Authority (FCA).

giffgaff has full permissions with the FCA to broker Consumer Credit to our members. giffgaff is also authorised to provide account information services. As a consequence of this, we are bound by the obligations of both the Consumer Credit Act 1974, the FCA Consumer Credit Handbook (known as CONC) and the Payment Services Regulations.

The FCA is focussed on Treating Customers (Members) Fairly and Good Customer (Member) outcomes. We are fully aligned with this this ethos being Customer (Member) Led is a key part of our strategy.

Strategic report (continued)

Regulators and government (continued)

Financial Conduct Authority (continued)

Under Principle 11 of the FCA we have a "Duty to Notify" as and when key matters arise and must deal with the regulator in an "open and honest way" .... "and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonable expect notice". We have followed this approach and have updated the FCA when necessary on key matters. We have also responded to routine information requests and have submitted requested reporting information on time.

There were no FCA complaints upheld in 2018.

Information Commissioner's Office

We are a member-led business with our people at our core and we are committed to ensuring that we look after the personal data we hold.

Our purpose, to provide iconic experiences, is underpinned by our Data Principles and is aligned with our obligations under data protection law. We maintain a governance framework, including an appointed Data Protection Officer, to help us do this.

As part of this framework, we maintain regular contact with the Information Commissioner's Office (the UK's independent body set up to uphold information rights). This includes our duties to report personal data breaches to the Information Commissioner's Office.

The Information Commissioner's Office publishes a range of information on its website, including significant instances of non-compliance. There have been no such instances in 2018 in relation to giffgaff.

Society

We're not just about giving back to our members at giffgaff. We're also passionate about supporting worthy causes. Our Payback scheme, which we've been offering to all giffgaff members since 2010, has so far donated over £650,000 to more than 22 different charities.

Our dedicated 'Ministry of Good Deeds' keeps generosity and giving back to local communities at the forefront of our minds. In 2018 we hosted a range of events including a number of sponsored bake-offs, food collections for the homeless, Contact the Elderly afternoon teas and a festive Santa run around Uxbridge. We also raised £15,000 for Great Cardiac Risk in the Young when a troop of brave giffgaff cyclists and walkers rode and strode their way across the South Downs for sponsorship.

Environment

During 2018 the office implemented a simple recycling system which saw 99% of the office waste recycled. Plastic waste was significantly reduced with the introduction of banning plastic coffee cups and issuing re-usable ones for staff. Office food waste now goes to Fred the monthly food bank collection and the furniture from the old office was donated to local schools and charities.

Strategic report (continued)

Important events post year end

Brexit

We are focused on supporting all of our consumers and businesses regardless of the uncertainty in the macro economy that we operate in. We are committed to ensuring our members receive the service they expect and need in the event of the UK leaving the European Union without a deal. Like all businesses we are taking the steps to prepare for all scenarios and any changes in underlying market conditions resulting from a no deal Brexit.

T UK has a Brexit Taskforce led by the Group Director of Regulatory Affairs and the Group Financial Controller who are closely monitoring the Brexit negotiations as they unfold. The Brexit Taskforce have thoroughly assessed and identified the Business' Brexit related risks which mainly are related to: commercial, operational, financial and human resources matters. These risks have been classified as either having a high likelihood or a high impact but not both and have in place proportionate risk management and mitigation processes to minimise the impact on the business. The directors are confident that the Business is well positioned to continue to provide uninterrupted services to our members despite the uncertainty.

5G Deployment

In July 2019, T UK announced the launch of the 5G network in October 2019, prioritising areas where consumers will benefit most. giffgaff plans to start a trial with members after the O2 launch in October to really understand the benefits. We will be working towards a full launch in early 2020.

Sale of Assets

The migration of the giffgaff member database and the sale of the original platform was completed in June 2019.

Billing and Ofcom

On 28 June 2018, the Company notified Ofcom that it had identified billing errors related to a specific instance of a members' goodybag usage. In a decision dated 30 July 2019, Ofcom found that the Company contravened its statutory obligations to render accurate bills to its members and, separately, in providing information to Ofcom in response to two formal requests for information dated 1 October 2018 and 26 November 2018 (the information requested related to Ofcom's investigation into giffgaff's metering and billing obligations). Ofcom decided to impose a penalty of £1.4 million in respect of giffgaff's contravention of its metering and billing obligations, and a £50,000 penalty for failing to provide correct information to Ofcom. Subsequently the Company has reviewed and is strengthening its billing processes, governance and how it responds to formal requests for information. Both amounts have been recorded in these financial statements.

gameplan

On 13 August 2019 it was decided to discontinue 'gameplan', the Company's development stage Personal Finance Management Tool, in order for the Company to focus on its core activities. The decision to discontinue gameplan is not expected to have a significant impact on our operations.

Strategic report (continued)

Performance and development

At the end of 2018, the key operating performance highlights of the Company are:

Revenue	giffgaff had substantial member base growth for the year ended 31 December 2018 in an increasingly competitive market. Our revenue for the year was £449,222,000 (2017: £407,412,000) and our profit after tax for the year was £30,560,000 (2017: £28,696,000).
Handsets	The handset business generated £50,079,000 of revenue for the year (2017: £48,199,000), contributing 11.1% (2017: 11.8%) of our total revenue, and we brokered 68,153 handset loans (2017: 67,110).
Member numbers	For the core mobile business, these are members who are active during a period of one month. Members are treated as being active if they have used the network (at least five times) or have made a purchase (top-up) in the preceding one month. We added 435,995 net member additions to the mobile business during the year ended 31 December 2018 (2017: 261,417 net additions).
Churn	Churn – this represents the percentage of members that have been disconnected in a period. It is calculated by dividing net disconnections in a period by the average member base (average of our opening and closing base) for the same period. Average monthly churn decreased from 4.3% in 2017 to 4.0% in 2018.
Average revenue per user ("ARPU")	Average revenue per user ("ARPU") – ARPU is calculated by dividing monthly total mobile service revenue (excluding inbound roaming) from sales to members for the preceding 12 months by the weighted average number of active members for the same period. Total ARPU decreased by £0.25 year-on-year to £11.50 (£11.75 in 2017).

