

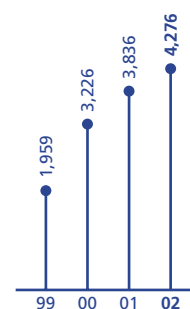
Annual Report and Financial Statements 2002 **mm** **O<sub>2</sub>**



	2002	2001	2001 (pro forma) <sup>1</sup>
	£m	£m	£m
Group turnover	4,276	3,200	3,836
EBITDA <sup>2</sup> before exceptional items	433	317	(39)
Exceptional items	(150)	(2,821)	(2,821)
Group operating loss	(856)	(3,164)	(3,809)
Capital expenditure (additions)	1,142	1,144	1,581
Year-end net debt	617		

<sup>1</sup>Includes the results of all operating entities of mmO<sub>2</sub> as though they were subsidiaries for the whole of the year ended 31 March 2001.

<sup>2</sup>EBITDA is our earnings before interest, tax, depreciation, amortisation and exceptional items and excludes our share of the operating profits and losses of our joint ventures and subsidiaries.



TOTAL PRO FORMA REVENUE  
£m



PRO FORMA CAPITAL EXPENDITURE  
£m

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## Form 20-F

US information included in this Annual Report will form part of mmO<sub>2</sub>'s Annual Report on Form 20-F that will be filed with the US Securities and Exchange Commission.

# welcome to mmO<sub>2</sub>

>>> It is our privilege to present the first Annual Report and Financial Statements for your Company, mmO<sub>2</sub>. Notwithstanding recent market sentiment regarding telecoms stocks, your Board believes that mmO<sub>2</sub> presents a real opportunity to create shareholder value by generating growth above the average for the mobile communications sector. Shareholder value is and will remain at the top of our agenda. >> Following our appointment last year, our initial task was to prepare mmO<sub>2</sub> for full independence as a FTSE 100 company. BT Wireless, as mmO<sub>2</sub> was then called, was a division of BT whose mobile operations had only recently been separated from BT's fixed line operations. >> As might be expected, there were negative aspects to the business. We found important shortfalls in operational performance, a lack of focus on key targets and the absence of a widely instilled, high-performance management culture. A corporate organisation did not yet exist. >> On the positive front, we discovered a strong track record of innovation, an experienced, technically capable and talented employee base and a willingness to embrace change amongst many of the staff. It was clear that mmO<sub>2</sub> businesses had a number of significant strategic strengths. >> We recruited a new Board and strengthened our executive team with the appointment of David Finch as Chief Financial Officer and a number of other external appointments. The demerger was agreed by the BT shareholders on 23 October 2001 and mmO<sub>2</sub> began life as a listed company on 19 November 2001 on the London and New York stock exchanges. >> As we approached our listing, we gave an account of our strategic strengths and hopes for mmO<sub>2</sub> to the investment community, bondholders and our banks. We could point to a European footprint of cohesive, wholly owned businesses, a well-established mobile communications presence in the UK and Ireland, growing businesses in Germany and the Netherlands and one of the leading mobile data and internet businesses in Europe. >> We would like to pay tribute to the many people in mmO<sub>2</sub> who have enabled us to execute the demerger in such a comparatively short time. The commitment and expertise shown gives us considerable confidence in the ability of mmO<sub>2</sub> people to face and overcome the challenges that lie ahead. >> We are delighted to have attracted a talented group of non-executive Directors, all with strong business reputations, to the Board of mmO<sub>2</sub>, which we believe is a testament to our potential as a company. They will bring the benefits of wide experience and relevant commercial wisdom to the Group.

**We are committed to you – our shareholders, our customers and our people** We are committed to delivering shareholder value. This will be at the core of everything we do, at the heart of every key decision. mmO<sub>2</sub> is a growth business in a growth market and we intend to deliver increasing shareholder value in the years ahead. >> We will become an increasingly effective competitor in the mobile communications marketplace. Our organisation will be focused on the customer and we will live and breathe our core mission: "To build an inseparable relationship with our customers by understanding their needs and delivering mobile solutions which they truly value". >> We will build an organisation that attracts the very best people. We will give them the tools to deliver on our commitments and we will reward them appropriately. >> We will continue to act as a responsible corporate citizen. We want to be seen as a leader in the strength of our commitment to meeting our community and environmental responsibilities.

**Our performance so far** Our revenue for the full year to 31 March 2002 was 11.5 per cent ahead of last year at £4.28 billion (2001: pro forma £3.84 billion), with EBITDA of £433 million (2001: pro forma EBITDA loss of £39 million). We ended the year with a base of 17.5 million active customers – up 12.2 per cent on last year. Reflecting our continued focus on improving operational performance, we took an exceptional restructuring charge of £150 million – leading to an estimated £70 million annual cost saving – and reduced full-year capital expenditure to £1.14 billion (2001: pro forma £1.58 billion). Our operating loss, which includes the exceptional charge above, was £856 million (2001: loss of £3,164 million). Tight cash management meant that we were able to finish the year with a net debt of £617 million, which was significantly lower than our expectations at the time of demerger.

PETER ERSKINE  
CHIEF EXECUTIVE OFFICER



DAVID VARNEY  
CHAIRMAN



**Going forward** In the rest of our statement we would like to describe how we see our markets – both the opportunities they offer and the challenges they present – our strategy for growth and our plans for building a high-performance organisation that will deliver value to shareholders, customers and employees.

**Mobile is still a growth market but one that is increasingly challenging** High levels of penetration of voice-based services in the developed European markets have led to a slowdown in the growth of the mobile market. Penetration rates in the UK and Germany, mmO<sub>2</sub>'s two largest markets, are now approaching 80 per cent and 65 per cent respectively and this has affected growth in new registrations. >> In future, growth for mobile operators will no longer primarily be driven by bringing new customers into the market. The challenge for mmO<sub>2</sub> will be to forge closer relationships with our customers and to win market share from our competitors. We will do that by offering customers a better overall experience, products that will improve their lives, the best available service and competitive pricing. >> We see exciting opportunities in mobile data services, where we have positioned ourselves as a leader in Europe. As traditional voice revenues per user level off, data services will become the primary source of mobile market growth. The timing of a take-off in mobile data services is uncertain. But we expect that in three to five years' time new mobile data applications will become commonplace, improving the lives of customers and generating significant revenue for mobile operators.

**Our strategy is clear, focused and bold – we have made a good start but we recognise the scale of the task ahead**

Our strategy is firmly focused on three key areas – improved operational performance and execution; managing our businesses cohesively and leadership in data services through investment in General Packet Radio Service (GPRS) and Universal Mobile Telephone System (UMTS), or "3G", networks and services. >> Operational excellence is central to our strategy. Each of our businesses must match and then exceed the best in customer satisfaction, network quality and cost efficiency. We have acknowledged that our performance on these measures is not satisfactory. To "fix the basics" we have introduced wide-ranging and demanding programmes across all mmO<sub>2</sub> businesses, and we have already seen good improvements in financial performance. >> In O<sub>2</sub> UK we have already lifted EBITDA margins to over 24 per cent and our aim is to increase them to above 30 per cent. We will reinforce the move to lower customer churn rates shown in last year's results. The drive is on to recruit high-quality customers in the post-paid, contract market. Improved operating efficiency, particularly in the area of Subscriber Acquisition Costs (SACs), where progress has been substantial, is the key to continued improvements in the profitability of our successful O<sub>2</sub> Ireland business. >> We need to achieve competitive scale and profitability in our businesses in Germany and the Netherlands. There is already evidence in our results of an improved performance in both markets. An important part of our strategy in these countries is to gain incremental customers and network traffic by forming innovative partnerships with third parties. We have already secured deals with Postbank and Tele2 in the Netherlands. Both deals will increase the utilisation of our networks and more agreements are in the pipeline. >> Network-sharing arrangements with T-Mobile has significantly reduced the future capital requirements involved in our transition from Global System for Mobile communications (GSM) and GPRS technologies to 3G technology. >> Germany and the Netherlands represent major opportunities to create substantial value for mmO<sub>2</sub> shareholders, but we do not underestimate the challenges of effective execution in these intensely competitive markets.

**One business, one brand, one focus and a high-performance culture** A common face to our customers is vital. In May 2002 we introduced a single customer brand – O<sub>2</sub> – creating a new force in European mobile communications and we are rolling it out in a consistent way across all our businesses. O<sub>2</sub> is a brand that conveys freshness and life, freedom and clarity. To make it come

alive for our customers we will need to offer the highest levels of service and to act as one single entity in whatever we do. >> We have introduced Project Perform to drive a new way of working across the Group. By cutting out duplication and costly bureaucracy we will be smarter and faster and get closer to the customer. We want to do things once and do them in the right way. >> As an example, we have formed a single product management unit – products O<sub>2</sub> – to cut the cost and time to market of new products, drive their delivery across all O<sub>2</sub> businesses and secure better deals with vendors. We have seen the benefits of this already in our recently launched data terminal products. Technology rationalisation and shared knowledge on network quality – the key to retaining customers and ensuring higher usage – will yield further synergies. In this drive for efficiency, we recently announced our intention to build a seamless pan-European broadband mobile data highway to support the development of advanced multimedia services and their rapid launch across mmO<sub>2</sub>'s businesses simultaneously. We will achieve this by consolidating all our existing supply contracts and replacing them with new strategic partnerships, under which Nortel Networks and Nokia are to become the principal network suppliers. >> We have introduced a change programme, Project Breathe, across all our businesses in order to build a customer focused, high-performance culture. We must listen to our customers, commit ourselves to changing their lives and build relationships with them. Only in this way can we release the full potential of our 14,000 employees and only in this way can we outperform the competition. >> We are delighted that our O<sub>2</sub> businesses won a number of top awards last year, recognising high performance in areas ranging from customer service, to network excellence, training and innovation. >> We place great stress on the development of our employees and want everyone in mmO<sub>2</sub> to work together and to live out mmO<sub>2</sub>'s core values – to be open, bold, trusted and clear in everything they do.

**Leading the data services market** Our commitment to 3G technology is absolute. We intend to launch 3G high-speed data services in both the UK and Germany during the summer of 2003. By then we believe that dual mode handsets, that allow roaming from 3G onto GPRS medium-speed data networks, will be available in quantity and the market will be ready for the launch of the new technology. In the meantime we will be driving the build-up of high-value contract customers on our GPRS networks, targeting both the consumer and business markets with new data products. >> Our target is to lift mobile data revenues from 11.7 per cent of mmO<sub>2</sub> service revenues to over 25 per cent in three years' time and to around 50 per cent in ten years' time. >> We were pioneers in introducing GPRS and in December 2001 our Manx Telecom business launched its third-generation network, the first fully operational 3G system in Europe. We intend to remain in the forefront of mobile data developments while continuing to adopt a cautious and pragmatic approach to capital expenditure – only investing when we believe market conditions are right.

**Capitalising on our leadership in data services is central to our strategy** Basic data services – person-to-person text messaging, information sent to mobiles via text and simple handset games – are already popular. But the adoption of GPRS devices, providing “always-on” mobile connections, will boost the adoption of more complex services, ranging from email to instant text messaging, multimedia messaging and interactive games. >> Business users will find that they can deal with emails on the move as easily as they do from their PC. Instant text messages will find their intended recipients whether they are using their PC or their mobile device. Multimedia messaging, with its ability to send video and photographic images with text, will have a host of business as well as consumer applications. Full mobile web browsing will become a reality. >> Complex technology for its own sake is not a driver for mmO<sub>2</sub>. Instead we will offer services that are relevant to our customers – ones that will enhance their ability to communicate with friends, with work, to be informed and to be entertained on the move, whenever and wherever they are. By doing this we will build a loyal customer base and capture the significant value that will become available in mobile data

services. >> By collaborating with content application and device partners, mmO<sub>2</sub> will be the leader in bringing new mobile data services to market. We were the first in Europe to sign an agreement with RIM of Canada for its BlackBerry™ GPRS terminal, that allows always-on access to corporate emails, and are distributing Handspring's Treo™ mobile organiser. We have also recently launched the xda from O<sub>2</sub>, an integrated mobile phone and Personal Digital Assistant (PDA). It will be a key challenge for us to schedule our investment in new services and technology to make the most of this significant profit opportunity. >> Mobile technology is also providing a solution to the complex issues surrounding effective communication between the UK's emergency services. mmO<sub>2</sub>'s Airwave business has a £2.5 billion, 20-year contract to be the sole supplier of core mobile radio services to the police forces of England, Scotland and Wales. We are actively seeking new clients amongst the public emergency services and our plans to complete the Airwave network by 2005 are on target.

**Our role in the community** mmO<sub>2</sub> takes seriously its responsibilities to the community and the environment. The Group has detailed policies in place addressing social, ethical and environmental issues. Health and safety matters are of prime importance to us and we co-fund a number of research initiatives into the health effects of mobile phone technology. >> We are determined to add value to the communities in which we operate, not only through our commercial activities, but also through active engagement with society.

**Outlook** Trading in a highly competitive but genuine growth industry, mmO<sub>2</sub> is a business of great potential, although significant challenges remain. Our German, Dutch and O<sub>2</sub> Online businesses are currently loss-making and we face increasing competition from existing providers of mobile services and new market entrants. The development costs of our 3G mobile networks will be substantial and the demand for 3G services is uncertain. However, the increasing sophistication of our investment appraisal process should enable us to deliver additional investment at acceptable rates of return. We have robust plans in place to generate shareholder value by delivering superior growth. The Board, the executive team and all our employees are committed to realising that exciting potential, day-by-day, month-by-month and year-by-year.

### History and development of the Company

On 10 May 2001, BT announced its intention to demerge our businesses. This was effected by a reorganisation, a scheme of arrangement and a demerger transaction. As a result of these transactions our operations have been conducted as an independent entity with key subsidiaries in the United Kingdom, Germany, the Netherlands, Ireland and the Isle of Man. In May 2002 we introduced a single customer brand, O<sub>2</sub>, and in support of that introduction each of the principal country company operating names except for Manx Telecom Limited in the Isle of Man, were changed to include the brand in their names. Accordingly, references throughout this annual report to the country operations, where appropriate, refer to the new operating company names. The reorganisation of our businesses in order to create our Group, the scheme of arrangement and the demerger transaction are described in more detail in the related party transactions section of "supplementary information for United States investors." The following is a brief summary of the development of our key businesses:

#### O<sub>2</sub> UK

O<sub>2</sub> UK is our main UK business and presently our most significant business in terms of its contribution to our revenues and profitability.

O<sub>2</sub> UK was formed as a joint venture between BT and Securicor Group plc in January 1984, with BT owning 51 per cent and prior to the demerger was called BT Cellnet. In April 1986, BT increased its stake to 60 per cent. In November 1999, BT acquired Securicor's remaining stake in the business for £3,173 million, including expenses. The business was managed separately from the businesses of either of its former shareholders.

O<sub>2</sub> UK provided analogue mobile telephone services from January 1985 until October 2000 and has provided GSM services since July 1994. In April 2000, O<sub>2</sub> Third Generation Limited, now one of our subsidiaries, was awarded one of the five UMTS licences in the United Kingdom for £4.03 billion, which was paid in May 2000. In June 2000, O<sub>2</sub> UK launched GPRS services to the UK market.

In implementing its strategy of increasing control over its distribution channels, O<sub>2</sub> UK has made a number of significant acquisitions and investments. In May 1997, O<sub>2</sub> UK acquired a 40 per cent shareholding in The Link Stores Limited, a UK telecommunications retail outlet, with Dixons Stores Group Limited as the principal shareholder. In March 1999, O<sub>2</sub> UK acquired a 100 per cent interest in Martin Dawes Telecommunications Holdings Limited for £131 million. At that time, Martin Dawes Telecommunications Holdings Limited owned an 80.2 per cent interest in Martin Dawes Telecommunications Limited. O<sub>2</sub> UK acquired the remaining 19.8 per cent interest for £26 million in September 1999. The Martin Dawes business changed its name to Lumina which has now adopted the O<sub>2</sub> UK identity. In September 1999, O<sub>2</sub> UK achieved 100 per cent control of DX Communications Limited by acquiring the remaining 74 per cent interest it did not already own for £20 million and, in April 2000, 100 per cent control of Mobile Phone Stores Limited by acquiring the remaining 60 per cent interest it did not already own for £44 million. Both DX Communications Limited and Mobile Phone Stores Limited have significant UK mobile telephone retail chains.

BT transferred to us the Airwave business in November 2001, which provides TETRA network services to certain public safety organisations in the United Kingdom. Prior to that BT already had transferred to us its contracts to provide network services to a number of police authorities in the United Kingdom. On demerger, O<sub>2</sub> UK also included the BT Mobile business (BT's own mobile service provider), the BT Paging business (the United Kingdom's leading paging network) and the BT Messaging business.

#### O<sub>2</sub> Germany

Our German business, O<sub>2</sub> Germany, was launched in May 1995 as a joint venture between BT and Viag AG, with BT holding a 50 per cent stake. BT's stake reduced to 45 per cent when Telenor AS acquired a 10 per cent stake in April 1997. Pursuant to agreements made in August 2000 and January 2001, BT increased its stake to 55 per cent by acquiring Telenor's 10 per cent stake for £1,032 million. In February 2001, BT acquired the remaining 45 per cent of the business from E.ON AG (formerly known as Viag AG) for £4,562 million. As part of the transactions, BT repaid loans totalling £3,615 million provided by E.ON AG and Telenor AS to O<sub>2</sub> Germany to fund its UMTS licence acquisitions. As a result of the reorganisation of our businesses in order to create our Group, the fixed line businesses previously owned by Viag AG were separated from its mobile businesses and do not form part of our Group.

O<sub>2</sub> Germany was awarded the fourth German GSM licence in May 1997 and launched GSM mobile services in October 1998. In August 2000, O<sub>2</sub> Germany was awarded a UMTS licence in Germany. The cost of the licence was £5.16 billion, which was paid in September 2000. In January 2001 it launched its GPRS service.

#### O<sub>2</sub> Netherlands

O<sub>2</sub> Netherlands was founded in September 1996 as a joint venture between BT and Nederlandse Spoorwegen N.V., the Dutch railway company, with BT holding a 50 per cent stake. Initially, the business provided fixed line services only, but in February 1998, it was awarded a mobile licence in the Netherlands and in October 1998 it launched its GSM mobile network operations. In July 2000, BT completed the acquisition of the remaining 50 per cent interest in the Telfort Group for £1,207 million. Also in July 2000, the Telfort Group was awarded one of the five UMTS licences for the Netherlands at a cost of £266 million and launched GPRS services to the business sector in July 2001. As a result of the reorganisation of our businesses in order to create our Group, the fixed line businesses of the Telfort Group were separated from its mobile businesses, and do not form part of our Group.

#### O<sub>2</sub> Ireland

Our Irish business, O<sub>2</sub> Ireland was formed in June 1995. BT acquired a 1 per cent interest in the issued voting share capital of O<sub>2</sub> Ireland from IIU Nominees Ltd in January 2000. In March 2000, BT acquired a further 49.5 per cent stake through its acquisition of Esat Telecom Group plc for £1,558 million. In April 2000, BT acquired the 1,500,000 non-voting shares held by a member of O<sub>2</sub> Ireland's management, and in April 2001 BT increased its interest to 100 per cent by acquiring Telenor's 49.5 per cent interest for £856 million.