Operating with integrity

We are committed to acting professionally, fairly and with integrity and do not tolerate any form of bribery or corruption. Our anti-bribery and corruption approach is summarised in our Business Principles, which are essential for everyone working either for or on our behalf. As a wholly owned subsidiary of T UK, a significant proportion of our policies and processes are consistent with those of our parent entity. These include employment policies, information management, and governance best practice. We are subject to audits carried out by the Business Assurance team in T UK, as well as external audits by the Information Commissioner's Office (ICO) and the British Standards Institute (BSI) on behalf of Ofcom. Further information regarding our approach to being a responsible Business, including our Business Principles, is published in the Group's Non-Financial Report available at https://www.o2.co.uk.

Principal risks and uncertainties

giffgaff has a risk management process that enables discovery, collation and reporting of risks relevant to the business. Mitigations are defined and implemented in order to bring the risk exposure into line with the business appetite for risk. The risk register is reviewed by giffgaff leadership and by giffgaff's shareholder, T UK, on a regular basis. Additionally giffgaff has access to risk management specialists in T UK.

We follow a risk management model which helps us prioritise our risks and develop initiatives to combat them. This framework is aligned with best practice in Internal Control (COSO1 II Report and ISO31000:2009 Principles and Guidelines for Risk Management) and supported by T UK risk and assurance experts.

Strategic report (continued)

Principal risks and uncertainties (continued)

The framework is designed to identify, assess, manage, monitor and treat significant risks that could have a negative impact on our future success. The framework allows the management team to be aware of key risks and opportunities, and assign the most effective resources to respond quickly.

Our most significant financial risks are referenced in note 19 to the financial statements. We also consider our non-financial or 'global' risks, the most significant of which are summarised below.

giffgaff was audited by the Information Commissioner's Office in January 2018 and awarded a 'green' rating for information risk management.

Risk Name	Risk Impact	Risk Treatment	Risk Evolution
Payment Card Industry (PCI) Security Standards Council compliance	The risk of failure to maintain standards of compliance required by the PCI.	Removal of data from systems no longer needed in the processes that they support. Board level focus on all related initiatives.	Decreased
Market competition	The risk of market competition removing giffgaff's differentiators leading to a mass loss of members & lack of new members.	Adapt and expand current offerings. Invest in giffgaff's key differentiators and forensically maximise the advantages of each.	Maintained
Revenue assurance risks	The risk of process or capability failure causing a charging issue for members.	Detective controls and engineering solutions.	Decreased
General Data Protection Regulation (GDPR) and data handling and access	The risk of failing to comply with GDPR regulations, member data being accessed or used without proper authority.	Extensive GDPR programme including dedicated GDPR team, audits, and ongoing compliance monitoring. Various security, IT and operational processes implemented.	Increased
Network Capacity	The risk of mobile services to giffgaff members being impacted by capacity constraints beyond giffgaff's control.	Engagement with giffgaff's host network to share forecasting, and deployment of additional spectrum gained at auction by Telefonica UK Limited.	Decreased

Principal risks and uncertainties (continued)

Risk Name	Risk Impact	Risk Treatment	Risk Evolution
Economic/Political Instability	There is a risk that uncertainty around the UK's political stability (most notably BREXIT) could impact our business operations e.g. supply chain, foreign exchange rates etc.	A multi-disciplinary "BREXIT Taskforce" led by T UK Finance and Regulatory Affairs is in operation and monitoring developments as they emerge and co-ordinating responses to the various potential exposure.	New
5G deployment plan	Our focus is to ensure that we deliver on the opportunities offered by 5G and leverage these for our members' benefit but this exposes us to a risk that we could launch our 5G propositions after our competitors.	We are consulting with our members and monitoring the competitor environment to ensure that we have a proposition that resonates with our audience.	New

The Strategic Report was approved by the Board on 23 August 2019.

By Order of the Board

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

Directors' report

The Directors of the Company present their report for the Company, which has been prepared in accordance with IFRSs as adopted by the European Union.

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

Directors and secretary

The Directors who held office during the year and up to the date of signing the financial statements were as follows:

Mark Evans
Michael Fairman (resigned on 5 October 2018)
Patricia Cobian (appointed on 5 October 2018)
Ashley Schofield (appointed on 17 January 2019)

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

Directors' liability insurance and indemnity

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

Corporate Governance

The giffgaff Board, which is comprised of the Chief Executive of giffgaff, and the Chief Executive Officer and the Chief Finance Officer of T UK, is responsible for the overall conduct of the business and its long-term success.

The Board is assisted in its function by the Executive Committee (comprising of giffgaff's Chief Executive Officer and Chief Financial Officer). Aiding the Executive Committee is the giffgaff Leadership Team consisting of the Chief Marketing Officer, Chief Commercial Officer, Chief Operating and Technical Officer, and Brand Director. Priorities for the Leadership Team include maintaining our growth performance in a challenging market, ensuring our product offering remains relevant to our members and growing the business responsibly in an evolving regulatory environment.

The Chief Executive Officer of giffgaff is accountable to the statutory Board of T UK. giffgaff's Chief Executive Officer and Chief Financial Officer also attend T UK's Assurance Forum which considers the internal control framework and assists the T UK Limited board in its oversight responsibilities.

Employee disclosures

The Company does not have contractual employees in its own right but it operates the same employment policies and procedures as T UK, the principal employer of the employees seconded to the Company.

Directors' report (continued)

Employee disclosures (continued)

The Company 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 Company 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 support services to employees. These policies contain guidance for line managers and employees including recruitment processes and additional arrangements which can be made as required due to any disability.

Further disclosure in relation to the employees can be found on page 4 of the Strategic Report.

Dividends

The Company did not pay a dividend for the year ended 31 December 2018 (2017: £nil).

Financial risk management objectives, policies and exposure

Details of the Company's approach to business risk management are set out in the Strategic Report, and approaches to financial risk management are set out in the financial statements in note 19 "Financial Instruments".

Important events since the end of the financial year

The Strategic Report (page 7) details the important events affecting giffgaff 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 are detailed in notes 16 & 17 of the financial statements.

Going concern

The Directors believe that the Company is well placed to manage its business risk successfully.

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

Political donations

The Company made no political donation during the year ended 31 December 2018 (2017: £nil).

Directors' report (continued)

Independent Auditors

Pursuant to section 487 of the Companies Act 2006, the auditors will be deemed to be reappointed and PricewaterhouseCoopers LLP will therefore continue in office.

The Directors' Report was approved by the Board on 23 August 2019.

By Order of the Board

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

Statement of Directors' 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 Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

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

The directors are 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.

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

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

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

The Statement of Directors' Responsibilities was approved by the Board on 23 August 2019.

By Order of the Board

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

Independent Auditors' report to the members of giffgaff Limited

Report on the audit of the financial statements

Opinion

In our opinion, giffgaff Limited's financial statements:

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

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

Basis for opinion

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

Independence

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

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

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

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

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, members, suppliers and the wider economy.

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.

Independent Auditors' report to the members of giffgaff Limited (continued)

Reporting on other information (continued)

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

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

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

Strategic Report and Directors' Report

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

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 14, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

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

Independent Auditors' report to the members of giffgaff Limited (continued)

Responsibilities for the financial statements and the audit (continued)

Use of this report

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

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility..

Graham Lambert

Graham Lambert (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Uxbridge
23 August 2019

Statement of comprehensive income
For the year ended 31 December 2018

	Note	**2018** **£000**	2017 £000
Revenue	2	**449,222**	407,412
Cost of sales		**(332,079)**	(294,334)
Gross profit		**117,143**	113,078
Administrative expenses		**(78,922)**	(77,482)
Profit before taxation	3	**38,221**	35,596
Taxation	7	**(7,661)**	(6,900)
Profit and total comprehensive income for year		**30,560**	28,696

The accompanying notes on pages 22 to 41 are an integral part of these financial statements.

Statement of financial position
As at 31 December 2018

	Note	31 December 2018 £000	31 December 2017 £000
Non-current assets			
Property, plant and equipment	8	**11,135**	9,350
Intangible assets	9	**11,150**	9,652
Deferred tax assets	14	**255**	-
		22,540	19,002
Current assets			
Inventories	10	**4,886**	6,004
Trade and other receivables	11	**55,183**	45,220
Cash and cash equivalents	12	**177,439**	118,398
		237,508	169,622
Current liabilities			
Trade and other payables	13	**(205,103)**	(166,439)
Provisions	15	**(155)**	-
Net current assets		**32,250**	3,183
Total assets less current liabilities		**54,790**	22,185
Non-current liabilities			
Deferred tax liabilities	14	-	(1)
Provisions	15	**(2,046)**	-
		(2,046)	(1)
Net assets		**52,744**	22,184
Equity			
Share capital	16	-	-
Retained earnings		**52,744**	22,184
Total Equity		**52,744**	22,184

The accompanying notes on pages 22 to 41 are an integral part of these financial statements.

The financial statements on pages 18 to 21 were approved and authorised for issue by the Board of Directors on 23 August 2019 and were signed on its behalf by:

MCE

Mark Evans
Director

Statement of changes in equity
For the year ended 31 December 2018

	Called up share capital	(Accumulated losses)/ Retained earnings	Total equity
	£000	£000	£000
At 1 January 2017	-	**(6,512)**	**(6,512)**
Total comprehensive income for the year	-	28,696	28,696
At 31 December 2017	-	**22,184**	**22,184**
Total comprehensive income for the year	-	30,560	30,560
At 31 December 2018	-	**52,744**	**52,744**

The accompanying notes on pages 22 to 41 are an integral part of these financial statements.

Statement of cash flows
For the year ended 31 December 2018

	Note	2018 £000	2017 £000
Profit before taxation		**38,221**	35,596
Adjustments to reconcile profit before taxation to net cash flows:			
Amortisation, depreciation and impairment charges		**5,908**	4,698
Working capital adjustments:			
(Increase)/ decrease in inventory		**1,118**	(698)
Increase in trade and other receivables		**(9,963)**	(4,766)
Increase in trade and other payables		**38,664**	33,649
Increase in other provisions		**2,201**	-
Taxation		**(7,917)**	(6,969)
Net cash flow generated from operating activities		**68,232**	61,510
Purchase of fixed assets		**(9,191)**	(6,441)
Net cash flow used in investing activities		**(9,191)**	(6,441)
Net increase in cash and cash equivalents		**59,041**	55,069
Cash and cash equivalents at start of the year		**118,398**	63,329
Cash and cash equivalents at 31 December	12	**177,439**	118,398

The accompanying notes on pages 22 to 41 are an integral part of these financial statements.