O<sub>2</sub> Ireland launched its commercial GSM services in March 1997 and launched its GPRS service in January 2002. O<sub>2</sub> Ireland has applied for one of the four UMTS licences to be offered by the Irish government.

### Manx Telecom

In 1987, our business in the Isle of Man, Manx Telecom, was awarded a 20-year licence to operate the Isle of Man telecommunications network. The licence originally covered fixed line telephony but was expanded in 1994 to include GSM mobile services and in 1999 to include UMTS services. Manx Telecom launched Europe's first UMTS network in December 2001, offering high-speed data and advanced business and e-commerce solutions.

### O<sub>2</sub> Online

O<sub>2</sub> Online, one of Europe's leading mobile internet businesses, was originally developed in 1997 as part of O<sub>2</sub> UK in the United Kingdom. O<sub>2</sub> Online closed down its operations in France and Spain and disposed of its operation in Italy in March 2002. O<sub>2</sub> Online currently has operations in the United Kingdom, Germany, the Netherlands and Asia.

### Reorganisation

As a result of the reorganisation of our businesses, the scheme of arrangement and the demerger transaction, we now own the international mobile businesses of BT described above. The reorganisation of our businesses is described in more detail in the "supplementary information for United States investors".

## Business Overview

### Introduction

We are a leading provider of mobile communication services in Europe. As at 31 March 2002 our business served 17.46 million mobile customers in the United Kingdom, Germany, Ireland, the Netherlands and the Isle of Man. Our mobile businesses in these countries are all wholly owned and together they cover territories with a total population of over 160 million people. Our combined Group turnover for the year ended 31 March 2002 reached £4,276 million, up 34 per cent from £3,200 million for the preceding year.

Reflecting our strategy to run our businesses cohesively, in September 2001, we announced a new brand, O<sub>2</sub>, for the Group.

We have well established and profitable mobile businesses in the United Kingdom and Ireland where O<sub>2</sub> UK and O<sub>2</sub> Ireland each have a track record of revenue and customer growth. In these countries, we have developed a strong presence in high-value markets, such as the business market, and in the provision of mobile data and internet services. As at 31 March 2002, O<sub>2</sub> UK's total number of corporate and small to medium enterprise customers was greater than that of any other UK operator and O<sub>2</sub> Ireland served 76 of the top 100 Irish companies. As part of the drive to manage our cost-base, in the UK, O<sub>2</sub> UK plans to scale back its permanent workforce during the fiscal year 2002/03 from 7,500 to 6,100 people, following the successful implementation of a reduction of approximately 250 in the past year.

As part of the cost-managing exercise, O<sub>2</sub> UK will also be closing 133 of its existing 320 retail outlets.

Our businesses in Germany and the Netherlands, which are currently loss-making, have grown significantly since they launched their GSM mobile networks in October 1998 and at 31 March 2002 had over 3.89 million and 1.25 million customers, respectively. These businesses have made a large investment in their networks and are now expanding their position in target markets by exploiting new and existing distribution channels and developing innovative products. In addition to their retail businesses, they are developing complementary wholesale services to exploit their network capacity. We are actively managing costs in all our businesses and at O<sub>2</sub> Germany, following a reduction of 400 employees during 2001/02, the company intends to decrease its staff levels in the forthcoming year from 3,900 to 3,400.

Our mobile businesses in the United Kingdom, Germany, the Netherlands and Ireland have all deployed mobile packet data capabilities based on GPRS technology. GPRS offers "always-on" connectivity for mobile office services, e-commerce, banking, online billing, telemetry, entertainment, mobile internet and other mobile data services. O<sub>2</sub> UK was the first mobile operator in the world to launch commercial GPRS services. O<sub>2</sub> Germany and O<sub>2</sub> Netherlands were also the first to launch operational GPRS networks in their markets.

GPRS serves as the key transitional stage in our roll-out of UMTS services. During 1999 and 2000, we secured licences to operate UMTS mobile services in the United Kingdom, Germany, the Netherlands and the Isle of Man. We have applied for a UMTS licence in Ireland and expect to have the result of that application by June 2002. In addition to conventional voice and data services, UMTS will offer high-resolution video and multimedia services and significant enhancements to the mobile data services available on GPRS. Our business in the Isle of Man launched Europe's first fully operational UMTS network in December 2001, offering a full range of high-bandwidth applications, including video telephony and advanced business and e-commerce solutions.

To achieve our goal of leadership in GPRS and UMTS services we believe we have positioned our Group as one of the leading providers of mobile data and internet services in Europe. We have done this in part through O<sub>2</sub> Online, our mobile internet business, which already has a leading position in Europe. The O<sub>2</sub> Online mobile offering is designed to create value for us by attracting high-value customers, by increasing the voice and data usage of our networks and by reducing churn through high-quality content, services and applications and closer relationships with customers.

Over the course of last year, O<sub>2</sub> UK developed relationships with suppliers for the provision of advanced data applications and devices such as the RIM BlackBerry™ email device and Handspring's Treo™ family of compact wireless communicator devices. These devices complement our growing range of mobile data products which already includes the xda from O<sub>2</sub>. The xda from O<sub>2</sub> is a new mobile multimedia device equipped with a PDA, phone and Microsoft's Pocket PC 2002 Phone Edition™ Software, which offers GSM and "always on" high-speed GPRS network connectivity. After



## business review

the completion of certain technical modifications it is the intention that the xda from O<sub>2</sub> will be available in the UK, Germany, the Netherlands and Ireland, with roaming capability across these countries.

We will be consolidating our existing supply contracts for the UMTS network and replacing them with new strategic partnerships. Nortel Networks and Nokia will become the principal suppliers of the broadband mobile data networks. This will help us reduce capital expenditure. We have also announced our intention to outsource the operation of the O<sub>2</sub> Netherlands network to Ericsson primarily to improve the operational efficiency of the network, and reduce operating costs. It is anticipated that on completion of the negotiation of this outsourcing agreement, the O<sub>2</sub> Netherlands network operations staff will transfer to Ericsson. No transfer of O<sub>2</sub> Netherlands assets is involved in this arrangement.

### Strengths

In summary, we believe the following key strengths will enable our Group to enhance its position as one of the leading providers of mobile communications services in Europe:

- >> European footprint of cohesive wholly owned businesses;
- >> established mobile businesses in the United Kingdom and Ireland;
- >> growing businesses in Germany and the Netherlands;
- >> well positioned for GPRS and UMTS success;
- >> a leading position in mobile data; and
- >> track record of innovation.

We have formulated a Group-wide strategy that will enable us to best leverage these strengths.

### Strategy

Our goal is to create shareholder value through above sector average growth in revenue and EBITDA. The key elements of our strategy to achieve this goal are to:

- >> emphasise operational performance and execution;
- >> achieve greater integration by managing our businesses cohesively; and
- >> lead in new data services through GPRS and UMTS.

### Emphasise operational performance and execution

#### Focus on higher-value customers in all of our businesses.

We will target business, individual professional and high-usage young adult customers, who also tend to be early adopters of data and next generation services.

In our more established operations in the United Kingdom and Ireland, we already have a strong position amongst corporate and small and medium enterprise customers. We intend to expand our business services portfolio, including data services, and to reinforce our direct and indirect distribution channels and sales support capabilities.

In Germany we aim to continue to reposition our business towards a higher-value customer base through building on services such as Genion which combines innovative product features with a competitive offering. We will build on O<sub>2</sub> UK's experience in serving business customers in order to increase our share of these customers in Germany, leveraging products initially introduced in the United Kingdom.

#### Achieve competitive scale in Germany and the Netherlands.

Our primary focus is on building our retail business. In this area we will continue to expand our direct channels, including owned shops, branded partner shops and web-based channels, but will also build partnerships with other businesses with established and complementary channels, allowing us to deliver targeted services to customers. An example of this is the partnership between Postbank and O<sub>2</sub> Netherlands providing mobile voice, portal and banking services to Postbank customers. Our partnership with Tele2, a leading supplier of carrier preselect services in the Netherlands, allows O<sub>2</sub> Netherlands to build scale and generate revenues by carrying the mobile traffic of the Tele2 fixed customer base at low incremental cost to O<sub>2</sub> Netherlands. Last year Tele2 entered into a similar arrangement with O<sub>2</sub> Germany. Last year we also entered into an arrangement with debitel Netherlands BV which became a virtual service provider, the first arrangement of its kind in the Netherlands.

**Focus on customer retention and conversion.** We have implemented a number of customer loyalty and retention measures, including targeted customer incentive initiatives and pre-contract termination "save" programmes, aimed at encouraging greater loyalty amongst our customers. In O<sub>2</sub> UK, for example, the Select customer retention programme targeted at high-value consumer and small and medium enterprise customers, has reduced churn from these customers.

Further improvements in GSM network quality and coverage will also be important for customer retention. Our future development of attractive data offerings, including more sophisticated and personalised services delivered using GPRS and UMTS technology, will also be a key factor in our conversion strategy.

**Focus on cost efficiencies.** We have reorganised both O<sub>2</sub> UK and O<sub>2</sub> Germany to place additional emphasis on cost control throughout their operations and to encourage targeting customers more effectively. Both O<sub>2</sub> UK and O<sub>2</sub> Germany are participating in downsizing programmes, and it is anticipated that these will yield further cost efficiencies. We undertake regular benchmarking exercises and pursue active best practice programmes to reduce our costs. Our network sharing agreements with Deutsche Telekom's mobile businesses (T-Mobile) in the United Kingdom and Germany, and the recently announced outsourcing of network operation and management to Ericsson by O<sub>2</sub> Netherlands, are examples of our focus on cost efficiency.

#### Achieve greater integration by managing our

**businesses cohesively** Our mobile businesses in the United Kingdom, Germany, the Netherlands, Ireland and the Isle of Man are all wholly owned. These countries have a total population of over 160 million people, giving us access to a population base that is the third largest amongst operators in Western Europe. We believe our sole control of these operations enhances our ability to manage them efficiently and on a cohesive basis. This structure, we believe, also provides for local accountability and market responsiveness while also allowing development of Group-wide synergies.

**Implement and exploit new branding.** We believe a common brand will help us to reinforce a consistent vision and strategic focus across our Group and, over time, facilitate a cohesive marketing orientation and uniform level of service.

**Integrate product and network development and management.** In March 2002 we put in place a single product team (products O<sub>2</sub>) across all four country markets to drive the delivery of our single product roadmap addressing products and services for business customers and consumers. We believe this will accelerate roll-out across our operating businesses and reduce development and implementation costs.

**Leverage technology.** We have reorganised our Technology function across our four main country markets to deliver efficiencies and help us bring products to market faster. Progress has been made in delivering platform capabilities across the Group.

**Lead in new data services through GPRS and UMTS**  
**Implement leading edge technology for data services.** Our planned investments in high-quality GPRS services and UMTS networks and in advanced software and service enabling platforms will be vital in allowing us to roll-out new services and applications quickly across our footprint. For example, we have funded development of the xda from O<sub>2</sub> with High Tech Computer Corporation and acquired exclusive distribution rights. To provide greater functionality to high-value international customers, we have implemented GPRS roaming capabilities across the O<sub>2</sub> networks in the United Kingdom, Germany, the Netherlands and Ireland.

O<sub>2</sub> Online, our mobile internet business, has also been a leader in developing and introducing innovative products and services through its relationships with key content and technology suppliers. We have introduced mobile unified messaging services, giving customers access to voice, text and internet messages from fixed and mobile devices.

In February 2002 we began trials of our new multimedia-messaging service and will be rolling this out during the course of the year. Users of the service will be able to send and receive media-rich messages – a combination of text, sounds, images and video – to specially enabled handsets.

**Build services and applications pipeline.** Development is under way on music and video applications. We will exploit the unique aspects of mobile networks such as location-based capabilities in our services and will enhance our “find and guide” services, such as O<sub>2</sub> UK’s *FindMe* service in the United Kingdom.

**Enhance mobile data services for business customers.** mmO<sub>2</sub> and Microsoft have announced plans to launch a package of new corporate services for use on a range of mobile devices over secure, high-speed GPRS mobile data networks. The agreement extends to all of mmO<sub>2</sub>’s mobile businesses in Europe, enabling its customers to roam and access information in the UK, Germany, the Netherlands and Ireland. We are also developing capabilities in payments, security and m-commerce to support business customers’ future demand for mobile business-to-business and business-to-consumer services.

## Operations (by country)

### O<sub>2</sub> UK

#### Operating performance

Turnover of O<sub>2</sub> UK businesses for the year to 31 March 2002 was £2,756 million (2001: £2,706 million) with EBITDA for the same

period of £670 million (2001: £555 million). Operating margin improved from 20.5 per cent to 24.3 per cent. Operating profit before exceptional items remained constant at £272 million (2001: £269 million). O<sub>2</sub> UK incurred an exceptional item of £86 million relating to the restructuring of the UK operations.

After the rapid expansion of recent years, the UK mobile phone market is approaching saturation in 2002, with penetration close to 80 per cent. The rate of growth has slowed, with new connections at O<sub>2</sub> UK for the year to 31 March 2002 totalling 495,000, of which 408,000 were pre-pay and 87,000 post-pay contract customers. Our active customer base at 31 March 2002 totalled 11.084 million, of which 7.542 million were pre-pay and 3.542 million post-pay, representing a market share of approximately 24 per cent.

The contract churn rate has improved from 44 per cent to 31 per cent. Blended SAC increased to £90 (2001:£87) owing to a richer mix of customers acquired during the year reflecting O<sub>2</sub> UK’s focus on higher value customers. Blended Average Revenue Per User (ARPU) declined but the key contract ARPU rose from £485 to £498.

Data service revenues, as a proportion of the O<sub>2</sub> UK total, rose from 5.8 per cent in 2001 to 11.8 per cent. Total text messages sent over the UK network more than doubled from 1.6 billion in the 2001 financial year to 3.4 billion in the 2002 financial year. O<sub>2</sub> UK ended the year as the UK market leader in text messaging with 29 per cent market share in March 2002.

#### Current objectives

We expect the UK market to remain active, however, with mobile operators focusing on retention and upgrade of existing customers, rather than acquisition of new customers.

As the UK market continues to mature, customer loyalty initiatives and the development of new products and services will become increasingly important. We believe that high levels of customer satisfaction, through proactive and dedicated customer care, have a key role to play in the success of new technologies such as GPRS and 3G mobile services. Accordingly, we are implementing a new, integrated systems platform to improve our back-office activities and to provide common network architecture for our entire customer service operation.

We will continue to invest in our GSM network, which we believe should remain in demand in the medium term. At 31 March 2002, it comprised over 6,500 base stations and covered over 99 per cent of the UK population and approximately 90 per cent of the UK land mass. In addition, our international roaming agreements (with over 306 networks) allow our customers to make and receive calls in 132 countries. We have made great progress in reducing the rate of dropped calls on our network, recognising that the improvements are a key element in customer satisfaction and encourage longer calls.

We have enhanced the quality of our GPRS services by retaining some capacity on our GSM network exclusively for data transmission. In June 2001, we entered into partnership with T-Mobile to co-ordinate the roll-out of our 3G networks, sharing new and existing base stations in some areas and allowing roaming

## business review

across each other's network. We anticipate that this agreement may lead to substantial capital and operational cost savings for O<sub>2</sub> UK. This partnership is subject to regulatory approval.

### Marketing, services and products

Our marketing focus is now on business, professional and young adult customers, who broadly represent the high-value segments of the market, both in post-pay and pre-pay, and who we believe are most likely to be early adopters of our more advanced mobile data products.

In the post-pay sector, we have developed a strong position amongst business customers. As part of our targeted approach to these customers, we have also launched an O<sub>2</sub> UK mobile portal for small and medium enterprises.

In the pre-pay sector, in common with other United Kingdom mobile operators, we have introduced a number of competitively priced products in response to the significant demand in the United Kingdom for consumer pre-pay packages. We are now targeting higher value where our competitors have relatively strong positions. We provide low handset subsidies compared to our post-pay offerings, reflecting our cost-sensitive approach to generating new pre-pay customers.

Customer retention is also a top priority. We continue to devote effort and resources to successful customer relationship management and on building up the popularity of our customer loyalty schemes, such as *First* and *Select*, both of which helped to reduce contract customer churn last year.

Our distribution channels include our own shops, our retail partners such as The Link, in which we hold a 40 per cent stake, and other retail outlets with which we have relationships, such as Dixons and The Carphone Warehouse.

### Data leadership

O<sub>2</sub> UK's strength in mobile data services was enhanced during the year by the formation of a number of partnerships to launch new GPRS terminals in the United Kingdom. We signed limited exclusivity agreements with RIM for the BlackBerry™ wireless email solution and with Handspring to bring its Treo™ organiser to the United Kingdom. We are about to launch the xda from O<sub>2</sub>, a fully integrated mobile phone and PDA.

We encourage the development of new applications by third parties in key industries, such as music, gaming and corporate systems integration. We have created a web-based community for them, known as Source O<sub>2</sub>, and established a Mobile Application Development and Integration Centre to assist in the design, development and launch process. We expect to provide developers with access to our live GSM, GPRS and, in the future, our 3G test environment. Over 4,000 application developers are currently members of this community.

### Mobile phone theft

Current levels of mobile phone theft in the UK are rising. O<sub>2</sub> UK already bars the SIM card of a mobile phone immediately upon learning that the phone has been stolen. But we have also recently announced plans to develop a new computer system to track early

call attempts and then to block calls from stolen handsets across the O<sub>2</sub> UK network.

We are participating in an industry-wide initiative to share handset serial (IMEI) numbers across all UK networks. We have also launched an education programme in schools, dealing with ways to reduce the risk of theft, along with plans to introduce a property marking system. Furthermore, we will continue our dialogue with government and regulatory and industry bodies to ensure that all new technologies and mobile devices have built-in security.

### O<sub>2</sub> Germany Operating Performance

Turnover of O<sub>2</sub> Germany for the year to 31 March 2002 was 29 per cent higher at £875 million (2001 pro forma: £677 million) with EBITDA losses for the same period reducing from £343 million in 2001 to £166 million in 2002. Operating losses before exceptional items have improved from £566 million in 2001 (pro forma) to £402 million in 2002. O<sub>2</sub> Germany incurred an exceptional item of £28 million in relation to the restructuring of its operations.

The German market, in common with other developed markets in Europe, is showing signs of maturity now that penetration has risen to high levels. Overall, the market, the largest in Europe, grew by 7 per cent last year, compared with an increase of 62 per cent in the previous year. Despite this slowdown in the market, O<sub>2</sub> Germany has generated strong growth in sales and has made significant progress in attracting high value customers.

The number of new connections at O<sub>2</sub> Germany for the year to 31 March 2002 totalled 724,000, of which 352,000 were pre-pay and 372,000 post-pay contract customers. At 31 March 2002, O<sub>2</sub> Germany had close to 3.9 million customers compared with 3.2 million 12 months previously, of which 49 per cent were pre-pay and 51 per cent post-pay, representing a market share of over 7 per cent.