Notes to the financial statements

1. Accounting policies

General information

The principal activity of giffgaff Limited (the "Company") is that of a mobile virtual network operator running on the O2 network, providing telecommunication services to the consumer mobile segment. The Company is incorporated in England and Wales and is domiciled in the United Kingdom. giffgaff Limited is a private company limited by shares registered in England and Wales under the number 4196996. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX.

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.

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.

The Company's financial statements are presented in Pound Sterling ('GBP') and all values are rounded to the nearest thousand GBP (£000) except where otherwise indicated.

Going concern

The Directors believe that the Company is well placed to manage its business risk successfully and have a reasonable expectation that the Company has adequate resources to continue in existence for the foreseeable future thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

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.

Revenue

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

<u>Mobile service revenue</u>

Mobile service revenue includes revenue earned for usage of T UK wireless network for voice, SMS and data transmission by the Company's members, as well as outbound roaming and interconnect revenue.

Revenue for pre-pay members is recorded as deferred revenue prior to commencement of services and is recognised as the pre-pay services are rendered. Outbound roaming revenue, earned from the Company's members roaming outside their domestic coverage area, is recognised based upon usage. Interconnect revenue, earned from other telecommunications operators whose customers terminate calls on giffgaff numbers, is recognised based upon usage.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Revenue (continued)

Hardware revenue

Hardware revenue principally consists of revenue from the sale of handsets. The revenue and related expenses associated with the sale of wireless handsets are recognised when the products are delivered and accepted by the member.

Handsets bought over time are funded by peer to peer loans, brokered by the Company. As a broker, giffgaff receives revenue on a commission basis, recognised at point of sale.

Other revenue

Other revenue comprises revenue earned as commission for peer-to-peer handset loans brokered by the Company, commission for the sale of price comparison products, and revenue for usage of the Company's billing platform infrastructure, recognised at point of sale.

Subscriber acquisition and loyalty programme cost

Member acquisition and retention costs are recognised as an expense for the period in which they are incurred. Advertising, promotion, sponsoring, communication and brand marketing costs are also expensed as incurred.

Employee benefits

Pension obligations

The Company does not have any contractual employees. Since September 2015 the Company's employees are seconded from T UK (previously seconded from Telefonica Digital Limited), an associate company within the Telefónica Group, which participates in the T UK Pension Plan ("Telefonica PP"), a scheme sponsored by T UK that provides benefits for the majority of UK employees in the Telefónica Group. Telefonica Europe plc (the Company's ultimate UK parent company) acted as Sponsor and Principal Employer of the Plan up to 14 December 2018. On this date a deed was signed by the trustees to transfer the plan into T UK as the majority of employees participating in the plan are employees of T UK.

During the reporting year, the Telefonica PP had both defined benefit and defined contribution sections. On 28 February 2013 the defined benefit sections of the Telefonica PP closed to further benefit accrual. Members of the defined benefit sections of the Telefonica PP 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 sections of the Telefonica PP were given the option to become members of the defined contribution section of the Telefonica PP. The defined contribution sections of the Telefonica PP remain open to new entrants and further accrual. The assets of the Telefonica PP are held independently of the Company's finances.

In T UK's capacity as a participating employer of the defined contribution section of the Telefonica PP, T UK pays contributions into the plan on behalf of employees of the Company. T UK has no further payment obligations once the contributions have been paid. The contributions are recharged to the Company and are recognised as employee benefit expense when they are due. Further disclosures on the Telefonica PP can be found in the financial statements of Telefonica Europe Plc.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Employee benefits (continued)

Share based payments

The Company recognises an expense for share awards and share options, which are both equity and cash 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 irrespective of whether the market or non-vesting condition is satisfied. Any proceeds received are credited to share capital and share premium when the share option or award is exercised. In addition, for cash-settled share based payment transactions, the Company measures the services received and the liability incurred at the fair value of the liability. Until the liability is settled, the Company re-measures the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognised in the statement of comprehensive income for the period.

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 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 that future taxable profits will be available against which deductible temporary differences can be utilised.

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

Property, plant and equipment

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

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

Plant and equipment	2 to 11 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.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Intangible assets

Software

Software is capitalised when it meets the criteria set out in the accounting standards for capitalisation, such as portal related costs, 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. These are costs that are directly associated with the production of identifiable unique software products controlled by the Company, including portal related assets which are expected to generate economic benefits over a period of more than one year, are recognised as intangible assets. Such computer software development costs recognised as intangible assets are amortised over their estimated useful lives not exceeding 6 years on a straight line basis.

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

Inventories

Inventories comprise SIM cards and 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.

Trade and other receivables

Trade and other receivables are carried at original invoice amount less provision for doubtful debts.

Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. Cash and cash equivalents includes cash in hand, deposits held at call with banks, and 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.

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.

Leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Rentals under operating leases are charged to the statement of comprehensive income in equal annual instalments over the periods of the leases.

Financial risk factors and management

The Company's operations expose it to a variety of financial risks including liquidity risk. The principal financial risks of the Company and how the Company managed these risks are discussed below. Principal business risks are addressed in the strategic report.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Liquidity risk

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.

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 cash and cash equivalents. 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.