Blended SAC costs reduced significantly over the year to £95.

ARPU was £313 for post-paid, £71 for pre-paid customers.

Over 70 per cent of new post-paid customers subscribe to Genion services, which generate higher ARPU than other post-paid services.

Data service revenues represented over 13 per cent of O<sub>2</sub> Germany's total service revenue.

Improved profitability has been led by progress in our core Genion product, a favourable post/pre-pay split, and cost efficiencies.

Business customers almost doubled during the year in the wake of a number of contract wins from major German businesses including HypoVereinsbank.

### Current objectives

We are focused on delivering efficiency gains, raising levels of customer service, and an improvement in the quality and utilisation of our network to improve our financial performance. Progress has been made on all these fronts.

We are co-operating with Deutsche Telecom's subsidiary, T-Mobile, in an agreement which, it is hoped, will save substantial costs in the build-up of our 3G network. With the 3G launch scheduled in 2003, the Company remains confident in its ability to meet its regulatory coverage requirements and work is progressing well. O<sub>2</sub> Germany has already acquired over 3,000 locations for 3G base stations.

With the roll-out of UMTS services and the entrance of new mobile virtual network operators, we believe that we will be well placed to take advantage of new wholesale opportunities. We intend to provide wholesale capacity on a selected basis to utilise our network efficiently. We will also seek to exploit person-to-machine or machine-to-machine applications, where our network could provide capacity for a variety of applications. We will also seek relationships with niche-market and full-scale mobile virtual network operators and specialist application service providers, such as those providing mobile connectivity and solutions to large-scale business customers.

#### Marketing, services and products

Our objective is to continue to grow our market share in Germany, including increasing our share of the post-pay consumer, business and wholesale sectors. Our primary sales focus is to attract and retain high-value customers and to position O<sub>2</sub> Germany as a leading provider of mobile data and location-based services.

In addition to standard value-added products, Genion offers innovative services, including location-based tariffing, which allows reduced tariffs when the customer is in or near home, the only product in Germany to do so.

The same location-based homezone concept is applied to services offered under the Genion Business brand – allowing high-value mobile users to make calls in or near their places of business at reduced tariffs. BMW, Siemens, Liebherr and ABB have all selected Genion homezone for their premises.

Customer care and customer retention are important to O<sub>2</sub> Germany, as it has historically faced a number of difficulties associated with being a new, growing business, which have affected its customer satisfaction levels. As part of our customer retention initiative, we have a dedicated retention team which tailors retention packages to customer categories. In addition, we use our data analysis capabilities to predict churn so that we can target customers for retention appropriately.

Our direct distribution channels currently include 270 O<sub>2</sub> Germany shops. Our indirect channels include telecommunications and electronic retailers as well as alternative channels such as supermarkets.

#### Data leadership

O<sub>2</sub> Germany launched an operational GPRS network in January 2001, the first operator in Germany to do so.

To support our drive for high-value customers we have devised a number of innovative solutions for the key corporate data communications market, including GPRS-based IP Virtual Private Network services and fleet management services.

The current year will see the launch of a range of GPRS services. The launch will be supported by the introduction of new products including RIM's BlackBerry™ wireless email solution, Handspring's Treo™ organiser, and from O<sub>2</sub>, the xda, our fully integrated mobile phone. The BlackBerry™ device has brought us early contract successes with both SAP and Bertelsmann.

We have pioneered a system of making hotel reservations from a mobile phone and a service that locates lost handsets. Our location-based services can be accessed through the SMS service, so that they are available from any mobile handset, even if it has no WAP capability.

We will be committing capital during 2003 to support the launch of 3G services.

#### O<sub>2</sub> Netherlands Operating performance

Turnover of O<sub>2</sub> Netherlands for the year to 31 March 2002 was £200 million (2001 pro forma: £114 million) with EBITDA loss for the same period of £51 million (2001 pro forma: £104 million). Operating loss improved from £150 million in 2001 to £119 million in 2002.

After the rapid expansion of recent years, the Dutch mobile phone market is approaching saturation in 2002, with penetration at over 70 per cent. The rate of growth has slowed, with new connections at O<sub>2</sub> Netherlands for the year to 31 March 2002 totalling 462,000, of which 405,000 were pre-pay and 57,000 post-pay contract customers. Our active customer base at 31 March 2002 numbered 1,255,000, of which 1,022,000 were pre-pay and 233,000 post-pay, representing a market share of approximately 11 per cent.

The contract churn rate has improved significantly from 32 per cent to 27 per cent. Blended SAC costs have decreased by 24 per cent from £99 in the year ended 31 March 2001 to £75. Blended ARPU increased from £151 to £163 during the year, with improvements in both pre-pay and post-pay ARPU.

Data as a proportion of service revenues was 8.9 per cent for the full year, and the number of SMS messages sent over the network more than doubled to 288 million.

#### Current objectives

We terminated our roaming agreement with Libertel which had been in place since 1998. By the first quarter of 2002, the network covered 97.5 per cent of Dutch households and 99 per cent of geographical territory.

We have announced a Letter of Intent with Ericsson to outsource the management of all our mobile network operations. This outsourcing initiative will improve our operational efficiency, accelerate the introduction of sophisticated multimedia services and deliver significant cost savings.

We also announced the Netherlands' first ever Enhanced Service Provider agreement with debitel Netherlands, a leading independent telecoms service provider. O<sub>2</sub> Netherlands will rent capacity to debitel on its GSM, GPRS and UMTS networks and provide it with access to computer systems that support text messages, voicemail and customer management and billing.

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We have secured a Memorandum of Understanding with KPN Mobile for the joint construction of both parties' future 3G networks. The agreement will facilitate the search for suitable locations for new 3G transmitter masts and aerials in the Netherlands and enable O<sub>2</sub> Netherlands and KPN Mobile to roll out 3G services more quickly.

### Marketing, sales and products

As part of its focus to retain higher value customers, O<sub>2</sub> Netherlands has focused on customer service. The operations of our Customer Service Centre were outsourced to a call centre specialist and this led to an increase in the level of service while accommodating growth in the customer base. We have improved the quality of our retail channel by focusing on telecoms specialists. It is hoped that all our customers will see benefits in the future from improved efficiency in Customer Relationship Management, with SMEs, in particular, now designated as a major growth market.

We have entered into an agreement with Tele2, a leading supplier of fixed carrier preselect services in the Netherlands. Under this agreement, Tele2 Mobiel will offer mobile services on our GSM 1800 network as a virtual mobile operator.

The distribution strategy and channels for O<sub>2</sub> Netherlands customers will aim to follow the distinct characteristics of our brands. We are making use of internet distributors, telemarketing and specialised retail channels for small business customers, value-added resellers and account managers for medium-sized businesses and account managers for large corporations.

### Data leadership

We became the first operator in the Netherlands to launch an operational GPRS network and introduced GPRS services for the business market in July 2001 based on our innovative Mobile Office contract. With this service, Dutch businesses are charged, for the first time, on the basis of the quantity of data they send and receive rather than time spent connected to the network.

Our product offering was reinforced by a limited exclusivity agreement with RIM for the BlackBerry™ always-on wireless email solution, which is aimed at the Dutch business professional. We have entered into several agreements with IT and marketing oriented companies to distribute thousands of handsets with WAP user access over the GPRS network.

At the beginning of 2001, we launched Corporate SMS, a new business service for sending mass SMSs to specific target groups. The service was taken up enthusiastically and highlighted the quality and capacity of our network and O<sub>2</sub> Netherlands' position as a provider of mobile data services for business.

In the mobile data market for consumers, in June 2001 O<sub>2</sub> Netherlands entered into a mobile banking agreement with the Postbank. Some 500,000 account holders who took part received a free pre-pay telephone from O<sub>2</sub> Netherlands.

The unique mobile banking handset is linked directly to users' postbank accounts and has various m-banking functionalities pre-programmed by O<sub>2</sub> Netherlands. These allow customers to request balance information, perform transactions and directly top up call

credit via a giro account. O<sub>2</sub> Netherlands made use of existing WAP technology for this project. Over two million balance queries and more than 100,000 transfers have been made since the project began last summer.

To provide the highest level of service in mobile data, we continue to form partnerships with business application developers. Such partnerships have led to the introduction of a number of innovative new services, including the delivery of a mobile campus to the University of Twente and the establishment of a mobile patient file for the health care sector.

### O<sub>2</sub> Ireland

#### Operating performance

Turnover of O<sub>2</sub> Ireland for the year to 31 March 2002 was £395 million (2001: £309 million) with EBITDA for the same period of £122 million (2001: £68 million). Operating margin improved from 22.0 per cent to 30.9 per cent and operating profit more than doubled to £58 million from £21 million in 2001.

After a period of rapid growth, which has lifted penetration of the mobile market in Ireland to over 75 per cent, growth in the number of customers has slowed significantly over the past 12 months. New connections at O<sub>2</sub> Ireland for the year ended 31 March 2002 totalled 207,000, of which 183,000 were pre-pay and 24,000 post-pay contract customers. Our active customer base at 31 March 2002 was 1,180,000, of which 824,000 were pre-pay and 356,000 post-pay. O<sub>2</sub> Ireland increased its share of the contract market from 41 per cent to 43 per cent and we retained our share of the pre-paid market at 39 per cent. Overall, market share was 40 per cent.

Blended SAC fell by 21 per cent in the course of the year and blended ARPU was £329 whilst the post-paid churn rate remained low at 23 per cent. Pre-pay churn for the year was 44 per cent, but includes a one off adjustment in July 2001 to the pre-paid base as a result of moving to a "three-month level of inactivity" for these customers.

Data revenues rose from approximately 6 per cent in 2001 to 10 per cent in 2002 as a proportion of total service revenues. In terms of non-voice services, SMS text messaging is the single most significant contributor. Mobile originated SMS messages passing through our Irish network totalled 667 million, almost double the total in the previous year.

Our mobile internet portal had 315,000 customers at the end of March 2002, an increase of 170 per cent compared to March 2001. Of those customers, 155,000, or 13 per cent of the total, are active WAP users, more than four times the number of a year ago.

#### Current objectives

In June 2000, we launched our mobile internet portal, Digifone On-Line (DOL), which allows our customers mobile and fixed line access to information on the internet. In addition to being a potential customer retention tool, the DOL portal is part of our strategy to establish leadership in the mobile data market, gaining recognition from customers and application providers before the roll-out of UMTS services. While branded separately for the Irish market, DOL is able to leverage the technology and content of our

UK operations, in particular of O<sub>2</sub> Online, our main mobile portal business. O<sub>2</sub> Ireland intends to leverage mmO<sub>2</sub>'s relationships with vendors for the supply of high-quality GPRS and UMTS devices.

We recently combined our four wholly-owned retail businesses into one operating unit. By consolidating our abilities in the retail area, we expect to enhance our operational effectiveness and the consistency of service we give to our customers.

By March 2002, O<sub>2</sub> Ireland had 1,200 sites for transmission masts and aerials on air. This represents 262 new sites on air in a 12-month period. We upgraded a number of our sites instead of building new ones thereby delivering improved network quality and capacity at a lower network cost.

### Marketing, services and products

In Ireland, our focus is on high-value mobile customers.

Our two main products are *Select*, our post-pay offering, and *Speakeasy*, our pre-pay offering. Within these brands, we have developed a variety of tariffs and value-added service offerings, including voicemail, handset insurance and dropped call compensation for our post-pay customers as well as WAP and other data services. In the business market, we offer a variety of advanced mobile data solutions, such as mobile virtual private networks and advanced data messaging services.

We have expanded O<sub>2</sub> Ireland's on-line services to include a popular wireless trivia game, SmartAss, and Group Text, a one-to-many text service. Our unique service, Call Me, was also launched. Aimed at the pre-paid market, Call Me enables customers to continue to communicate when their pre-paid balance is zero.

As part of our distribution strategy, we use independent dealerships as well as home entertainment stores and smaller outlets such as newsagents. We have a dedicated corporate sales function comprising separate teams who support the specific needs of our large corporate and small to medium enterprise customers.

### Data leadership

Non-voice services now stand at 10 per cent of total revenues. In January 2002, O<sub>2</sub> Ireland, after undertaking extensive trials with our key corporate customers over the preceding nine months, became the first Irish mobile operator to launch a full GPRS service to corporate, small business and post-paid consumer customers. We were also the first to provide GPRS roaming services to Irish customers in the UK, Germany and the Netherlands.

At this stage we are offering 16 GPRS-based applications to our customers. These range from remote security monitoring to Customer Relationship Management solutions and corporate intranet access.

We became the first Irish mobile operator to offer always-on email services through the BlackBerry™ wireless email solution, a terminal that uses GPRS technology to provide always-on mobile access to corporate email. We believe that this terminal, along with other GPRS-enabled devices in the O<sub>2</sub> portfolio, will be a vital part of our efforts to generate high-value, data revenue streams from the business sector.

## Manx Telecom

### Operating performance

mmO<sub>2</sub>'s wholly-owned Manx Telecom is an integrated communications company providing fixed and mobile, data, voice and internet network services to the Isle of Man.

Turnover in 2002 was £43 million (2001: £38 million) and EBITDA was £16 million (2001: £12 million) and operating profit was £11 million (2001: £8 million). At 31 March 2002 we had 47,000 mobile customers with 45 per cent on post-pay contracts.

In December 2001 we launched our 3G network, the first fully operational system in Europe.

### Current objectives

Our aim in the business market is to offer end-to-end solutions across the value chain, retain customer ownership, move towards a consultancy role and gain new revenue from bringing business to the island.

### Marketing, sales and products

As the only network operator on the island, our marketing is aimed at expanding the size of the market. In the business sector we have targeted small- and medium-sized businesses with standardised services and large customers with tailored telecommunications solutions.

Manx Telecom has been at the forefront of introducing new telecommunications technology and services. Having launched GSM services in 1996, we introduced broadband fixed network technology at an early stage to allow high-speed data connection for our customers.

### Data leadership

Manx Telecom is offering a number of advanced broadband applications on its 3G network, including location-based services, video telephony, high-quality information services with pictorial content, video streaming content, mobile office, online gaming and video surveillance.

Our location-based service, Isle of Man on Air, uses a GPS system, installed in a car, into which a 3G handset is plugged. A personal computer display shows where the user is located on the island and gives location-specific information about tourist attractions and other amenities, including golf courses, restaurants and hotels. The system makes use of text, audio and still and moving images and pictures.

Almost 150 single-mode 3G handsets have been distributed to customers in the business, government and community sectors in an initial trial to assess likely demand patterns for advanced data services.

We reached an agreement with Nationwide bank to collaborate on the development of financial applications for 3G services.

Using the Manx Telecom 3G network, Nationwide customers are able to take advantage of a wide variety of banking services. Among the services available, customers are able to check balances, pay bills, transfer funds between Nationwide accounts, set up direct debits and standing orders or arrange an e-loan – all on the move.

## business review

### O<sub>2</sub> Online

#### Operating performance

By the year end our mobile Internet business had a total of 4.9 million customer registrations and generated an average of more than 200 million WAP page impressions a month – a level more than double that of a year ago. More than 1.5 million customers – up 50 per cent over the year – regularly used our innovative WAP services including chat rooms, games, local cinema and gig guides and the official 2001 WAP site for Channel 4's "Big Brother" programme.

The Online tariffs have attracted over 300,000 high-value customers to O<sub>2</sub> in the UK in 2001/02. This led us, in November 2001, to launch O<sub>2</sub> Online tariff packages in the Netherlands. Users in both countries have demonstrated usage of all data services above the industry average:

- >> 99 per cent of our customers send text messages<sup>1</sup>, compared with the UK market average of 72 per cent that claim to have sent or received a text message<sup>2</sup>. Some 42 per cent of users had also downloaded icons or graphics from a website compared to the market average of just 6 per cent.
- >> 52 per cent of our customers own a WAP phone and 81 per cent of them are active users<sup>3</sup>, compared with 12 per cent and 25 per cent, respectively, for the UK market as a whole<sup>1</sup>.

#### Current objectives

During the year we created a new internal organisation – products O<sub>2</sub> which encompasses the O<sub>2</sub> Online business, but also has expanded responsibility to include product development and product marketing for all mmO<sub>2</sub> businesses in Europe – for both consumer and business products.

This central organisation has made progress in delivering platforms, systems and capabilities across the Group. We outsourced our global platform management operation to Cap Gemini and deployed a new technology platform developed by long-standing supplier Openwave. We expect that the implementation of these programmes once across the Group may result in substantial long-term cost savings.

In addition, O<sub>2</sub> has been developing its messaging communications portfolio – a key growth area for data services.

#### Marketing, services and products

Our online products and services generate their own revenue streams. They also attract users from all other mobile networks to our web portals who are then introduced to the benefits of our online mobile service provider business. By registering on O<sub>2</sub>'s portals, customers can benefit from a wide range of service features in the areas of entertainment, travel, finance, shopping, banking, travel and communication services.

O<sub>2</sub> Online's product portfolio ranges from basic consumer services – such as ringtones, icons and information alerts sent via text message – to more advanced products. These include mobile games, instant messaging and multimedia messaging.

O<sub>2</sub> Online has been working on ways to integrate communication services on the internet with mobile devices to allow customers to organise their lives more effectively. This includes the ability to send and receive emails from web and WAP portals, an integrated calendar which will send messages to customers' handsets to remind them of important dates, an advanced messaging service, allowing customers to send a single message to any number of people simultaneously and an integrated address book which can be accessed from the web and WAP portal.

In February 2002 we began trials of our new multimedia messaging service and will be rolling this out across the O<sub>2</sub> companies during the course of the year. Users of the service will be able to send and receive media-rich messages – a combination of text, sounds, images and video – to specially enabled handsets.

#### Airwave

Once complete, the Airwave network will provide a fully integrated, national digital radio service designed to meet the needs of the police and other public safety organisations.

Airwave's customers currently include the police and a regional fire and rescue body, but the network also offers advantages over present communications technology to a wide range of other emergency organisations.

Unlike other O<sub>2</sub> networks, which are based on GSM and GPRS technology and which we intend to be based on 3G in the future, the Airwave network is based on the open European standard for digital terrestrial trunked radio (TETRA).

Under the terms of a £2.5 billion, 20-year contract with the Home Office, Airwave will be sole supplier of core mobile radio services to all 54 Police Forces in England, Scotland and Wales. The service is already operating in a number of forces. Lancashire, Greater Manchester, North Yorkshire, Suffolk, West Mercia and Leicestershire were amongst the first to introduce it and The Metropolitan Police Service will switch to Airwave in late 2003. We expect national roll-out to be completed by 2005.

The current analogue radio systems used by police forces are up to 30 years old and many cannot operate with each other or with other emergency services, including fire brigades and ambulance fleets. Lack of communication at major emergencies and disasters has been highlighted as a significant factor in hampering the effective co-ordination of rescue efforts by the emergency services.

Airwave should provide a common platform for public safety organisations, giving them true interoperability and extensive geographical coverage for both vehicles and hand-held terminals. Capacity should be available whenever and wherever a public safety user needs it, with voice quality approaching that of fixed lines.

Airwave can also carry data applications, including automatic vehicle location, and information from the Police National Computer, as easily and efficiently as voice traffic.

<sup>1</sup>O<sub>2</sub> commissioned research (ICM, Dec 2001).

<sup>2</sup>O<sub>2</sub> commissioned research (BMRB, Feb 2002): c.50 per cent of mobile users believed to have sent a text message.

<sup>3</sup>O<sub>2</sub> commissioned research (Survey.com, Sept 2001).

Lancashire Fire & Rescue already has a contract in place with us. Airwave gives a greater depth of coverage than traditional single channel radio and our network allows full communication with other public safety users and emergency services.

In the health market, the Airwave service should reduce response times for key health professionals whilst enhancing the quality of patient care through mobile data applications, including the transmission of patients' records and remote patient monitoring.

We are currently talking to a wide variety of potential Ministry of Defence users, from the Army Training Estate and explosive disposal groups, to the Royal Military Police and the Military Guard Services.

## Regulation

We conduct most of our business in the United Kingdom, Germany, the Netherlands, Ireland and the Isle of Man. We are therefore subject to national regulation in each of those countries as well as European Union-wide regulation. The following summary describes those regulations in force, which are material to our key business activities in the countries in which we principally operate.

### Regulation in the EU

European Union, or EU, legislation has a direct impact on how we are regulated in each of the countries in which we principally operate.

EU law provides that operators with significant market power (SMP), including those with SMP in the mobile telephone networks market, must offer interconnection on a reasonable and non-discriminatory basis. Operators with SMP in the national interconnection market (being the market for interconnection in the combined fixed and mobile markets) must also charge cost-oriented interconnection tariffs.

EU law restricts the collection, use and processing of personal data and guarantees individuals certain rights, including the right of access to personal data, the right to have inaccurate data rectified and a right of recourse in the event of unlawful processing. Individuals also have the right to withhold permission to use their data for direct marketing.

EU rules also regulate electronic commerce, or e-commerce, service providers and provide for harmonised rules on the conclusion of contracts by electronic means.

### A New regulatory framework

On 14 February 2002, the European Communities adopted four new Directives relating to communications. These set out the new EU regulatory framework for electronic communications which must be put in place in the member states by 25 July 2003.

Some key features of the new regime are:

- >> the abolition of licensing in favour of a "general authorisation" and certain specific obligations;
- >> restrictions on the possible subject matter of the regulatory obligations which can be applied by national regulators; and
- >> a new definition of SMP which is aligned to the competition law concept of dominance. Operators which have SMP in any relevant market (either alone or jointly) may be subjected to particular regulatory obligations (such as price controls, or obligations to offer interconnection at cost-related prices).

The new regulatory framework may materially affect the nature of regulation to which we are subject and may affect the services we offer or may wish to offer in the future.

There is a proposal that current EU Directives concerning the processing of personal data and the protection of privacy may be updated and extended. If implemented, this proposal may materially affect the nature of the services we offer or may wish to offer in the future.

### Competition law

We are also subject to the general competition law of the EU and, in particular, Articles 81 and 82 of the EC Treaty, which respectively prohibit anti-competitive agreements or concerted practices and the abuse of a dominant position.

EU competition law is enforced by the European Commission, which can impose fines of up to 10 per cent of a group's worldwide annual turnover for breaches of Article 81 or 82. Companies which breach EU competition law may also be sued in national courts by third parties which suffer loss as a result of the breach.

The European Commission is currently conducting an inquiry into competition in the markets for mobile roaming services in the European Economic Area, or the EEA. The investigation is continuing and no conclusions have yet been reached. If the European Commission finds that there have been infringements of Articles 81 and/or 82, it could fine infringing operators. Action could also ultimately be taken to force certain operators to reduce their wholesale and retail charges for roaming.

### Infrastructure sharing

We are proposing to enter into 3G infrastructure-sharing arrangements in the UK and Germany to which Article 81 of the EC Treaty may apply. They have therefore been formally notified to the European Commission for clearance or exemption. We expect a decision from the Commission later this year.

## Regulation in the United Kingdom

### Overview

Mobile telecommunications networks and services are regulated in the United Kingdom under, among other statutes, the Telecommunications Act 1984, or Telecommunications Act, and the Wireless Telegraphy Acts 1949-1998, or Wireless Telegraphy Acts. Under the Telecommunications Act, responsibility for the regulation of telecommunications activities lies with the Secretary of State for Trade and Industry and with the Director General of Telecommunications, who is head of the Office of



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Telecommunications (OfTel). Under the Wireless Telegraphy Acts, responsibility for licensing and regulating the use of frequency spectrum lies with the Radiocommunications Agency. The operation of a mobile telecommunications network requires a licence under both the Telecommunications Act and the Wireless Telegraphy Acts. We have been granted licences under each Act. These licences are described below.

On 7 May 2002 the UK Government published a draft Communications Bill. The UK regulatory regime will change significantly when the new draft Communications Bill becomes law (currently anticipated for June 2003). The new legislation will repeal substantial parts of the Telecommunications Act and will implement the provisions of the new EU regulatory framework. It will also provide for the functions of OfTel and the Radiocommunications Agency (and other communications regulators) to be transferred to a single regulator, the Office of Communications (OFCOM).

### Telecommunications licences

We hold a full mobile Public Telecommunications Operator (mobile PTO) licence under the Telecommunications Act in the name of O<sub>2</sub> UK. This permits us to operate a mobile telecommunications network and any elements of a fixed telecommunications network we may require. Our mobile PTO licence was granted on 22 March 1994 and can only be revoked by the Secretary of State on ten years' notice or in certain limited circumstances.

We also have a non-Public Telecommunications Operator Telecommunications Act licence to operate telecommunications systems for the provision of radio paging services and have a Telecommunications Act licence for providing the Airwave service to emergency services. Our paging licence was granted on 15 May 2001 and is terminable by the Secretary of State for Trade and Industry on ten years' notice given at any time after the 15th year (so it cannot expire before 2026).

### Frequency licences

We have Wireless Telegraphy Acts licences for the frequencies necessary to run our GSM network and also hold one of five Wireless Telegraphy Acts licences for UMTS spectrum which obliges us to roll-out our third generation network so that it covers 80 per cent of the UK population by 31 December 2007.

We also hold Wireless Telegraphy Acts licences in relation to our allocation of radio spectrum and the use of stations and equipment involved in the provision of our paging services and our Airwave services.

### National roaming

We have reached agreement with Hutchison 3G to permit them to use our second generation network to originate and terminate calls to and from its subscribers while it builds its own UMTS network. The obligation only applies once Hutchison 3G's own network covers 20 per cent of the UK population.

### Network access and interconnection

Vodafone and we must provide interconnection on non-discriminatory and transparent terms as we are designated as having SMP in the mobile market and we may not unreasonably refuse access to our network.

The charges we make to other operators for terminating calls on our network (termination charges) are currently subject to a price cap of 9 per cent after allowing for an increase in such charges equal to the increase in the relevant year in the UK Retail Price Index (RPI). OfTel proposed to amend the licences of all four mobile operators (Vodafone, O<sub>2</sub> UK, Orange and One 2 One) to require that termination charges be capped at RPI – 12 per cent.

This price cap may be changed, or replaced with some other form of regulation when the Competition Commission completes its investigation (for which the deadline is January 2003). If the price cap is increased or some other form of regulation is imposed this could cause a reduction in the revenues we receive from termination charges.

### Planning, health and environmental measures

In May 2000, the Independent Expert Group on Mobile Phones, under the Chairmanship of Sir William Stewart, published its report, known as the Stewart Report, into mobile phones and health. In a document published by the Department of Health on the same day the Government accepted many of the recommendations of the Stewart Report. The Department of Health published guidelines in December 2000 recommending that the widespread use of mobile phones by children under the age of 16 should be discouraged for non-essential calls. We, together with the other mobile operators in the United Kingdom, have committed ourselves to addressing community concerns and have given ten commitments to that end.

### Data protection

We are subject to data protection and privacy rules which limit the way in which we can process and use our customers' personal data. In particular, we can only use this data for marketing purposes if we have the consent of our customer to do so.

### Competition Act 1998

We are subject to UK competition law which is set out in the Competition Act 1998. This mirrors the provisions of EU competition law, prohibiting anti-competitive agreements or concerted practices and the abuse of a dominant position in the UK.

The Competition Act is enforced by the Director General of Fair Trading, and (where "commercial activities connected with telecommunications" are concerned) the Director General of Telecommunications.

As under EU law, companies which breach UK competition law can be fined. They can also be sued for damages by third parties who suffer loss as a result of the breach.

## Regulation in Germany

### Overview

The German Telecommunications Act regulates the award of licences for the conduct of certain telecommunications activities and the allocation of frequencies. RegTP, supported by other government bodies, has powers under the German Telecommunications Act to regulate these matters.

### Telecommunications and frequency licenses

We hold the necessary licences with nationwide coverage which, together with our frequency licences, authorise us to run mobile telecommunications operations in Germany.

We were awarded one of four GSM licences in May 1997 by the Federal Ministry of Post and Telecommunications. Our GSM licence is valid until 31 December 2016. Under our GSM licence, frequencies will be allocated to us upon request up to a specified maximum amount.

Our UMTS licence is valid until 31 December 2020. Our licences may be revoked by RegTP in certain circumstances, including breaches of the obligations arising from our licences and the obligations arising under the German Telecommunications Act.

Our UMTS licence obliges us to roll-out our third generation network so that it covers at least 25 per cent of the population by the end of 2003 and 50 per cent of the population by the end of 2005.

### National roaming

The anti-trust authorities in Germany have indicated that national roaming agreements may infringe competition laws but that in the case of O<sub>2</sub> Germany's agreement with T-Mobile, this is unlikely to be the case at least until 2004 as, according to the anti-trust authorities, it would consider O<sub>2</sub> Germany to be a new entrant at least until this date.

### Infrastructure sharing

On 5 June 2001, RegTP announced that it will interpret licence conditions to permit network co-operation and infrastructure sharing. The infrastructure we will be able to share in Germany includes radio base stations as well as antennas. Infrastructure sharing agreements remain subject to national or European competition rules. We have entered into an agreement with T-Mobile in relation to infrastructure sharing in Germany. In addition to our licence obligations, our infrastructure sharing agreement is subject to competition rules and is the subject of a formal notification to the EU Competition Commission.

### Network access and interconnection

RegTP may determine the terms on which interconnection is provided if operators are unable to reach commercial agreement between themselves in a reasonable timeframe. None of the mobile network operators is yet obliged to grant another carrier interconnection to its network on non-discriminatory or cost-oriented terms.

### Price regulation

We will not be subject to price regulation under the German Telecommunications Act unless we are designated as having SMP in any market. In common with other licensees, we must submit our prices and other general terms and conditions to RegTP in writing before they take effect. RegTP may object to them within a period of four weeks. An objection would render the terms and conditions invalid.

### Number portability and carrier selection

Telecommunications carriers are obliged, by virtue of the German Telecommunications Act, to provide number portability. RegTP has suspended this obligation for mobile networks operators until 31 October 2002, having regard to the necessary technical adjustments required.

Telecommunications carriers are also under an obligation under the German Telecommunications Act to offer carrier "preselection" which may be overridden by a carrier selection prefix each time a call is made, also referred to as call-by-call.

### Service providers

Other mobile telecommunications operators are required to allow service providers to market their GSM services. There is, however, no such requirement in our GSM licence. As a consequence, we market our own services exclusively. A claim has been filed against us with the civil courts by the service provider Debitel, stating that we have a statutory obligation under the Telecommunications Customer Protection Ordinance to permit service providers to market our GSM services. If Debitel succeeds in its claim before the civil courts, we will be obliged to grant them, and subsequently other service providers, the ability to market our services. Our UMTS licence obliges us to permit service providers to market our UMTS services once they become available.

### Data protection

We are subject to data protection regulations in Germany and we believe that we are in compliance with these regulations. We are currently dealing with the Federal Data Protection Office on certain matters that were raised by an audit.

### Planning, health and environmental

In order to address public concerns about any alleged health and environmental risks of increased electromagnetic emissions from our infrastructure, we have collaborated with the other mobile and UMTS operators in Germany in establishing an information sharing body. We, in common with other telecommunications infrastructure providers in Germany, rely on rights of way to allow us to install and maintain our infrastructure. The constitutionality of these rights of way is disputed. All holders of telecommunications licences have automatic rights of way over public land. In so far as private landowners are concerned, our rights of way are more limited.

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### Competition law

We are subject to German competition law which is set out in the act governing restraints of competition. This legislation is broadly similar to EU competition law and prohibits anti-competitive agreements and concerted practices and the abuse of a dominant position. Competition is regulated in Germany both by RegTP and the Federal Cartel Office. The Federal Cartel Office has in the past refrained from initiating proceedings where RegTP deals with the case.

### Regulation in the Netherlands

#### Overview

The Dutch Telecommunications Act 1998, or Dutch Telecommunications Act, provides the current regulatory framework for the provision of fixed and mobile telecommunications services in the Netherlands. The installation and provision of public telecommunications networks and services, leased lines and broadcasting networks, may be provided pursuant to registration under the Dutch Telecommunications Act, but the use of frequencies required for mobile network services is subject to a licensing requirement under the Dutch Telecommunications Act. The Independent Post and Telecommunications Authority (OPTA) and the Minister of Transport, Public Works and Water Management both have supervisory functions under the Dutch Telecommunications Act. The main regulatory provisions applicable to our Dutch business are outlined below.

#### Frequency Licences

On 26 February 1998 O<sub>2</sub> Netherlands acquired two licences to build, maintain and exploit telecommunications infrastructure as necessary to offer public mobile telecommunications services. Both licences terminate on 25 February 2013.

O<sub>2</sub> Netherlands has a UMTS licence valid until 31 December 2016. By 1 January 2007 O<sub>2</sub> Netherlands is obliged to have rolled-out its UMTS network to cover all municipalities with more than 25,000 inhabitants and all main roads, railways and waterways between them.

#### Network access and interconnection

We and other public telecommunications operators (both fixed and mobile) are obliged to negotiate interconnection arrangements with other public telecommunications operators. OPTA may determine the terms on which interconnection is provided if operators are unable to reach commercial agreement between themselves in a reasonable timeframe.

OPTA is seeking to reduce call termination charges and has recently concluded that call termination charges between KPN and O<sub>2</sub> Netherlands should be reduced in stages between 1 May 2002 and July 2003. We have challenged this decision and it has been suspended. The Dutch Competition Authority (NMa) is also conducting an investigation into call termination charges.

#### Number portability and carrier preselection

OPTA has imposed technical and other obligations upon mobile operators requiring them to introduce and offer number portability to customers.

### Infrastructure sharing

Under the Dutch Telecommunications Act and the Dutch Competition Act we may co-operate with other UMTS licence holders on joint infrastructure for UMTS networks provided we maintain our independence.

### Data protection

An act to implement the EU Directive relating to data protection was implemented on 1 September 2001. This act imposes stricter conditions on the collection, use and processing of personal data by us. The act also imposes notification obligations on us. We are also obliged to review and update our current data protection notifications before 1 September 2002.

### Competition law

The Competition Act reflects Articles 81 and 82 of the EC Treaty and gives the Dutch competition authority power to enforce prohibitions against anti-competitive agreements and concerted practices, as well as the abuse of a dominant position. The competition authority also supervises the telecommunications market in this respect and co-operates with OPTA. We are fully co-operating with the competition authority investigation into alleged tariff agreements between all five operators. In the event that infringements of the Competition Act are proved, the competition authority can impose penalties of up to €450,000 or 10 per cent of the turnover of the relevant party, whichever is higher, and also has the power to impose specific legal enforcement measures.

### Regulation in Ireland

#### Overview

The operation of mobile telecommunications networks and the provision of mobile telephony services in Ireland is regulated under the Postal and Telecommunications Services Act 1983 (as amended), or Irish Postal and Telecommunications Act, and the Wireless Telegraphy Act 1926 (as amended), or Irish Wireless Telegraphy Act. We have been granted licences under each act necessary to provide mobile telecommunications services and systems in Ireland. The Director of Telecommunications Regulation (DTR) heads the Office of the Director of Telecommunications Regulation (ODTR), or the Irish Director of Telecommunications Regulation, the Irish telecommunications regulatory authority. Under the recently signed Communications Bill 2002, the functions of the ODTR will transfer to a new three person Communications Commission. Penalties for breach of licence have also been increased under the 2002 Bill with fines up to four million Euros or 10 per cent of turnover.

#### Telecommunications Licences

The term of our current mobile telecommunications licences are 15 years from commencement, which for GSM 900 band is 16 May 1996 and in respect of services provided in the GSM 1800 band, is 1 January 2000.

The DTR may amend a Mobile Telecommunications Licence where the amendment is objectively justifiable and proportionate. The DTR may suspend or revoke a licence where, in its opinion, such revocation or suspension is necessary to comply with Irish or EU law, where the licensee has ceased to provide any licensed services, where the licensee becomes insolvent or is placed into receivership,

where the licensee is guilty of an offence under the Competition Acts in connection with the provision of the licensed services, or where the licensee fails to comply with a direction from the DTR to enforce the licence following material and persistent breach by the licensee.

We have been designated as having SMP in the mobile telephony market and the national market for interconnection in Ireland and are therefore subject to conditions which relate to cross-subsidisation, separate accounts, approval of customer contracts, misuse of data, bodies representing users' interests, undue preference and unfair discrimination. We are also obliged to have transparent and cost-orientated interconnection charges.

In addition to a mobile telecommunications licence, we hold a licence that permits us to use any elements of a fixed network we may acquire.

### Frequency Licences

In addition to mobile telecommunications licences, we hold Irish Wireless Telegraphy Act licences that permit us to use apparatus and radio spectrum in the operation of our mobile telecommunications networks. Our Irish Wireless Telegraphy Act Licence is renewed annually.

We also hold from time to time a large number of radio link licences granted by the DTR which authorise the use of mobile telegraphy apparatus for the purpose of establishing radio links between transmission stations we operate. These radio link licences are renewed regularly.

### Interconnection

We and Vodafone (previously Eircell) have been designated as having SMP in the mobile telephony market and the national market for interconnection in Ireland. Accordingly, we are obliged to adhere to principles of non-discrimination and transparency in relation to interconnection offered to third parties and may not unreasonably refuse access to our network.

We are also obliged to comply with the requirement of ensuring that our charges for interconnection are transparent and cost-oriented.

### Third generation (UMTS) mobile licensing

**The UMTS Licensing.** The process to award UMTS licences is currently underway in Ireland. We have submitted our application for a licence and await the outcome of the comparative assessment process (beauty contest), the results of which are due to be announced in June 2002.

As a precondition to entering the UMTS competition, we have committed to the provision of national roaming facilities for five years on our network for new entrant UMTS licensees who meet minimum roll-out requirements.

**Number Portability.** The DTR has decided to introduce full mobile number portability in the fourth quarter of 2002 in Ireland.