New IFRS and interpretations of the International Financial Reporting Standards Interpretations Committee (IFRS IC)

The accounting policies adopted are consistent with those of the previous financial year.

At the date of preparation of the financial statements, the following IFRS and IFRS IC interpretations have been published.

IAS/IFRS standards	**Effective for accounting periods beginning on or after**
IFRS 9 *Financial Instruments*	1 January 2018
IFRS 15 *Revenues from Contracts with Customers*	1 January 2018
IFRS 16 *Leases*	1 January 2019
Amendments to IFRS 10 and IAS 28 (September 2014) *Sales or Contribution of Assets between an Investor and its Associate of Joint Venture*	See below[1]

[1] The IASB has acknowledged a conflict between these amendments and IAS 28 Investments in Associates and Joint Ventures. In December 2017 the IASB published an amendment to IFRS 10 and IAS 28, deferring the effective date of these amendments indefinitely.

The adoption of IFRS 9 has not had a material impact as impairment/ credit or loss on intercompany balances do not carry any significant risks within the Group.

The Company has analysed the potential impact of the application of the other aforementioned standards, amendments and interpretations. The adoption of IFRS 15 has not had any material impact on the amounts recognized in the prior or current period and is not expected to impact future periods.

Notes to the financial statements (continued)

1. Accounting policies (continued)

New IFRS and interpretations of the International Financial Reporting Standards Interpretations Committee (IFRS IC) (continued)

IFRS 16 Leases – effective 1 January 2019

Adoption of IFRS 16 will result in all leases being recognised in the statement of financial position, since the distinction between operating and finance leases is removed. Under the new standard, an asset (that is, the right to use the leased item) and a financial liability to pay rentals are recognised. A lessee may elect not to apply the general requirements to short-term leases and leases of low-value assets.

The Company acts as a lessee on one lease agreement, which is the lease of its office building. Such contracts are generally accounted for as operating leases under the current lease standard, with lease payments being recognised on a straight-line basis as an expense in the income statement over the contract term.

The lease term is 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. 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 arrangement.

The standard allows for two transition methods: retrospectively for all periods presented, or using a modified retrospective approach. The Company shall adopt the modified retrospective transition method, recognising the cumulative effect of initial application as an adjustment to retained earnings in the year of initial application of IFRS 16.

Certain practical expedients are also available on first time application. The Company will apply the practical expedient that allows the Company to not reassess whether a contract is or contains a lease on the date of initial application of IFRS 16. The new requirement will therefore be applied to all contracts previously identified as leases under the current accounting standard.

In addition, the following practical expedients will also be adopted by the Company on transition to the new requirements:

- Right of use asset measurement: for leases previously classified as an operating lease the Company shall recognise a right of use asset at the date of initial application measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.
- Initial direct costs: the Company will exclude initial direct costs from the measurement of the right of use asset at the date of initial application.

The Company expects that the changes introduced by IFRS 16 will have a significant impact on its financial statements from the date of adoption. Based on the assessment performed to date, the Company expects that the opening balance sheet at the date of initial application will show an increase in assets and liabilities of £6 million in connection with the rights of use and payment obligations arising from the contracts that are classified as operating leases under the current lease standard. The impact expected in equity is not significant at 1 January 2019. Amortisation of the right of use assets and recognition of interest costs on the lease obligation on the statement of comprehensive income will replace amounts recognised as lease expenses under the current lease standard, thus increasing operating income before depreciation and amortisation. Classification of lease payments in the statement of cash flows will be affected by the requirements of the new lease standard: a significant portion of the lease payments recognised as cash flows from operating activities in the statement of cash flows under the current lease standard, will be classified as cash flows from financing activities upon application of the new lease accounting requirements.

Notes to the financial statements (continued)

1. Accounting policies (continued)

New IFRS and interpretations of the International Financial Reporting Standards Interpretations Committee (IFRS IC) (continued)

IFRS 16 Leases – effective 1 January 2019 (continued)

The Company estimates that the main differences between the lease commitments disclosed in note 18 and the new lease liability measurement will relate mainly to:

- Discount rate differences: to the extent that there are differences in lease terms, the discount rates used are different as a consequence.

Estimated adoption impacts are based on the assessment conducted to date. Actual impacts at 1 January 2019 could be different because the Company is continuing to review the impacts of the initial application of the new requirements due to the estimations required and testing of new systems used in the implementation project. The new accounting policies will not be final until the Company presents its first financial statements subsequent to the effective date of IFRS 16.

Critical accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates. 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 negative 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 Company's financial statements are discussed below.

The following are considered significant accounting estimates:

<u>Property, plant and equipment and intangible assets</u>

Accounting for property, plant and equipment and intangible assets 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 intangible assets are depreciated or amortised on a straight-line basis over their estimated useful lives and taking into account their expected residual values. When the Company estimates useful lives, various factors are considered including expected technological obsolescence and the expected usage of the asset. The Company regularly reviews 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 change on depreciation and amortisation charges for the year.

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

Notes to the financial statements (continued)

2. Revenue

Significant revenue streams are detailed below:

	2018 £000	2017 £000
Mobile service revenue	**392,069**	351,331
Handsets revenue	**50,079**	48,199
Other revenue	**7,074**	7,882
Total revenue	**449,222**	407,412

3. Profit before taxation

The following items have been included in arriving at the profit before taxation:

	2018 £000	2017 £000
Staff costs (note 4)	**10,534**	7,981
Amortisation of intangible assets (note 9)	**3,072**	2,816
Depreciation of property, plant and equipment (note 8)	**2,526**	1,881
Impairment loss (note 9)	**310**	-
Operating lease costs	**655**	506
Auditors' remuneration (note 6)	**13**	13
Inventories:		
Cost of inventories recognised as an expense (included in cost of sales)	**49,234**	**49,853**

4. Employees

The Company does not have contractual employees in its own right. All employees are seconded from T UK, who incur the employee costs and recharge these to the Company on a monthly basis.