### Indirect access

In July 2000, the DTR published a paper entitled "The Regulatory Framework for Access in the Mobile Market", or the Access Paper, which sets out views on the regulatory issues associated with indirect access provision. According to the DTR, mobile operators with SMP in the mobile market (currently Vodafone and us) are obliged to negotiate interconnection with "qualifying operators". In addition, mobile operators that have been designated as having SMP in the national market for interconnection (currently Vodafone and us) must provide interconnection on a cost-oriented basis. The DTR has indicated that she may consider undertaking further consultation on carrier preselection for mobile networks.

### Data protection

We are subject to data protection regulations in Ireland. The EU Directive on data protection has not yet been implemented in Ireland.

### Competition Acts 1991 and 1996

In addition to EU competition law, we are also subject to Irish competition law which is set out in the Competition Acts 1991 and 1996. This legislation is modelled on EU competition law. It prohibits anti-competitive agreements and arrangements and the abuse of dominant position, which affect trade in any goods or services in Ireland or in a substantial part of Ireland.

### Regulation in the Isle of Man

The Isle of Man is a self-governing Crown Dependency with its own parliament and is not part of the United Kingdom or the EU. Accordingly, our operations in the Isle of Man are predominantly governed by Manx legislation and regulations.

### Telecommunications Licences

Our principal licence relating to our fixed network operations in the Isle of Man, or the Fixed Licence, was issued on 27 June 1986 and came into force on 1 January 1987. It continues in force until 31 December 2006. Our principal licence relating to our mobile network operations in the Isle of Man, or the Mobile Licence, was issued on 28 October 1994. The Mobile Licence expires on 31 December 2006. Our current GSM mobile network is operated under the Mobile Licence and the Isle of Man Communications Commission has consented to our proposed UMTS service also being operated pursuant to the Mobile Licence. In addition, we also benefit from certain other licences granted under applicable Manx legislation in relation to paging, satellite and internet services. We are subject to retail price restrictions and charge reviews by the Isle of Man Communications Commission under our licences. Our Fixed Licence also requires us to publish the terms and conditions on which offers of certain telecommunications services are made.

## business review

### Mobile network services and spectrum allocation

We have been granted Wireless Telegraphy Acts licences by the UK Radiocommunications Agency that permit us to establish and use stations and apparatus for mobile transmissions in the operation of our mobile networks. On 19 February 2001 the Radiocommunications Agency granted us a Schedule for Third Generation Mobile Services, renewed annually, and we will operate our proposed UMTS network pursuant to this Schedule and the 1994 Mobile Licence referred to above.

### Independent review of telecommunications regulation

The Isle of Man Communications Commission recently commissioned a report from a firm of independent consultants on the future regulatory policy that should be adopted in the Isle of Man. The report, published on 12 July 2001, recommended that competition be gradually introduced in respect of certain services, that negotiations should commence with Manx Telecom for a new 15-year licence for the period after 2006 and that new legislation be introduced to strengthen the powers of the Communications Commission, to introduce an interconnection regime based on the EU model and to introduce a system of tariff controls. The Communications Commission has welcomed the recommendations of the report.

### Key Markets and Employees

Europe includes some of the most advanced markets for mobile services in the world. These markets are characterised by relatively high mobile penetration rates and revenues per customer and are amongst the leading markets for the emergence of mobile data services. These markets are also characterised by high population density and GDP per capita. Across Western Europe, the proportion of total voice traffic carried over mobile rather than fixed line networks continues to increase. These markets are also seeing an increasing proportion of mobile revenues attributable to mobile data services and we expect this trend to continue.

Our mobile businesses cover two of the largest markets in Europe, with the UK and German markets giving us access to a total population of over 140 million people. All our markets have seen growth over the last few years in the number of mobile telephone users, in large part reflecting strong demand for competitively priced pre-pay offerings. Our markets are seeing the emergence of additional wholesale opportunities for network operators. Through wholesale agreements, network operators are able to sell capacity and services on a large scale to other service providers and mobile virtual network operators.

Historically, the number of customer connections to mobile telephone networks in the markets where we are present has been greater during the second half of the financial year than during the first half, primarily due to increased sales during the Christmas period. See "Operating and Financial Review and Prospects – Factors Affecting Our Business."

The following chart below presents selected data regarding the principal countries in Europe in which our businesses operate.

Country	Population <sup>1</sup> (in millions)	Mobile <sup>1</sup> customers' penetration at 31 March 2002 (%)	mmO <sub>2</sub> customers at 31 March 2002 (in 000's)
Germany	83.2	63.4	3,891
United Kingdom	59.8	78.0	11,084
The Netherlands	16.0	72.4	1,255
Ireland	3.9	76.6	1,180
<b>Total</b>	<b>162.9</b>		<b>17,410</b>

<sup>1</sup> Source: EMC Worldwide Cellular Database, May 2002.

The Group had 14,300 full-time employees at 31 March 2002, as set forth by country in the table below:

Country	Number of employees
United Kingdom	7,872
Germany	3,852
The Netherlands	892
Ireland	1,412
Isle of Man	272
<b>Total</b>	<b>14,300</b>

For the year ended 31 March 2002, the aggregate number of temporary staff employed by our businesses was 1,377.

In the United Kingdom, a number of our employees are represented by two labour unions: Connect, which has representation rights in respect of management employees and the Communications Workers Union, which has representation rights in respect of clerical, engineering and technical employees. Membership of these unions is individual and voluntary. In addition, certain managers are represented by a non-unionised employee representative body. Our other operating businesses also meet with their employee representative bodies, or works councils, regularly. We believe that our businesses have a good relationship with our employees and their representatives.

Approximately 75 per cent of our permanent employees are covered by collective bargaining agreements. These agreements are kept under review, with changes being made through discussion with the relevant representative body as required.

### Network and service platform technology

We have launched a major initiative to build a common infrastructure to support the development of services and applications across our networks. The deployment of a common network architecture will be essential to bring economies of scale, support pan-European services and enable tailoring for local market requirements. As part of this process we intend to implement common service enabling platforms across our four key businesses, which will allow new applications to be swiftly rolled-out across these networks without requiring costly and time-consuming redevelopment.

### **Information technology**

The flexibility and functionality of our information systems will be critical to our strategy and to the successful operation of our businesses. We are currently reliant on a wide range of systems, partly as a result of the speed of growth in the mobile market, but also as a result of our acquisitions of retailers and service providers. In addition, our customer base has expanded rapidly. O<sub>2</sub> UK has signed an agreement with IBM to deliver world-class customer service and business support capability for voice, text and mobile internet markets.

### **Intellectual property**

BT transferred to us its interest in certain software and other materials attracting copyright that were used exclusively in connection with our businesses and which those businesses originally funded. BT has transferred to us all of its rights in certain trademarks and domain names used exclusively in our UK businesses, except that BT has retained rights in trade marks and domain names previously used in our business which comprise names and logos that relate to the BT Group, such as "BT" and BT's full-piper and half-piper logos. BT has retained all other intellectual property rights used in our UK businesses which have not been transferred to us and which are not already owned by us.

Our UK businesses and O<sub>2</sub> Netherlands have been granted the right until 31 March 2003 to continue to use the BT name, BT's full-piper logo and BT's half-piper logo to the extent that they used such name and logos before the demerger transaction, except in respect of fixed-line telephony goods and services and all other hardware and telecommunications equipment, and certain internet-related services. BT only has a limited right to charge us royalties where, for example, we do not meet certain quality standards.

We also have a limited non-exclusive royalty-free licence from BT, for the operation of our worldwide businesses, to continue to use any and all patents, copyright, unregistered design rights, database rights and know-how.

In May 2002, we introduced a single new customer brand, O<sub>2</sub>. We have actively taken steps to protect the new brand, including the acquisition of core trademark registrations in O<sub>2</sub> brand and related brand materials. In addition, we have other pending national and European Community trademark applications in ancillary classes.

We are aware that various third parties use O<sub>2</sub> or similar brands in connection with other goods and services. We have entered into agreements with some such third parties which permit the brands to co-exist. These agreements contain some restrictions on use of our brand but we do not believe that these restrictions conflict with our business model or day-to-day activities. It is not our intention to trade under the O<sub>2</sub> brand in the United States, where our securities trade under the mmO<sub>2</sub> plc name.

We have also acquired a range of domain names, including the core domains of mmo2.com, o2.co.uk, o2.ie, o2.nl and o2online.de.

We have applied for patent protection relating to technology used in our HomeZone service. The HomeZone service is one of our products marketed in Germany under the Genion name. A third party owns two patents which cover the technology used in the HomeZone service. To date, this third party has not sought to challenge our patent applications or prevent us from using the HomeZone technology. We believe that it is unlikely to take any such action in the future. However, if that third party sought successfully to do so, we might have to stop using the HomeZone technology. Also, in Germany, a third party has sought to revoke our German trade mark registration for our "Genion" brand. We have already entered into a co-existence agreement with this party and are presently active in negotiating a settlement agreement in respect of the current dispute.

### **Insurance**

We maintain the types and amounts of insurance customary in the industries and countries in which our Group operates, including coverage for employee-related accidents and injuries and property damage. We consider our insurance coverage and that of our operating businesses to be adequate both as to the nature of the risks covered and amounts insured for the business conducted by us.

# corporate social responsibility

## Our approach

Our vision at mmO<sub>2</sub> is to enrich people's lives whatever they're doing, wherever they are, through mobile communications. Corporate Social Responsibility (CSR) is an important part of this vision. By taking responsibility for and managing our social, environmental and ethical impacts, we aim to add value to our business and also to society. Our objective is to develop and sustain our business, our markets, our resources and the communities in which we operate for the long term.

Our former parent left us with a strong legacy in CSR. We are, however, a new company with our own values, eager to devise our own CSR framework. mmO<sub>2</sub> is currently in the process of developing a long-term CSR strategy that will reflect our core values and our commitments to continuous development and engagement with our employees, customers, suppliers and representatives of society.

Within mmO<sub>2</sub>, CSR is managed by a dedicated team, supported by experts drawn from across our businesses. We are currently developing a governance structure for our activities in this area to ensure that we will adhere to the appropriate disclosure and reporting guidelines. We also support the Disclosure Guidelines on Social Responsibility issued by the Association of British Insurers.

## Management & Risk

The Board takes regular account of the significance of social, environmental and ethical matters to our business as part of our internal control systems. These systems are designed to minimise or eliminate risks that we have identified and evaluated, and to manage those significant risks that threaten the achievement of our business objectives.

A risks register, including social, environmental and ethical matters, made up of 84 sub-elements, has been developed. Accountability for each identified risk has been allocated to an individual Board member who will have the responsibility for implementing an appropriate key control strategy for the risk. The register will form the basis for training Directors in CSR matters and a programme is scheduled to take place in the coming year.

mmO<sub>2</sub> already has detailed policies in place which explain how we manage our undertakings and the associated risks. Policies relating to, for instance, Corporate Governance, Health, Safety and Environment support our risk management strategy and our philosophy of continual improvement. A detailed reference to our policies and their management will become available on our website [www.mmo2.com](http://www.mmo2.com) during 2002/03. More information can also be found in the Risk and Internal Control sections of this report.

## Ethics

The Group has in place a wide-ranging ethics policy on issues such as the environment, diversity and procurement that will undergo further development during 2002/03. Our policy sets standards and guidelines for the way mmO<sub>2</sub> should operate on ethical matters. Responsibility for monitoring and auditing our ethics policy lies with our Internal Audit department.

During the 2002/03 financial year we will also develop an ethical trading policy and code of conduct for our own supply chain,

working with other companies to secure continuous improvement on issues such as human rights, ethical trade and international working conditions. We welcome the opportunity to assess our compliance with codes of conduct and will actively work towards compliance where they are applicable, agreed and reasonable.

## Health, safety and environment

We have established a Group-wide health and safety strategy agreed at Board level, with clearly defined roles and responsibilities. This was introduced with a view to enhance our well-established policies and procedures. As a minimum expectation we comply with all UK and EU health and safety legislation and all relevant industry standards.

Health and safety issues are of prime importance to us. Our overriding principle is that we expect a zero tolerance to injury and ill health arising from work activity.

A number of European countries have carried out scientific reviews on the health effects of mobile phone technology and have identified the need for further research. A joint UK government and industry-funded Mobile Telecommunications and Health Research programme, of which we are a funder, has been established and similar programmes are expected to be put in place in Germany and the Netherlands. We fund and participate in industry groups, such as the FEI's Mobile Telecommunications Advisory Committee (MTAC) in the UK and Informationszentrum Mobilfunk (12MF) in Germany whose objectives are to address health concerns about radio frequency emissions and to improve communication and consultation with various stakeholder groups.

A group-wide environment policy is under development with clear targets and milestones for implementation and will become available on our website during the course of 2002/03. We will build on the solid foundation established by O<sub>2</sub> UK which is certified to ISO14001, the international standard for environmental management systems.

## Our people

We aim to maintain a working environment that relates strongly to our core mmO<sub>2</sub> values of boldness, openness, transparency and trustworthiness. Lifelong learning through training and development is one of our key commitments. We want to encourage our employees to develop themselves, particularly in achieving customer service qualifications, which helps to underpin our strong commitment to excellence in customer service.

Diversity is well developed both in employment policy and supporting procedures and we have a number of staff dedicated to enhancing our opportunities in this field.

Further details on our employees can be found in the Directors' report.

## Engagement with society

Our business principle has a clear ethos in that we are committed to enriching people's lives through our products and services. But we are also determined to add value to the communities in which we operate.

We are currently developing the most appropriate vehicle for mmO<sub>2</sub>'s charitable work and its engagement in the community. mmO<sub>2</sub> is already a member of Business in the Community. Our current community involvement is largely conducted through our operating businesses. Contributions such as our involvement in Leeds Cares, the Slough Reading Buddies scheme, Sternstunden, a children's charity, and our support for the Cork Gaelic Athletic Association, to name only a few initiatives, are something we rightly regard with pride.

In addition to our involvement in the community, mmO<sub>2</sub> has explored the opportunities provided by cause-related marketing projects that have benefits to society. We have undertaken to plant 15,000 trees in forests in the UK, Ireland, Germany and the Netherlands, a major project combining the corporate values and the marketing objectives of mmO<sub>2</sub>.

We are reviewing our activities to ensure that when we strive to meet the demands of customers, we do so in a responsible way, through dialogue and active engagement with society.



## operating and financial review and prospects

This commentary discusses, and is based on, the audited consolidated financial information of the Group prepared in accordance with UK GAAP, included on pages 62 to 88. This commentary should be read in conjunction with this financial information.

Definitions of the operating metrics (including ARPU, churn, SAC, pre-pay customers and post-pay customers), used in this commentary, and the exchange rates applied in calculating the sterling amount of those metrics where applicable, can be found in the non-financial metrics section on page 89 of this document.

### Introduction

We provide voice and data mobile communications services and products in the United Kingdom, Germany, the Netherlands and Ireland through our wholly owned mobile businesses, O<sub>2</sub> UK, O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Ireland, respectively, and through our mobile internet business, O<sub>2</sub> Online. We also supply fixed and mobile communications services in the Isle of Man through our wholly owned subsidiary, Manx Telecom.

Historically, our business has been based predominantly in the United Kingdom, although we have had joint ventures or subsidiaries in Germany and the Netherlands throughout our last three financial years. Since the end of the financial year ended 31 March 2000, we have significantly expanded our business in Germany, the Netherlands and Ireland. We completed the acquisition of the remaining shares in our German mobile joint venture, O<sub>2</sub> Germany, on 20 February 2001 and the remaining interest in our Dutch mobile joint venture, O<sub>2</sub> Netherlands, on 30 June 2000. We acquired a controlling interest in our Irish operation, O<sub>2</sub> Ireland, on 30 March 2000 and purchased the remaining shares in O<sub>2</sub> Ireland on 18 April 2001. We have also acquired UMTS licences in the United Kingdom, Germany, the Netherlands and the Isle of Man, and have applied for a UMTS licence in Ireland.

For the period up to 19 November 2001, the date of demerger from BT, we were not constituted as a separate legal group of companies under a separate holding company within the existing BT group. However, our consolidated financial statements, contained elsewhere in this document have been prepared as though we had existed as a stand-alone group throughout the period. Whilst we believe that the financial information set out in our consolidated financial statements is an appropriate presentation, this financial information is not necessarily indicative of the financial results that might have occurred had we been an independently financed and managed public entity during the periods presented or of our financial results that may occur in any future period.

O<sub>2</sub> UK, our more established business, has had steadily increasing operating profit over the past three financial years. Despite O<sub>2</sub> UK's positive results, our Group has incurred consolidated operating losses over the same period. Our recent operating losses are largely the result of consolidating the results of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands in our financial statements from the 2001 financial year, and amortisation and write-down of goodwill recorded on these and other acquisitions.

As newer telecommunications businesses incurring significant start-up costs, O<sub>2</sub> Germany and O<sub>2</sub> Netherlands have historically

been, and currently are, loss making. We expect these businesses to continue to incur operating losses as they continue to increase their customer base. In addition, O<sub>2</sub> Online recorded increasing operating losses up to the 2001 financial year, but has returned a smaller loss in the 2002 financial year.

### Factors affecting our business

During the last three financial years, our results of operations have been significantly affected by the acquisitions of our German, Dutch and Irish businesses and other corporate transactions described above. Certain other key factors affecting results of operations in the periods under review are discussed below.

### Growth in the mobile market

In the periods under review, the mobile telecommunications market has grown significantly in all the countries where we operate. By 31 March 2002, penetration rates are approaching 80 per cent in the United Kingdom, 65 per cent in Germany, 72 per cent in the Netherlands and 77 per cent in Ireland. Our pro forma total number of registered customers, assuming we owned on 31 March 1999 each of the businesses which we now own, increased from approximately five million at 31 March 1999 to approximately 16.5 million at 31 March 2001. From 31 March 2001, we revised the definition of how we measure our customer base, from including all our registered customers to only including those customers who have recently made or received a call. Our total active customer base has increased from 15.5 million at 31 March 2001 to 17.5 million at 31 March 2002.

The markets in which our businesses operate are now characterised by high penetration rates. As a result, we are placing greater focus on customer retention and conversion, and on generating increased usage rather than acquiring new mobile customers. In general, we expect subscriber acquisition costs to decrease and subscriber retention costs to increase, although, reflecting our focus on higher value customers, subscriber acquisition costs for certain customers, in particular high valued post-pay customers, may increase.

### Introduction of pre-pay products

A significant portion of our growth in customers in recent years has resulted from the success of pre-pay mobile products. We introduced our pre-pay products across the group during the period from July 1998 to August 1999, and now our pre-pay customers account for 68 per cent of our customers in the United Kingdom, 49 per cent in Germany, 81 per cent in the Netherlands and 70 per cent in Ireland. Pre-pay services offer us several significant advantages, including lower SAC, higher average per minute charges, reduced credit risk and lower administrative costs. However, lower average outgoing usage minutes for pre-pay customers have resulted in lower ARPU.