	2018	2017
Monthly average number of full time employee equivalents (including executive Directors)	**No.**	No.
Technology	**36**	28
Member Operations	**95**	76
Administration	**10**	8
Total employees	**141**	112

The benefits expense incurred in respect of these employees was:

	2018 £000	2017 £000
Wages and salaries	**8,680**	6,560
Social security costs	**1,053**	805
Pension costs	**774**	628
Share based payments	**27**	(12)
Total employee benefits expense	**10,534**	7,981

Notes to the financial statements (continued)

5. 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 17 for further details).

During the current year, no directors accrued retirement benefits under a defined benefit pension plan (2017: None). One director (2017: One) accrued retirement benefits under a defined contribution pension plan during the year. None of the Directors were entitled to receive shares in respect of qualifying service under long-term incentive plans (2017: One).

Directors of the Company are part of the key management of the Company. Key management is defined as the executive management and the Directors of the Company (two of which were remunerated by T UK for their services to the Group and whose emoluments are included in the disclosures as there is no sensible basis of allocating that can be applied). Key management compensation for services to the Company for the period were as follows:

	2018	2017
	£000	£000
Salaries and short-term employee benefits	**3,474**	3,344
Long term incentive plans	**-**	1,373
Post-employment benefits	**63**	43
Termination benefits	**-**	485
Total key management compensation	**3,537**	5,245

The remuneration of the Directors of the Company (two of which were remunerated by T UK for their services to the Group) for the year ended 31 December was as follows:

	2018	2017
	£000	£000
Aggregate emoluments in respect of qualifying services	**2,338**	2,975
Aggregate amounts paid under long term incentive plans	**-**	1,373
Aggregate amount of company contributions paid to a pension scheme	**8**	14
Termination benefits	**-**	485
Total director remuneration	**2,346**	4,847

In respect of the highest paid Director during the period:

	2018	2017
	£000	£000
Aggregate emoluments in respect of qualifying services	**1,549**	2,394
Aggregate amounts paid under long term incentive plans	**-**	1,373
	1,549	3,767

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

Notes to the financial statements (continued)

6. Auditors' remuneration

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

	2018 £000	2017 £000
Audit services:		
UK statutory audit fees	**13**	13
Total auditors' remuneration	**13**	13

The fees were paid to PricewaterhouseCoopers LLP.

7. Taxation

	2018 £000	2017 £000
Current tax - current year	**7,827**	6,924
Current tax – adjustments in respect of prior year	**90**	44
Deferred tax - current year	**(124)**	(68)
Deferred tax – adjustments in respect of prior periods	**(132)**	-
Taxation	**7,661**	6,900

	2018 £000	2017 £000
Profit before taxation	**38,221**	35,596
Profit before taxation multiplied by rate of corporation tax in the UK of 19% (2017: 19.25%)	**7,262**	6,852
Effects of:		
Expenses not deductible for tax purposes	**432**	1
Income not taxable	**(6)**	(2)
Prior year adjustment	**(42)**	44
Effect of change in tax rate	**15**	5
Total taxation charge	**7,661**	6,900

The Finance Act 2013 reduced the main rate of corporation tax to 20% with effect from 1 April 2015. The Finance Act 2015 further reduced the rate to 19% with effect from 1 April 2017.

Notes to the financial statements (continued)

8. Property, Plant and Equipment

	Plant and Equipment £000	Assets in the course of construction £000	Total £000
Cost			
At 1 January 2017	16,181	3,264	**19,445**
Additions	2	3,594	**3,596**
Reclassifications	2,980	(2,980)	**-**
At 31 December 2017	19,163	3,878	**23,041**
Additions	-	4,311	**4,311**
Reclassifications	7,881	(7,881)	**-**
At 31 December 2018	**27,044**	**308**	**27,352**
Accumulated depreciation			
At 1 January 2017	11,810	-	**11,810**
Charge for the year	1,881	-	**1,881**
At 31 December 2017	13,691	-	**13,691**
Charge for the year	2,526	-	**2,526**
At 31 December 2018	**16,217**	-	**16,217**
Net book amount			
At 31 December 2018	**10,827**	**308**	**11,135**
At 31 December 2017	5,472	3,878	9,350

In 2019 giffgaff migrated its member database onto its own platform, and sold the previous one. This disposal and the proceeds will be accounted for in the financial statements for 2019.

Notes to the financial statements (continued)

9. Intangible Assets

Cost	Software £000	Intangible assets in the process £000	Total £000
At 1 January 2017	18,493	5,000	**23,493**
Additions	19	2,826	**2,845**
Reclassifications	4,844	(4,844)	**-**
At 31 December 2017	23,356	2,982	**26,338**
Additions	-	4,880	**4,880**
Reclassifications	4,502	(4,502)	**-**
At 31 December 2018	**27,858**	**3,360**	**31,218**
Accumulated amortisation and impairment			
At 1 January 2017	13,870	-	**13,870**
Charge for the year	2,816	-	**2,816**
At 31 December 2017	16,686	-	**16,686**
Charge for the year	3,072	-	**3,072**
Impairment loss	310	-	**310**
At 31 December 2018	**20,068**	-	**20,068**
Net book amount			
At 31 December 2018	**7,790**	**3,360**	**11,150**
At 31 December 2017	6,670	2,982	9,652

Due to a change in strategy, the costs associated with gameplan have been included at recoverable amount and an impairment loss of £310,000 has been incurred in the financial year 2018. This reflects the reduced value of this development project to giffgaff.