As our ARPU from pre-pay customers is lower than for post-pay customers, to maintain profitability we give lower handset discounts to pre-pay customers. Within the industry generally, subscriber acquisition costs are lower for pre-pay customers than for post-pay customers. Our overall subscriber acquisition costs per new customer have fallen substantially in the years ended 31 March 2001 and 2002, mainly driven by a decrease in O<sub>2</sub> UK's subscriber acquisition costs as a result of the substantial increase in the number and proportion of its pre-pay customers.

### Seasonality

Historically, the number of customer connections to mobile telephone networks in the markets where we are present has been greater during the second half of the financial year than during the first half, primarily owing to increased sales during the Christmas period. Therefore, our revenues from equipment sales and connection charges, and the aggregate costs of customer equipment and dealer commissions and our other related costs of sales, have been greater during the second half of the financial year than during the first half. However, there is no assurance that this trend will continue and it is difficult to predict the seasonality of customer connections in the future.

### Impact of regulation

Our businesses operate in highly regulated markets, and governmental regulation frequently limits the revenue we may receive from certain sources, particularly in the United Kingdom. This is discussed fully in the Regulation section of our business review.

### Critical accounting policies

The Group's consolidated financial statements are prepared in accordance with accounting principles that are generally accepted in the UK. As part of these reporting guidelines management are required to identify and disclose the accounting policies relating to all aspects of the results and financial position of the Group used in preparing the financial statements. The preparation of consolidated financial statements requires the management to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of certain contingent assets and liabilities. The accounting policies used in preparing the Group's financial statements for the year ended 31 March 2002 are disclosed in note 1 of those financial statements.

The following accounting policies are considered to be critical to the understanding of the consolidated financial statements. These policies have the potential to have a significant impact on the Group's financial statements, either because of the significance of the financial statement item to which they relate, or because they require a high degree of judgement and estimation owing to the uncertainty involved in measuring, at a specific point in time, events that are continuous in nature.

#### Tangible and intangible fixed assets

We estimate the useful lives of property, plant and equipment, goodwill and other intangible assets, in order to determine the amount of depreciation and amortisation to be charged in any reporting period. These useful lives are estimated at the time the asset is acquired, and are based on historical experience with similar assets, as well as taking into account future anticipated events affecting their life. Changes in technology or changes in the Group's intended use of these assets may cause the estimated life or the value of these assets to change.

We perform a review of the estimated useful life, residual value and depreciation method for each category of tangible fixed assets, (being property, plant and equipment and assets in the course of construction), at the end of every reporting period. Our review of these assets may indicate that their lives need to be shortened,

resulting in an increased depreciation charge in future periods. Alternatively, our review may indicate a decrease in the value of the asset, recognised by an impairment charge.

Additionally, goodwill and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. In assessing impairments we calculate a value-in-use based on discounted cash flows projections which generally cover a ten-year period. These cash flows take into account management's estimates of the future operations.

A review in accordance with the above policy was performed as at 31 March 2002 and 31 March 2001. The carrying values of the goodwill and other assets of the Group's subsidiary undertakings in Germany, Ireland, the Netherlands and the UK have therefore been compared with their value in use to the Group.

The value in use has been derived from discounted cash flow projections which cover the ten years from 1 April 2002. The projections cover a ten year period as management of the Group consider that the growth in these businesses will exceed the average growth rate for the relevant market in the countries concerned over ten years. Also, the development of the technology and assets required for such growth means ten year projections would more fairly reflect their long-term values. After the ten year period, the projections use a long-term growth rate compatible with projections for the countries concerned. The discount rate used to arrive at this calculation was 9 per cent, which is the Group's estimated risk adjusted cost of capital.

In calculating the value in use there is considerable uncertainty as to the discounted future earnings used. In assessing the future value of the assets, assessments have been made using the best estimates available and reflect growth rates projected ten years into the future, long-term growth rates beyond year ten, the discount rate, the competitive landscape, take up and charge rate of data services and the timing of the available, functioning, technological infrastructure to support their roll-out. The actual outcome is uncertain and these estimates may change over time as subsequent changes in the mobile telecommunications industry, including advances in technology or changes in the performance of our business, as a result of competitive pressure or otherwise, or potential difficulty in the implementation of the UMTS network, may in the future shorten the estimated useful lives of the intangible assets or result in the further write-off of a portion of these assets.

Based on the review performed in 2002, no impairment charge has been made. The review in 2001 resulted in an exceptional charge to operating costs of £2,800 million in respect of O<sub>2</sub> Germany. This charge is included in the exceptional line item of the profit and loss account. The charge has been allocated to the goodwill arising on the acquisition of remaining 55 per cent interest in O<sub>2</sub> Germany that was purchased during the year ended 31 March 2001. The remaining goodwill of £918 million will be amortised over 20 years in accordance with the Group's accounting policies.

#### Revenue recognition

We only recognise in turnover, transactions that are considered to be

## operating and financial review and prospects

part of our principal ongoing operations. We recognise voice and data service revenue in the profit and loss account based on minutes of airtime processed over the Group's networks. Turnover derived from connection fees and subscriptions is recognised evenly over the estimated customer relationship period, or the contracted period to which they relate. Income received from sales of pre-pay call cards is deferred until the customer has used the value in the card to pay for relevant calls. Revenues from handsets are recognised at the point of sale.

In connection with recording revenue, we maintain provisions for doubtful debts for estimated losses that result from the inability of a portion of our customers to make required payments. We base our provision on historical results and future expectations, the economic and competitive environment and other relevant factors, and review the provision regularly.

### Income taxes

Under US GAAP, income taxes are provided using the liability method prescribed by ASB Standard No. 109, "Accounting for Income Taxes". Under the liability method, deferred income taxes reflect the tax effect of net operating losses and investment carry forwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. The financial effect of changes in tax laws or rates is accounted for in the period of enactment.

### Basis of presentation of financial statements

The consolidated financial statements have been prepared using merger accounting principles as if the businesses comprising the mmO<sub>2</sub> plc group had been part of the Group for all periods presented, since they have been under common control throughout this period. Businesses acquired from, or disposed to, third parties during the periods presented have been accounted for using acquisition accounting, from or to the date control passed.

The principal components of our Group in the periods under review have been as follows:

- >> O<sub>2</sub> UK, our UK business, has been included throughout the periods covered by the consolidated financial statements;
- >> O<sub>2</sub> Germany, our mobile business in Germany, has been consolidated since we increased our interest to 100 per cent on 20 February 2001. Prior to this date, we owned a 45 per cent stake in the company from its inception until 15 January 2001, when our interest increased to 55 per cent. In our consolidated financial statements we accounted for this interest under the equity method as a joint venture until 20 February 2001, when we obtained regulatory approval to acquire the remaining interest and control;
- >> O<sub>2</sub> Netherlands, our mobile business in the Netherlands, has been consolidated since 30 June 2000, when we acquired the remaining 50 per cent interest in the company, and obtained full control. Prior to 30 June 2002, we held a 50 per cent joint venture interest in O<sub>2</sub> Netherlands B.V. which has been accounted for in our consolidated financial statements under the equity method as a joint venture;

- >> O<sub>2</sub> Ireland, our mobile business in Ireland, has been included in our consolidated financial statements from 30 March 2000, when our interest in the issued voting share capital of O<sub>2</sub> Ireland increased to 50.5 per cent from the 1 per cent acquired in January 2000. We acquired the remaining 49.5 per cent interest in O<sub>2</sub> Ireland on 18 April 2001;
- >> Various businesses and assets in the United Kingdom have been operated throughout the period of the consolidated financial statements as separate units within the BT Group, including the BT Mobile, BT Shops and Airwave businesses. The businesses and assets of all these operations were transferred to the Group prior to demerger. The assets and results of each of these operations have been included in the consolidated financial statements for all periods presented;
- >> The O<sub>2</sub> Online internet portal business was operated initially as a division of O<sub>2</sub> UK. However, in 2001, the business and assets of O<sub>2</sub> Online were transferred into a separate legal entity, a wholly-owned subsidiary of O<sub>2</sub> UK; and
- >> Manx Telecom Limited, O<sub>2</sub> Third Generation Limited and Cellular Radio Limited have been included throughout the periods presented in the consolidated financial statements.

### Introduction to results of operations

The following is a brief description of the items comprised within turnover, cost of sales and administrative expenses within our results of operations.

#### Turnover

Our turnover from operations can be analysed into three areas, service, equipment and other revenue, with service revenue our principal source of income. These income streams are briefly described below:

- >> **Service.** Our principal source of income is derived from our customers' use of our mobile networks. This includes both voice-related airtime and data services, such as SMS, WAP and GPRS. Interconnection fees from other networks terminating calls on our customers' mobile phones, and roaming fees from other network customers using our networks, are also included within our definition of service revenue.
- >> **Equipment.** Equipment revenue is derived from the sale of handsets and other accessories; and
- >> **Other.** Other revenue primarily relates to revenue received from other mobile networks in situations when we are acting as a retailer or as a service provider. Other revenue also includes connection charges and revenue from other sources such as voice messaging and paging services.

#### Cost of sales

The principal items within cost of sales are:

- >> **Service.** Service cost of sales mainly comprises interconnection charges and operation and maintenance costs relating to our networks. These costs may be sub-divided into costs of a variable nature and costs which are more fixed in nature. Interconnection charges are the payments made by us to other fixed line or mobile network operators, both in the local country and roaming costs when our customers make calls or send SMS messages that are terminated on a competitor's network. These

costs are variable in nature, increasing as the usage of the network increases. Costs relating to the operation and maintenance of our networks mainly comprise core transmission costs, mast site leases, network equipment maintenance and depreciation charges related to our network assets. These costs are more fixed in nature, and depend on the size of the network, not the usage of the network. Service cost of sales will significantly increase once we commence providing services pursuant to our UMTS licences, because service cost of sales will include amortisation of our UMTS licence acquisition costs over the remaining life of these licences and depreciation of our UMTS networks once they are constructed;

- >> **Equipment.** Equipment cost of sales includes the cost of purchasing handsets and other hardware items, such as SIM cards, from manufacturers; and
- >> **Other.** Other cost of sales primarily relates to the cost of services from other mobile networks when we are acting as a retailer or service provider. Other cost of sales also includes the network cost of providing voice messaging and paging services.

#### Administrative expenses before exceptional items

Principal administrative expenses are:

- >> **Promotional and advertising.** These costs primarily comprise bonuses and commissions to retailers, mainly for acquisition, but increasingly for retention, of customers. Promotional and advertising expenses also include expenditure on advertising, marketing and loyalty programmes;
- >> **Overhead.** Overhead expenses include personnel costs relating to functions such as finance, planning, network, regulatory, legal, marketing and customer care. They also include property charges, facilities, training and information technology support;
- >> **Depreciation.** This includes depreciation expenses not related to network assets; and
- >> **Amortisation.** This comprises amortisation expenses on goodwill arising on the acquisition of businesses.

#### Exceptional items

Exceptional items are large non-recurring expenses and incomes that have been disclosed separately to avoid distortion of reported trading profit. In the period under review, the Group incurred £150 million of exceptional costs: £27 million of these costs were directly attributable to the demerger from BT and the remaining £123 million related to the restructuring of the UK and German businesses of the Group post demerger. In the year ended 31 March 2001 an exceptional item of £2,800 million relating to the write-down of the carrying value of the goodwill relating to O<sub>2</sub> Germany was included in our consolidated results.

## Operating results

### mmO<sub>2</sub> consolidated results of operations for the years ended 31 March 2002, 2001 and 2000

The following table presents certain financial data for our Group for the years ended 31 March 2002, 2001 and 2000 extracted from our consolidated financial statements:

	2002 £m	Year ended 31 March 2001 £m	2000 £m
Group turnover	<b>4,276</b>	3,200	2,618
Cost of sales	<b>(2,714)</b>	(1,814)	(1,410)
Gross profit	<b>1,562</b>	1,386	1,208
Administrative expenses before exceptional items	<b>(2,268)</b>	(1,729)	(1,141)
Exceptional items	<b>(150)</b>	(2,821)	(47)
EBITDA <sup>1</sup> before exceptional items	<b>433</b>	317	385
Group operating (loss)/profit	<b>(856)</b>	(3,164)	20
Group's share of operating loss of joint ventures	–	(303)	(281)
Group's share of operating profit of associates	<b>8</b>	17	11
Total operating loss	<b>(848)</b>	(3,450)	(250)
Net interest payable and similar charges	<b>(25)</b>	(9)	(8)
Loss on ordinary activities before taxation	<b>(873)</b>	(3,459)	(258)
Tax on loss on ordinary activities	<b>23</b>	(70)	9
Loss on ordinary activities after taxation	<b>(850)</b>	(3,529)	(249)
Minority interests	–	(4)	(1)
Loss for the financial year	<b>(850)</b>	(3,533)	(250)

<sup>1</sup>EBITDA is our earnings before interest, tax, depreciation, amortisation and exceptional items, excluding our share of operating profits and losses of our joint ventures and associates. EBITDA is not a measure of financial performance under UK or US GAAP and may not be comparable to similarly titled measures of other companies because EBITDA is not uniformly defined. EBITDA should not be considered by investors as an alternative to Group operating profit or profit on ordinary activities before taxation as an indication of operating performance, or as an alternative to cash flow from operating activities as an indication of cash flows.

### Year ended 31 March 2002 compared to year ended 31 March 2001

#### Group turnover

The following table shows contributions of our businesses to Group turnover:

	Year ended 31 March 2002 £m	2001 £m	per cent variation
O <sub>2</sub> UK	<b>2,756</b>	2,706	2
O <sub>2</sub> Germany <sup>1</sup>	<b>875</b>	65	1,246
O <sub>2</sub> Netherlands <sup>2</sup>	<b>200</b>	90	122
O <sub>2</sub> Ireland	<b>395</b>	309	28
O <sub>2</sub> Online	<b>100</b>	15	567
Other operations	<b>54</b>	47	15
Intragroup eliminations	<b>(104)</b>	(32)	225
<b>Total</b>	<b>4,276</b>	3,200	34

<sup>1</sup>Included within our consolidated Group from 20 February 2001.

<sup>2</sup>Included within our consolidated Group from 30 June 2000.

## operating and financial review and prospects

Group turnover increased by 34 per cent from £3,200 million for the year ended 31 March 2001, to £4,276 million for the year ended 31 March 2002. This increase in revenues is principally owing to the inclusion within our consolidated Group of a full year of results from O<sub>2</sub> Netherlands and O<sub>2</sub> Germany which became fully owned subsidiaries in June 2000 and February 2001 respectively. In addition, the revenue of O<sub>2</sub> Online has increased over six fold.

### O<sub>2</sub> UK

O<sub>2</sub> UK's overall turnover increased by two per cent from £2,706 million for the year ended 31 March 2001 to £2,756 million for the year ended 31 March 2002. Turnover largely comprises of service revenue, which increased by ten per cent from £2,207 million for the year ended 31 March 2001 to £2,426 million for the year ended 31 March 2002.

Increases in O<sub>2</sub> UK's turnover of five per cent during the year ended 31 March 2001 was primarily owing to the growth of its customer base and the overall growth in usage in the mobile market. However, during the year ended 31 March 2002, we have seen the expected slowdown in growth of the mobile phone market, as penetration levels approach 80 per cent. This has led to the smaller increase in overall revenues in the financial year ended 31 March 2002 compared to the 2001 financial year.

O<sub>2</sub> UK's total active customer base increased from 10.6 million at 31 March 2001 to 11.1 million at 31 March 2002, an increase of five per cent, which includes a net increase in post-pay subscribers of approximately 100,000 over the year. Post-pay churn has shown a significant decrease from 44 per cent for the year ended 31 March 2001 to 31 per cent for the current year.

The following table shows a breakdown of O<sub>2</sub> UK's turnover:

	Year ended 31 March 2002 £m	2001 £m	per cent variation
Service	2,426	2,207	10
Equipment	136	222	(39)
Other	194	277	(30)
<b>Total</b>	<b>2,756</b>	<b>2,706</b>	<b>2</b>

**Service** Service revenue is the principal element of O<sub>2</sub> UK's revenue, comprising 88 per cent of total turnover for the year ended 31 March 2002. O<sub>2</sub> UK's service revenue increased by ten per cent from £2,207 million for the year ended 31 March 2001 to £2,426 million for the year ended 31 March 2002. Of this, service revenue from post-pay customers is the principal source of income, with post-pay revenue accounting for over 65 per cent of the total.

O<sub>2</sub> UK's revenue has increased as a result of a combination of an increase in the subscriber base, an increase in the post-pay ARPU, and better retention of existing users.

Post-pay subscribers' gross additions for the year ended 31 March 2002 total 1.3 million, taking our total post-pay customer base to 3.5 million (representing 87,000 net additions for the year). The post-pay churn rate has decreased significantly from 43.5 per cent as at 31 March 2001 to 31.0 per cent at 31 March 2002.

These improvements have been as a result of the operation focusing on business, professionals and young adult customers, which we believe represent the higher value segments of the market, both in pre-pay and post-pay. We are also concentrating on retaining our high-value customers through successful customer relationship management initiatives, such as our effective customer loyalty, retention and upgrade schemes, *First* and *Select*, which have assisted in reducing our contract churn.

Data revenues, as a proportion of total service revenues increased steadily through the year from less than ten per cent at 31 March 2001 to 11.8 per cent for the year ended 31 March 2002. Included within these statistics, the popularity of text messages continued to grow, with over 3.4 billion messages sent during the year ended 31 March 2002, compared with 1.6 billion the prior year.

**Equipment and other revenue** Both equipment and other revenues have decreased compared to the prior year. Equipment revenues are generally decreasing as handset sale prices are reducing. In addition the higher proportion of new pre-pay customers over the year has decreased the overall equipment revenue as handset prices for pre-pay customers are lower than for post-pay.

O<sub>2</sub> UK's other revenue in both the 2001 and 2002 financial years mainly comprised revenue from Lumina, a service provider acquired in the 2000 financial year, which had a customer base which included both O<sub>2</sub> UK and Vodafone customers. As a result of this acquisition, O<sub>2</sub> UK receives revenues from customers connected to the Vodafone network. We have been actively working to migrate these customers to our own network, and as a result the revenues generated from the Vodafone customers has decreased.

### O<sub>2</sub> Germany

O<sub>2</sub> Germany was consolidated from 20 February 2001 and contributed £65 million to Group turnover for the year ended 31 March 2001. During the year ended 31 March 2002, O<sub>2</sub> Germany contributed £875 million to Group revenue.

The following table details O<sub>2</sub> Germany's revenue between service and other revenues:

	Year ended 31 March 2002 £m	2001 £m	Year ended 31 December 2000 <sup>1</sup> £m
Service	696	45	470
Equipment	127	13	119
Other	52	7	11
<b>Total</b>	<b>875</b>	<b>65</b>	<b>600</b>

<sup>1</sup>The year ended 31 December 2000 comparatives, translated from the Euro at €1.6208/£1, are included for illustration purposes only. Audited results for the year ended 31 March 2001 are not available.

**Service** O<sub>2</sub> Germany's service revenue for the year ended 31 March 2002 has increased over 15 times on the revenue for the period from acquisition to 31 March 2001 as a result of consolidating a full year's results for the first time, and by 48 per cent on the 12 month period ended 31 December 2000.