10. Inventories

	2018 £000	2017 £000
Handsets held for resale	**4,647**	5,707
SIM cards	**239**	297
Inventories	**4,886**	6,004

Notes to the financial statements (continued)

11. Trade and other receivables

	2018 £000	2017 £000
Prepayments	**4,016**	4,121
Other debtors	**4,141**	962
Accrued revenue	**1,275**	2,244
Amounts owed by group companies	**45,751**	37,893
Trade and other receivables	**55,183**	45,220

Amounts owed by group companies relate to trading activities. These amounts are unsecured, interest free and repayable on demand.

At the end of the year ended 31 December 2018, the Company had no provisions relating to amounts owed by other group companies (2017: nil). This assessment is undertaken each financial year through an examination of the financial position of the related party.

12. Cash and cash equivalents

	2018 £000	2017 £000
Cash and cash equivalents	**177,439**	118,398

13. Trade and other payables

	2018 £000	2017 £000
Amounts owed to group companies	**142,094**	115,273
Other taxation and social security	**21,136**	18,220
Accrued expenses	**11,082**	5,735
Deferred income	**30,791**	27,211
Trade and other payables	**205,103**	166,439

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

Notes to the financial statements (continued)

14. Deferred tax assets/ (liabilities)

The movement on the deferred tax asset/ (liability) is as shown below:

	£000
At 1 January 2017	(68)
Prior year charge to statement of comprehensive income	-
Current year credit to statement of comprehensive income	67
At 31 December 2017	(1)
Prior year credit to statement of comprehensive income	132
Current year credit to statement of comprehensive income	124
At 31 December 2018	**255**

Deferred tax assets/(liabilities)	**Accelerated tax depreciation £000**	**Other £000**	**Total £000**
At 1 January 2017	(104)	36	(68)
(Charge)/ credit to statement of comprehensive income	(7)	74	67
Effect of change in tax rate	6	(6)	-
At 31 December 2017	(105)	104	(1)
Prior year credit to statement of comprehensive income	118	14	132
Current year credit to statement of comprehensive income	8	116	124
At 31 December 2018	**21**	**234**	**255**

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

Notes to the financial statements (continued)

15. Provisions

	Asset retirement obligation £000	Lease Incentive £000	Total £000
Current	-	155	155
Non-current	500	1,546	2,046
At 31 December 2018	**500**	**1,701**	**2,201**

	Asset retirement obligation £000	Lease Incentive £000	Total £000
At 1 January 2017	-	-	-
At 31 December 2017	-	-	-
Additional provision in year	500	1,765	2,265
Utilised for the year	-	(64)	(64)
At 31 December 2018	**500**	**1,701**	**2,201**

Asset Retirement Obligation

giffgaff is required to restore the lease premises of its office to its original condition at the end of its lease term. A provision has been recognised for the present value of the estimated expenditure required to remove any leasehold improvements. These costs have been capitalised as part of the cost of leasehold improvements and are amortised over the shorter of the term of the lease and the useful life of the asset.

Lease Incentive

giffgaff's lease accommodation includes partial fit-out costs provided by the lessor as a lease incentive. The assets obtained by the group have been recognised as furniture and equipment at fair value and are depreciated over the shorter of their useful life and the lease term. The lease incentive is presented as part of the lease liabilities and is reversed on a straight-line basis over the lease term. The remaining value will be taken in equal instalments for the term of the lease.

16. Share capital

	Number of shares	**2018 £**	Number of shares	2017 £
Called up, allotted and fully paid				
Ordinary shares of £1 each	**1**	**1**	1	1

The Company has one class of issued share capital, comprising ordinary shares of £1. Subject to the Company's articles of association, and applicable law, the Company's ordinary shares confer on the holder the right to receive notice of 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.

Notes to the financial statements (continued)

17. Share based payments

The amounts recognised in profit before taxation for share based payment transactions with employees for the year ended 31 December 2018 were as follows:

Period from 1 January to 31 December 2018	**2018**	2017
	£000	£000
Equity settled share based payments	**27**	(12)
Total share based payments	**27**	(12)

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

Telefonica Performance Investment Share Plan 2018-2022

The Telef6nica, 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 Telef6nica 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 Telef6nica 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.

Telefonica Performance Investment Share Plan 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 Telef6nica 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 Telef6nica 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 Telef6nica S.A., upon fulfillment of certain requirements, namely:

Notes to the financial statements (continued)

17. Share based payments (continued)

Telefonica Performance Investment Share Plan 2018-2022 (continued)

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

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

Talent for the Future Share Plan (TFSP) 2014-2019

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

At the General Shareholders' Meeting of Telefónica S.A. held on 30 May 2014, a long-term share-based incentive plan called "Talent for the Future Share Plan" was approved for certain Telefónica Group employees.

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

The term of the plan is five years and it is divided into three phases. At the beginning of each phase, each participant was allocated a notional number of shares. According to the plan, the number of shares to be delivered will depend upon Telefónica S.A.'s Total Shareholder Return ("TSR") performance compared to the TSR of the companies making up the 50th percentile of the Comparison Group. The initial and the second share allocations took place on 1 October 2014 and on 1 October 2015 respectively. Regarding the third phase of this 2017-2019 plan, Miami S.A.'s Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

2,021 shares were assigned in the first phase with a fair value of €6.82 per share. No shares were assigned in the second and third phases of the plan.

The first phase expired on 30 September 2018. Delivery of shares was not required at the end of the phase according to the general conditions of the plan.

Other share-based payment plans

Global Employee Share Plan 2015-2018

At the Telefónica S.A. Ordinary General Shareholders' Meeting on 30 May 2014, the shareholders approved a new voluntary plan for incentivised purchases of shares for the employees of the Group. Under the plan employees were offered the option to acquire Telefónica S.A. shares during a twelve-month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements.

The total term of the plan was two years. Employees joining the plan could acquire Telefónica S.A. shares through maximum monthly instalments of €150 (or the local currency equivalent) up to a maximum of €1,800

Notes to the financial statements (continued)

17. Share based payments (continued)

Other share-based payment plans (continued)

over a period of 12 months (acquisition period) and the minimum contribution to be made by each participant would be €25. Shares were delivered upon vesting of the plan, on 31 July 2018. The employees that remained part of the Telefónica Group and held on to the shares for one year following the acquisition period (the shareholding period), were entitled to receive one free share for each share they acquired and retained throughout the shareholding period.

The acquisition period commenced in July 2015 and ended in June 2017. The plan's shareholding period came to an end in July 2018. On the vesting date, no employees were delivered shares according to the general conditions of the plan.

18. Financial commitments and contingent liabilities

Operating lease commitments

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

	2018	2017
	£000	£000
Within one year	**71**	856
Between two and five years	**2,666**	-
Over five years	**4,569**	-
Total operating lease commitment	**7,306**	856

Other commitments

There were no other commitments at 31 December 2018 (2017: £nil).

19. Financial instruments

Financial risk factors and management

The Company has financial assets in the form of cash. The purpose of the Company's Policy on risk management is to manage the interest rate risk that arises from the Company's operations and sources of finance.

The main sources of risk arising from the Company's financial instruments are interest rate risk, credit risk and liquidity risk. Management of the Company's financial risks is achieved mostly through being part of the larger Telefonica group, which operates group wide policies in each area and is able to hedge positions on a group basis.

Notes to the financial statements (continued)

19. Financial instruments (continued)

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 cash and cash equivalents. 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.

Liquidity risk

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

The Company's liquidity risk is managed through being a part of the larger Telefónica Group.

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 interest received on cash and cash equivalents.

Fair value estimation

The fair value of the cash and cash equivalents approximates to the book carrying value due to the short-term or on demand maturity of these instruments.

20. Related party disclosure

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

	2018	2017
	£000	£000
Purchases from group companies	**(188,241)**	(164,533)
Total transactions	**(188,241)**	(164,533)

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

Other related party balances are detailed in notes 11 and 13.

Related party transactions with Directors and key management are detailed in note 5.

Notes to the financial statements (continued)

21. Parent company and controlling party

The immediate parent company is T UK. The ultimate parent company and controlling party is Telefónica, S.A., a company incorporated in Spain. Copies of the financial statements of Telefónica, S.A. may be obtained from its registered office at Gran Via 28, Madrid, Spain. Telefónica, S.A. is the largest group for which consolidated financial statements are prepared. O2 Holdings Limited is the smallest group for which consolidated financial statements are prepared.

22. Subsequent events

Brexit

We are focused on supporting all of our consumers and businesses regardless of the uncertainty in the macro economy that we operate in. We are committed to ensuring our members receive the service they expect and need in the event of the UK leaving the European Union without a deal. Like all businesses we are taking the steps to prepare for all scenarios and any changes in underlying market conditions resulting from a no deal Brexit.

T UK has a Brexit Taskforce led by the Group Director of Regulatory Affairs and the Group Financial Controller who are closely monitoring the Brexit negotiations as they unfold. The Brexit Taskforce have thoroughly assessed and identified the Business' Brexit related risks which mainly are related to: commercial, operational, financial and human resources matters. These risks have been classified as either having a high likelihood or a high impact but not both and have in place proportionate risk management and mitigation processes to minimise the impact on the business. The directors are confident that the Business is well positioned to continue to provide uninterrupted services to our members despite the uncertainty.

5G Deployment

In July 2019, T UK announced the launch of the 5G network in October 2019, prioritising areas where consumers will benefit most. giffgaff plans to start a trial with members after the O2 launch in October to really understand the benefits. We will be working towards a full launch in early 2020.

Sale of Assets

The migration of the giffgaff member database and the sale of the original platform was completed in June 2019.

Billing and Ofcom

On 28 June 2018, the Company notified Ofcom that it had identified billing errors related to a specific instance of a members' goodybag usage. In a decision dated 30 July 2019, Ofcom found that the Company contravened its statutory obligations to render accurate bills to its members and, separately, in providing information to Ofcom in response to two formal requests for information dated 1 October 2018 and 26 November 2018 (the information requested related to Ofcom's investigation into giffgaff's metering and billing obligations). Ofcom decided to impose a penalty of £1.4 million in respect of giffgaff's contravention of its metering and billing obligations, and a £50,000 penalty for failing to provide correct information to Ofcom. Subsequently the Company has reviewed and is strengthening its billing processes, governance and how it responds to formal requests for information. Both amounts have been recorded in these financial statements.

gameplan

On 13 August 2019 it was decided to discontinue 'gameplan', the Company's development stage Personal Finance Management Tool, in order for the Company to focus on its core activities. The decision to discontinue gameplan is not expected to have a significant impact on our operations.