This increase in revenues, apart from the effect of consolidating for the first time, is principally as a result of the significant increase in the subscriber base, from 3.2 million active subscribers at 31 March

2001, to 3.9 million active subscribers at 31 March 2002. This increase in subscribers was substantially evenly divided between post-pay and pre-pay net additions, with post-pay accounting for 372,000, and pre-pay 352,000 net additions during the year ended 31 March 2002.

A large proportion of the post-pay additions during the year relate to customers who have subscribed to the Genion Home service, our location-based tariffing technology, which allows reduced call rates within the *homezone*. O<sub>2</sub> Germany also offer an equivalent service to business customers. Both Genion Home and Business are part of our drive across the Group to attract high-value customers.

Post-pay ARPU has decreased from £358 for the 12 months ended 31 December 2000, to £313 for the year ended 31 March 2002. The fourth quarter ARPU to 31 March 2002 of £313 has shown an increase of two per cent over the third quarter ended 31 December 2001 ARPU of £306, as our drive to target the higher value customers started to have an effect.

In line with our Group-wide commitment to become a leader in data services, in January 2001 O<sub>2</sub> Germany became the first operator in Germany to launch an operational GPRS network, and have introduced a number of data applications and hardware during the current year. This has been reflected in the increase in the proportion of data revenues which have risen to 14.5 per cent during the three months ended 31 March 2002, from 13.6 per cent for the quarter ended 30 June 2001. The principal element of data revenue is generated by text messages; O<sub>2</sub> Germany recorded 958 million text messages in the year ended 31 March 2002.

**Equipment and other revenues** Equipment revenue has increased approximately ten times to £127 million for the year ended 31 March 2002, and by seven per cent on the 12 month period ended 31 December 2000, which is principally a result of the increase in the subscriber base over the periods. Other revenue has increased seven times from £7 million in the year ended 31 March 2001 to £52 million in the year ended 31 March 2002.

#### **Other mobile telecommunication businesses**

The revenue of our other mobile telecommunication businesses in Europe has increased by 49 per cent from £399 million in the year ended 31 March 2001 to £595 million in the year ended 31 March 2002.

O<sub>2</sub> Ireland's revenue has increased by 28 per cent from £309 million for the year ended 31 March 2001, to £395 million for the year ended 31 March 2002. This increase in revenue is a combination of the increase in the customer base, offset by slight fall in ARPU. Contract customer numbers increased from 332,000 at 31 March 2001 to 356,000 active subscribers at 31 March 2002 and the pre-pay customers increased from 641,000 at 31 March 2001 to 824,000 at 31 March 2002.

O<sub>2</sub> Netherlands was acquired outright in June 2000, and so only contributed to the Group's results for nine months of the year ended 31 March 2001. As a result the consolidated revenues of O<sub>2</sub> Netherlands have increased by 122 per cent from £90 million in the year ended 31 March 2001 to £200 million in the current financial year. Revenue has also increased as a result of the

combination of an increase in subscriber numbers together with an increase in blended ARPU for the year.

The customer base in O<sub>2</sub> Netherlands has increased significantly by 58 per cent from a total active base of 793,000 at 31 March 2001 to 1,255,000 active subscribers at 31 March 2002. During the year, O<sub>2</sub> Netherlands secured a mobile banking agreement with Postbank, in which new subscribers to O<sub>2</sub> Netherlands received a free pre-pay phone. Some 475,000 Postbank account holders received the subsidised phone since the arrangement began. This has contributed to the pre-pay ARPU increasing from £80 for the year ended 31 March 2001 to £84 for the year ended 31 March 2002.

Post-pay active subscribers have increased from 176,000 at 31 March 2001 to 233,000 at 31 March 2002, and post-pay ARPU has also increased from £469 to £492 over the same period. The level of contract churn has decreased from 32 per cent to 27 per cent.

#### **O<sub>2</sub> Online**

O<sub>2</sub> Online has shown continual growth in revenue since it was launched in 1997. Revenue has increased by over six times, from £15 million in the year ended 31 March 2001, to £100 million in the year ended 31 March 2002. Approximately two-thirds of the revenue in the 2002 financial year was intragroup, principally for provision of WAP gateway and portal services to other Group companies.

#### **Net operating expenses before exceptional items**

Net operating expenses before exceptional items may be analysed between cost of sales and administrative expenses. Net operating expenses increased by 41 per cent from £3,543 million for the year ended 31 March 2001 to £4,982 million for the 2002 financial year, principally as a result of consolidating a full year's results of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands for the first time.

#### **Group cost of sales**

Group cost of sales increased by 50 per cent from £1,814 million for the year ended 31 March 2001, to £2,714 million for the year ended 31 March 2002. The increase in cost of sales in the 2002 financial year was primarily the result of consolidating a full year's result of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands in our consolidated financial statements for the first time.

The gross margin percentages (gross profit divided by turnover) of our newer businesses in Germany and the Netherlands are lower than those of our more established businesses in Ireland and the UK. This is because the newer businesses are in the process of building their respective customer bases. This has had the effect of reducing the Group gross margin by six percentage points from 43 per cent in the 2001 financial year to 37 per cent in the 2002 financial year.

The increase in activity of O<sub>2</sub> Online and Airwave has also contributed to the increase in the Group cost of sales.

#### **Group administrative expenses before exceptional items**

Group administrative expenses before exceptional items have increased by 31 per cent from £1,729 million for the year ended 31 March 2001 to £2,268 million for the year ended 31 March 2002. The increase in administrative expenses in the 2002 financial year was primarily the result of consolidating a full year's result of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands in our consolidated financial statements for the first time.

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Group administrative expenses before exceptional items as a percentage of turnover has decreased slightly from 54 per cent in the 2001 financial year to 53 per cent in the year ended 31 March 2002. Our newer businesses of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands have higher ratios than the ratios of our more established businesses, because they are still building their respective customer bases. The negative impact of consolidating both O<sub>2</sub> Germany and O<sub>2</sub> Netherlands for a full year for the first time in the 2002 financial year has been mitigated by the cost reduction exercises across the Group.

An analysis of the net operating expenses before exceptional items, between the operating companies is provided in the table below:

	Year ended 31 March		per cent variation
	2002 £m	2001 £m	
O <sub>2</sub> UK	<b>2,458</b>	2,418	2
O <sub>2</sub> Germany <sup>1</sup>	<b>1,275</b>	103	1,138
Other mobile telecommunication businesses <sup>2</sup>	<b>655</b>	488	34
O <sub>2</sub> Online	<b>194</b>	163	19
Goodwill amortisation	<b>369</b>	287	29
Other operations and central costs	<b>31</b>	84	(63)
<b>Total</b>	<b>4,982</b>	3,543	41

<sup>1</sup>Included within our consolidated Group results from 20 February 2001.

<sup>2</sup>Includes the operations of O<sub>2</sub> Netherlands, from 30 June 2000, and O<sub>2</sub> Ireland.

**O<sub>2</sub> UK** O<sub>2</sub> UK's net operating expenses before exceptional items have increased by two per cent, from £2,418 million for the year ended 31 March 2001 to £2,458 million for the year ended 31 March 2002. Net operating expenses as a percentage of turnover has remained constant at 89 per cent for the two financial years under review.

The variable element of O<sub>2</sub> UK's service cost of sales has increased in line with the network usage. Interconnection charges increased significantly during the financial year 2002, compared to the year ended 31 March 2001, reflecting the increased calls from O<sub>2</sub> UK customers terminating on other networks, including other mobile networks whose termination charges are generally higher than charges levied by fixed line network providers.

O<sub>2</sub> UK's depreciation charge has increased from £256 million in the year ended 31 March 2001 to £372 million in the year ended 31 March 2002, which reflects the increased investment in improving O<sub>2</sub> UK's network quality.

The advertising and marketing spend for the year ended 31 March 2002 has decreased by over 25 per cent on the 2001 financial year, principally as a result of lower subscriber acquisition costs which have decreased by 26 per cent over the same period. Both the pre-pay and post-pay average subscriber acquisition cost have decreased, with the post-pay SAC's decreasing from £184 to £180 per subscriber, and the pre-pay decreasing from £63 to £53 per subscriber.

Compared to the year ended 31 March 2001, O<sub>2</sub> UK's overheads have decreased slightly by less than 1 per cent for the year ended 31 March 2002, which, despite the increased turnover and

concentration on improving customer service, reflects the cost control measures implemented during the year.

**O<sub>2</sub> Germany** O<sub>2</sub> Germany's net operating expenses before exceptional items increased significantly from £103 million for the period from acquisition to 31 March 2001, to £1,275 million for the year ended 31 March 2002, reflecting the consolidation of O<sub>2</sub> Germany's full year results into the Group's results for the first time.

Net operating expenses as a percentage of turnover was 146 per cent for the 2002 financial year. For O<sub>2</sub> Germany, and indeed our other newer mobile operation in Netherlands, we expect this ratio to be higher than the same ratio of our more established businesses, as the newer businesses are in the process of building up their customer bases.

The total depreciation charge (both network and non-network) was £228 million for the year ended 31 March 2002, which represented 21 per cent of the net book value of tangible fixed assets at 31 March 2002.

Subscriber acquisition costs have decreased by 33 per cent from £142 per subscriber over the year ended 31 December 2000 to £95 per subscriber for the year ended 31 March 2002, although the total subscriber acquisition costs have increased over the year.

**Other mobile telecommunication businesses** Net operating expenses before exceptional items for our other mobile telecommunication businesses, O<sub>2</sub> Netherlands and O<sub>2</sub> Ireland, has increased by 34 per cent from £488 million for the year ended 31 March 2001, to £655 million for the year ended 31 March 2002.

The principal reason for this increase is the inclusion of O<sub>2</sub> Netherlands net operating expenses before exceptional items for the full year ended 31 March 2002 for the first time, which, compared to the 2001 financial year, has increased by 60 per cent.

In addition, net operating expenses before exceptional items have also increased in O<sub>2</sub> Netherlands as a result of the increased usage of the network, in line with an increase in the customer base from 793,000 at 31 March 2001 to 1,255,000 at 31 March 2002. Additionally, O<sub>2</sub> Netherlands recorded high subscriber acquisition costs, as a result of the PostBank arrangement, where customers were given a free mobile phone.

O<sub>2</sub> Ireland's net operating costs before exceptional items have increased by 17 per cent from £287 million in the year ended 31 March 2001 to £336 million in the year ended 31 March 2002, reflecting the effect of the 28 per cent increase in revenue during the 2002 financial year as compared to the 2001 financial year. The effect of the revenue increase was reduced as a result of the implementation of cost control measures.

### **O<sub>2</sub> Online**

O<sub>2</sub> Online's net operating expenses before exceptional items increased by 19 per cent from £163 million for the year ended 31 March 2001 to £194 million for the year ended 31 March 2002. The revenue of O<sub>2</sub> Online has increased by greater than six fold over the same period, but as part of our Group-wide cost control measures we have significantly reduced the ratio of net operating expenses to turnover.

### Goodwill amortisation

The goodwill amortisation charge included in the Group's results has increased by 29 per cent from £287 million in the year ended 31 March 2001 to £369 million for the year ended 31 March 2002. This increase is as a result of including a full year's amortisation charge in respect of the goodwill on O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Ireland for the first time in the 2002 financial year.

### Exceptional items

Exceptional items for the year ended 31 March 2002 amounted to £150 million. These related to the costs arising as a result of the demerger of the Group from BT, in November 2001, and costs relating to the reorganisation of the Group subsequent to the demerger. We incurred exceptional costs of £27 million which were directly attributable to the demerger of the Group from BT. The remaining £123 million of exceptional items relate to the restructuring of our UK and German operations post demerger, of which £87 million was in respect of redundancy costs.

Exceptional items for the year ended 31 March 2001 totalled £2,821 million. Of this total, £2,800 million represents a non-cash charge for the write-down of goodwill, reflecting impairment of the carrying value of O<sub>2</sub> Germany. In February 2001, the acquisition of the remaining 55 per cent interest in O<sub>2</sub> Germany for £7,713 million, including debt, was completed. Goodwill of £3,718 million arose on this transaction, the consideration for which was negotiated in August 2000. An impairment review was undertaken under the requirements of the UK Accounting Standard FRS 11, which indicated the requirement for an impairment review. The remaining £21 million exceptional item was a write-off of information technology systems no longer required, following the separation of the fixed and mobile businesses of O<sub>2</sub> Germany.

### EBITDA

EBITDA is our earnings before interest, tax, depreciation, amortisation and exceptional items, excluding our share of operating profits and losses of our joint ventures and associates. EBITDA is not a measure of financial performance under UK or US GAAP and may not be comparable to similarly titled measures of other companies because EBITDA is not uniformly defined. EBITDA should not be considered by investors as an alternative to Group operating profit or profit on ordinary activities before taxation as an indication of operating performance, or as an alternative to cash flow from operating activities as an indication of cash flows.

Our more established business, O<sub>2</sub> UK, has had positive EBITDA over the last three financial years. Similarly, O<sub>2</sub> Ireland has had positive EBITDA since it has been included within our consolidated Group since 30 March 2000, the date of its acquisition. O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Online, our newer businesses, have had negative EBITDA. The following table shows contributions of our businesses to Group EBITDA.

	Year ended 31 March 2002	2001
	£m	£m
O <sub>2</sub> UK	670	555
O <sub>2</sub> Germany <sup>1</sup>	(166)	(15)
O <sub>2</sub> Netherlands <sup>2</sup>	(51)	(76)
O <sub>2</sub> Ireland	122	68
O <sub>2</sub> Online	(68)	(143)
Other operations	(74)	(72)
<b>Total</b>	<b>433</b>	<b>317</b>

<sup>1</sup>Included within our consolidated Group from 20 February 2001.

<sup>2</sup>Included within our consolidated Group from 30 June 2000.

Group EBITDA increased by 37 per cent from £317 million for the year ended 31 March 2001 to £433 million for the year ended 31 March 2002. Group EBITDA increased for the year ended 31 March 2002 owing to increased EBITDA contributed by O<sub>2</sub> UK and O<sub>2</sub> Ireland, despite consolidating a full year of O<sub>2</sub> Germany's and O<sub>2</sub> Netherlands' losses for the first time. O<sub>2</sub> Online showed a significant improvement of EBITDA in the 2002 financial year, whilst the negative EBITDA of the other operations, including the central costs remained significantly unchanged.

### Group's share of operating losses of joint ventures

During the year ended 31 March 2001, the Group had interest in two joint ventures, O<sub>2</sub> Germany and O<sub>2</sub> Netherlands. The remaining interest in both these companies were purchased during the year, O<sub>2</sub> Netherlands on 30 June 2000, and O<sub>2</sub> Germany on 20 February 2001. The share of losses recognised in the Group consolidated results prior to these acquisition dates was £18 million and £285 million respectively.

The Group now wholly owns its mobile operations in the UK, Ireland, the Netherlands and Germany. The Group no longer has interests in any joint ventures.

### Total operating loss

The total operating loss of the Group decreased significantly from a loss of £3,450 million for the year ended 31 March 2001 to a loss of £848 million for the year ended 31 March 2002.

The operating loss in the 2001 financial year included the impairment charge of £2,800 million relating to the write-down of the goodwill arising on the acquisition of O<sub>2</sub> Germany, and the £21 million write-off of O<sub>2</sub> Germany IT assets. The operating loss before exceptional items was £629 million in the 2001 financial year.

The 2002 financial year's operating loss before exceptional items was £698 million, which is an 11 per cent increase in the Group loss compared to the previous financial year, which is a result of consolidating a full year's operating losses of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands for the first time.



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### Net interest payable

Net interest payable relates to the finance charges payable on external debt net of interest received on amounts invested. Prior to demerger, we were principally funded by BT and no interest was applied to that element of our funding. At 19 November 2001, the date we demerged from BT, we had net debt of £506 million. For the year ended 31 March 2002, the Group's net interest charge was £25 million, an increase of £16 million on the charge for the year ended 31 March 2001. In the 2002 financial year, the principal elements of our interest charge were the interest on our revolving credit facility amounting to £6 million, and the interest accrued on our long-term bonds, which we issued in January 2002, of £12 million. In accordance with UK GAAP, we are amortising the issue costs of our bank facility and our bonds over the lives of the facilities (five and ten years respectively), through the interest line in the profit and loss account. Amortisation of these costs amounted to £4 million in the 2002 financial year. We also have interest payable in relation to the O<sub>2</sub> UK loan notes and interest on our finance leases and other borrowings, and have received interest on our short-term investments.

### Tax on loss on ordinary activities

The Group has a tax credit of £23 million for the year ended 31 March 2002 and a tax charge of £70 million for the year ended 31 March 2001. The decrease in the tax charge is principally because tax losses which were surrendered to BT in previous periods are now available for offset against UK taxable profits of the Group. With the exception of Manx Telecom and O<sub>2</sub> Ireland, we do not anticipate incurring a tax charge in the next few years. We expect to pay tax on the profits of Manx Telecom and O<sub>2</sub> Ireland earned in this period.

### Year ended 31 March 2001 compared to 31 March 2000

For the period up to 31 March 2001 covered by this discussion, we included all registered users in our calculation of our customer base and ARPU. After 31 March 2001 we refined our measurement of our subscriber base by including only active subscribers, which we believe more fairly reflects our customer numbers. All references to customer numbers and ARPUs in the following comparison of the results of the two years ended 31 March 2001 refer to registered users.

### Group turnover

The following table shows contributions of our businesses to Group turnover:

	Year ended 31 March 2001 £m	2000 £m
O <sub>2</sub> UK	2,706	2,582
O <sub>2</sub> Germany <sup>1</sup>	65	–
O <sub>2</sub> Netherlands <sup>2</sup>	90	–
O <sub>2</sub> Ireland <sup>3</sup>	309	–
O <sub>2</sub> Online	15	1
Other operations	47	49
Intragroup eliminations	(32)	(14)
<b>Total</b>	<b>3,200</b>	<b>2,618</b>

<sup>1</sup>Included within our consolidated Group results from 20 February 2001.

<sup>2</sup>Included within our consolidated Group results from 30 June 2000.

<sup>3</sup>Included within our consolidated Group results from 30 March 2000.

Group turnover increased by 22 per cent from £2,618 million for the year ended 31 March 2000 to £3,200 million for the year ended 31 March 2001. This increase in revenues in 2001 is principally owing to the inclusion within our consolidated Group of O<sub>2</sub> Ireland from the end of March 2000, O<sub>2</sub> Netherlands from the end of June 2000 and O<sub>2</sub> Germany from February 2001.

### O<sub>2</sub> UK

O<sub>2</sub> UK's turnover increased by five per cent from £2,582 million for the year ended 31 March 2000 to £2,706 million for the year ended 31 March 2001. O<sub>2</sub> UK's turnover comprised largely of service revenue, which increased by 18 per cent from £1,874 million for the year ended 31 March 2000 to £2,207 million for the year ended 31 March 2001. This increase was primarily owing to the growth of its customer base and the overall growth in usage in the mobile market.

O<sub>2</sub> UK's total registered customers increased significantly from 7.4 million at 31 March 2000 to 11.2 million at 31 March 2001, owing to the success of its pre-pay products. Registered pre-pay customers increased from 49 per cent of our total customer base to 69 per cent over the period under review.

Post-pay churn increased from 41 per cent for the year ended 31 March 2000 to 44 per cent for the year ended 31 March 2001 which was primarily owing to migration of post-pay customers to pre-pay service on our networks and those of our competitors. Pre-pay churn increased from 12 per cent for the year ended 31 March 2000 (the first full year in which we offered pre-pay service) to 16 per cent for the year ended 31 March 2001.

The following table shows a breakdown of O<sub>2</sub> UK's turnover:

	Year ended 31 March 2001 £m	2000 £m
Service	2,207	1,874
Equipment	222	314
Other	277	394
<b>Total</b>	<b>2,706</b>	<b>2,582</b>

**Service.** O<sub>2</sub> UK's service revenue increased by 18 per cent from £1,874 million for the year ended 31 March 2000 to £2,207 million for the year ended 31 March 2001.

O<sub>2</sub> UK's service revenue from post-pay customers was the primary source of its service revenue during the last three financial years, accounting for approximately 76 per cent of O<sub>2</sub> UK's total service revenue for the year ended 31 March 2001. Since its launch of pre-pay products, pre-pay service revenue has increased as a percentage of its total service revenue to 24 per cent for the year ended 31 March 2001.

O<sub>2</sub> UK's post-pay service revenue was relatively unchanged over the two financial years ended 31 March 2001, because the decrease of 0.3 million post-pay subscribers from 31 March 2000 to 31 March 2001 was offset by the increased usage and ARPU for post-pay customers over the same period. However, the effect of this increased usage and ARPU was partially offset by lower tariffs, reduced interconnection charges, as a result of UK regulatory

controls, and reduced monthly subscription fees. Reductions in connection and monthly subscription fees represent part of our shift from up-front charges to usage as a basis for service revenue. ARPU for O<sub>2</sub> UK's post-pay customers, gross of discounts, increased from £455 for the year ended 31 March 2000 to £485 for the year ended 31 March 2001, reflecting our strategy of focusing on higher value customers and the migration of some lower ARPU post-pay customers to pre-pay products.

O<sub>2</sub> UK's pre-pay service revenue more than doubled in the 2001 financial year as compared to the year ended 31 March 2000. These increases reflect the growth in the registered pre-pay customer base from 3.6 million at 31 March 2000 to 7.7 million at 31 March 2001, partly offset by a decrease in usage per customer during the two financial years. These revenue increases were also partially offset by lower tariffs and reduced interconnection charges to other operators, as a result of regulatory controls. These have resulted in lower pre-pay ARPU gross of discounts, which decreased £112 for the year ended 31 March 2000 to £104 for the year ended 31 March 2001.

Service revenue has also benefited from increased revenues generated by SMS, which were first introduced in 1994 and enhanced in April 1999 by enabling messaging between networks. Although SMS revenue was not significant historically, it amounted to £122 million, or six per cent of O<sub>2</sub> UK's service revenue for the year ended 31 March 2001, and is expected to continue to increase.

**Equipment.** Equipment revenue as a proportion of total revenue has shown a decline over the period under review, decreasing from 12 per cent for the year ended 31 March 2000 to ten per cent for the year ended 31 March 2001 mainly as a result of reduced handset prices generally and the higher proportion of pre-pay customers in O<sub>2</sub> UK's customer base, because pre-pay handset prices are lower than for post-pay customers.

**Other.** Other revenue decreased by 30 per cent from £394 million for the year ended 31 March 2000 to £277 million for the year ended 31 March 2001. Other revenue in the 2000 and 2001 financial years mainly comprised revenue from Lumina, which was acquired by the O<sub>2</sub> UK Group in March 1999. Lumina had a customer base that included both O<sub>2</sub> UK and Vodafone customers. As a result of this, O<sub>2</sub> UK received revenues from customers connected to the Vodafone network. These revenues amounted to £224 million for the year ended 31 March 2000 and £120 million for the year ended 31 March 2001. The decrease in other revenues over the last financial year is primarily the result of this reduction in Lumina's Vodafone customers.

### O<sub>2</sub> Germany

O<sub>2</sub> Germany was consolidated from 20 February 2001 and contributed £65 million to Group turnover in the year ended 31 March 2001. For the periods prior to its acquisitions, O<sub>2</sub> Germany was accounted for as a joint venture.

### Other mobile telecommunication businesses

O<sub>2</sub> Netherlands was consolidated from 30 June 2000 and for the year ended 31 March 2001 contributed £90 million to Group turnover. For the periods prior to acquisition, O<sub>2</sub> Netherlands was accounted for as a joint venture.

O<sub>2</sub> Ireland was consolidated from 30 March 2000. For the year ended 31 March 2001, O<sub>2</sub> Ireland contributed £309 million to Group turnover. O<sub>2</sub> Ireland's number of registered customers increased from 628,000 at 31 March 2000, of which 262,000 were post-pay and 366,000 were pre-pay, to 1,059,000 at 31 March 2001, of which 332,000 were post-pay and 727,000 were pre-pay. O<sub>2</sub> Ireland's post-pay ARPU decreased from £645 for the 2000 financial year to £637 for the 2001 financial year. O<sub>2</sub> Ireland's pre-pay ARPU decreased from £215 for the 2000 financial year to £194 for the 2001 financial year.

### O<sub>2</sub> Online

O<sub>2</sub> Online, our mobile internet business, which was launched in 1997, generated turnover of less than £1 million for the year ended 31 March 2000, and £15 million for the year ended 31 March 2001, which was almost entirely intragroup. Revenue recorded during each financial year was primarily derived from an intragroup charge in return for the provision of WAP gateway and portal services.

### Other operations

Other revenue was relatively constant in the 2000 and 2001 financial years, at £49 million and £47 million. This revenue is primarily comprised of revenue from Manx Telecom Limited and Cellular Radio Limited, as lessor of our UK analogue network to O<sub>2</sub> UK. The decrease in the 2001 financial year was primarily the result of a decrease in Cellular Radio Limited's revenue over the period, which was all intragroup, partially offset by increased revenues at Manx Telecom resulting from growth in its customer base, in particular customers of its mobile business.

### Cost of sales

The following table shows contributions of our businesses to Group cost of sales:

	Year ended 31 March 2001	2000
	£m	£m
O <sub>2</sub> UK	1,419	1,380
O <sub>2</sub> Germany <sup>1</sup>	54	–
Other mobile telecommunication businesses <sup>2</sup>	253	–
O <sub>2</sub> Online	85	14
Other operations	16	16
Intragroup eliminations	(13)	–
<b>Total</b>	<b>1,814</b>	<b>1,410</b>

<sup>1</sup>Included within our consolidated Group results from 20 February 2001.

<sup>2</sup>Includes the operations of O<sub>2</sub> Netherlands, from 30 June 2000, and O<sub>2</sub> Ireland from 30 March 2000.

Group cost of sales increased by 29 per cent from £1,410 million for the year ended 31 March 2000 to £1,814 million for the year ended 31 March 2001. Group cost of sales as a percentage of total turnover increased from 54 per cent in the 2000 financial year to 57 per cent for the 2001 financial year.

The increase in cost of sales in the 2001 financial year was primarily the result of consolidating the results of O<sub>2</sub> Germany, O<sub>2</sub> Ireland and O<sub>2</sub> Netherlands in our consolidated financial results for the first time. Cost of sales was particularly high as a percentage of contributions to Group turnover for the 2001 financial year for both O<sub>2</sub> Germany, 83 per cent, and O<sub>2</sub> Netherlands, 102 per cent, which are newer

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businesses in the process of building their respective customer bases. We expect O<sub>2</sub> Germany and O<sub>2</sub> Netherlands to continue to have a high level of cost of sales for the next few years.

O<sub>2</sub> Online also contributed to the increase in Group cost of sales in the 2001 financial year owing to the expansion of its business in the United Kingdom and internationally following the launch of O<sub>2</sub> Online's web and WAP portals, as described below.

Cost of sales as a percentage of contribution to Group turnover for O<sub>2</sub> UK, our more established business, remained relatively flat over the period at 53 per cent and 52 per cent for the 2000 and 2001 financial years respectively. O<sub>2</sub> Ireland showed a comparable cost of sales percentage for the 2001 financial year at 52 per cent.

### O<sub>2</sub> UK

O<sub>2</sub> UK's cost of sales increased by three per cent from £1,380 million for the year ended 31 March 2000 to £1,419 million for the year ended 31 March 2001. The following table shows a breakdown of O<sub>2</sub> UK's cost of sales.

	Year ended 31 March	
	2001	2000
	£m	£m
Service	792	714
Equipment	440	430
Other	187	236
<b>Total</b>	<b>1,419</b>	<b>1,380</b>

**Service.** Service cost of sales increased by 11 per cent from £714 million for the year ended 31 March 2000 to £792 million for the year ended 31 March 2001. Interconnection charges grew significantly during the years under review mainly as a result of the increased number of calls from O<sub>2</sub> UK customers that terminated on other networks, and from increased usage abroad. In addition, calls to other mobile network operators attract a higher average charge than calls to fixed-line networks, and in the last two financial years the proportion of calls to other mobile networks has increased, as mobile phone penetration increases. Network depreciation expense remained relatively constant in the two financial years under review. Transmission costs decreased in the year ended 31 March 2001 owing to reductions in tariffs and changes in circuit product mix.

**Equipment.** Equipment cost of sales increased by two per cent from £430 million for the year ended 31 March 2000 to £440 million for the year ended 31 March 2001. Despite a higher number of customers in the 2001 financial year, costs remained relatively stable during the 2001 financial year mainly as a result of lower overall handset procurement costs and a higher proportion of pre-pay customers in the UK's customer base. On average, the procurement cost of pre-pay handsets is lower than that of post-pay handsets.

**Other.** Other cost of sales decreased by 21 per cent from £236 million for the year ended 31 March 2000 to £187 million for the year ended 31 March 2001. O<sub>2</sub> UK's other cost of sales in the 2000 and 2001 financial years mainly comprised costs generated by Lumina, which purchases airtime from Vodafone. Payments made by O<sub>2</sub> UK to Vodafone were £151 million for the year ended 31 March 2000, decreasing to £80 million for the year ended 31 March 2001 which reflected reduction of Lumina's Vodafone customers.

### O<sub>2</sub> Germany

The Group first consolidated O<sub>2</sub> Germany's results in February 2001. O<sub>2</sub> Germany contributed £54 million to cost of sales for the year ended 31 March 2001, which represents the period from 20 February 2001 to 31 March 2001. O<sub>2</sub> Germany will contribute higher amounts to Group cost of sales in future periods. For the periods prior to its acquisition, O<sub>2</sub> Germany was accounted for as a joint venture.

### Other mobile telecommunications businesses

O<sub>2</sub> Netherlands contributed £92 million to Group cost of sales for the year ended 31 March 2001, which represented the period from acquisition by the Group. O<sub>2</sub> Ireland contributed £161 million to Group cost of sales for the year ended 31 March 2001.

### Other operations

Other cost of sales remained constant at £16 million for the two years ended 31 March 2001. Other cost of sales is primarily comprised of costs relating to Manx Telecom.

### O<sub>2</sub> Online

O<sub>2</sub> Online cost of sales increased from £14 million for the year ended 31 March 2000 to £85 million for the year ended 31 March 2001 owing principally to the expansion of O<sub>2</sub> Online's business in Europe and the Asia Pacific region. It is also owing to the increase in scale of O<sub>2</sub> Online's operations in the UK following the development and launch of O<sub>2</sub> Online's web and WAP portals. These increased costs primarily comprised payments to Openwave, O<sub>2</sub> Online's most significant supplier, providing know-how and consultancy services relating to O<sub>2</sub> Online's portals and WAP services, payments to other BT companies for portal, ISP and technology services, marketing and personnel costs.

### Administrative expenses before exceptional items

The following table shows contributions of our businesses to Group administrative expenses before exceptional items:

	Year ended 31 March	
	2001	2000
	£m	£m
O <sub>2</sub> UK	986	1,016
O <sub>2</sub> Germany <sup>1</sup>	49	–
Other mobile telecommunication businesses <sup>2</sup>	235	–
O <sub>2</sub> Online	78	12
Other operations	98	46
Goodwill amortisation <sup>3</sup>	287	67
Intragroup eliminations	(4)	–
<b>Total</b>	<b>1,729</b>	<b>1,141</b>

<sup>1</sup>Included within our consolidated Group results from 20 February 2001.

<sup>2</sup>Includes the operations of O<sub>2</sub> Netherlands, from 30 June 2000, and O<sub>2</sub> Ireland from 30 March 2000.

<sup>3</sup>Goodwill amortisation relates to goodwill recorded on the acquisitions of O<sub>2</sub> UK, O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Ireland and acquisitions made by operating units.

Group administrative expenses before exceptional items increased by 52 per cent from £1,141 million for the year ended 31 March 2000 to £1,729 million for the year ended 31 March 2001. Group administrative expenses before exceptional items as a percentage of total turnover increased from 44 per cent in the 2000 financial year to 54 per cent for the 2001 financial year.

The increase in the 2001 financial year was largely the result of consolidating the results of O<sub>2</sub> Germany, O<sub>2</sub> Ireland and O<sub>2</sub> Netherlands in our combined financial information for the first time, which contributed in total £284 million. Administrative expenses were particularly high as a percentage of contributions to Group turnover for the 2001 financial year for O<sub>2</sub> Germany, 75 per cent, and O<sub>2</sub> Netherlands, 121 per cent, which are newer businesses in the process of building their respective customer bases. We expect O<sub>2</sub> Germany and O<sub>2</sub> Netherlands to continue to have a high level of administrative expenses for the next few years.

The increase in the 2001 financial year was also owing to higher goodwill amortisation in that year, primarily comprising a full year of goodwill amortisation relating to the acquisition of the remaining 40 per cent interest in O<sub>2</sub> UK in the 2000 financial year and to the acquisitions of O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Ireland.

The increase in the 2001 financial year also reflects a significant increase in administrative expenses for O<sub>2</sub> Online, which rose from £12 million in the 2000 financial year to £78 million in the 2001 financial year. This increase is owing to the expansion of O<sub>2</sub> Online's business in the United Kingdom and internationally, as discussed below.

Administrative expenses as a percentage of contribution to Group turnover for O<sub>2</sub> UK, our more established business, decreased from 39 per cent for the 2000 financial year to 36 per cent for the 2001 financial year. O<sub>2</sub> Ireland's selling and administrative expenses as a percentage of contribution to Group turnover for the 2001 financial year was 41 per cent.

### O<sub>2</sub> UK

O<sub>2</sub> UK's administrative expenses before exceptional items decreased by three per cent from £1,016 million for the year ended 31 March 2000 to £986 million for the year ended 31 March 2001.

The following table shows a breakdown of O<sub>2</sub> UK's administrative expenses before exceptional items:

	Year ended 31 March	
	2001 £m	2000 £m
Promotional and advertising	472	528
Overhead	454	445
Depreciation	60	43
<b>Total</b>	<b>986</b>	<b>1,016</b>

Promotional and advertising expenses for O<sub>2</sub> UK decreased by 11 per cent from £528 million for the year ended 31 March 2000 to £472 million for the year ended 31 March 2001. This decrease was owing to an increase in the proportion of pre-pay customers, for whom we pay lower bonuses and commissions to retailers and to cuts in advertising and marketing expenses generally.

Overhead expenses remained relatively constant, only increasing by two per cent from £445 million to £454 million during the period under review, despite increased turnover, owing to the implementation of cost control measures.

Non-network depreciation expense increased by 40 per cent from £43 million to £60 million for the years ended 31 March 2000 and 2001 respectively, owing to increased investment in information technology.

### O<sub>2</sub> Germany

The Group first consolidated O<sub>2</sub> Germany's results in February 2001. O<sub>2</sub> Germany contributed £92 million to administrative expenses before exceptional items for the year ended 31 March 2001, which represents the period from 20 February 2001 to 31 March 2001. O<sub>2</sub> Germany will contribute higher amounts to the Group results in future periods. For the periods prior to its acquisition, O<sub>2</sub> Germany was accounted for as a joint venture.

### Other mobile telecommunications businesses

O<sub>2</sub> Netherlands contributed £109 million to Group administrative expenses before exceptional items for the year ended 31 March 2001, which represented the period from acquisition by the Group. O<sub>2</sub> Ireland contributed £126 million to Group administrative expenses before exceptional items for the year ended 31 March 2001.

### O<sub>2</sub> Online

O<sub>2</sub> Online contributed £78 million to Group administrative expenses before exceptional items for the year ended 31 March 2001, which primarily comprised higher advertising, content and staff related costs as a result of the expansion of O<sub>2</sub> Online's business in Europe and the Asia Pacific region, and the increase in the scale of O<sub>2</sub> Online's operations in the United Kingdom following the development and launch of O<sub>2</sub> Online's web and WAP portals.

### Other operations

Other administrative expenses before exceptional items increased by 113 per cent from £46 million for the year ended 31 March 2000 to £98 million for the year ended 31 March 2001. These were primarily comprised of head office costs for mmO<sub>2</sub> and, to a lesser extent, expenses relating to the roll out of Airwave and expenses relating to Manx Telecom. In the 2001 financial year, the year of the launch of the TETRA network, expenses relating to Airwave nearly doubled as compared to the previous financial year. The remaining increase was primarily due to higher head office costs for mmO<sub>2</sub>, which increased in line with the expansion of our Group's operations.

### Exceptional items

Exceptional items for the year ended 31 March 2001 totalled £2,821 million. Of this total, £2,800 million represents a non-cash charge for the write-down of goodwill, reflecting impairment of the carrying value of O<sub>2</sub> Germany. The acquisition of the final 55 per cent interest in O<sub>2</sub> Germany was completed in February 2001 for £7,713 million, including debt, which gave rise to goodwill of £3,718 million. An impairment review was undertaken under the requirements of the UK Accounting Standard FRS 11. The remaining £21 million exceptional item was a write-off of information

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technology systems in Germany, following the separation of the fixed and mobile businesses of O<sub>2</sub> Germany. Exceptional items for the year ended 31 March 2000 comprised £47 million of costs relating to closing and writing off the O<sub>2</sub> UK analogue network.

### Group's share of operating loss of joint ventures

Group's share of operating loss of joint ventures increased from £281 million for the year ended 31 March 2000 to £303 million for the year ended 31 March 2001. The following table sets forth our share of operating losses of our joint ventures for the two years under review:

	Year ended 31 March 2001	2000
	£m	£m
O <sub>2</sub> Netherlands	(18)	(64)
O <sub>2</sub> Germany	(285)	(217)
<b>Total</b>	<b>(303)</b>	<b>(281)</b>

### Total operating loss

The total operating loss increased from £250 million for the year ended 31 March 2000 to £3,450 million for the year ended 31 March 2001. Total operating loss before exceptional items increased from £203 million for the year ended 31 March 2000 to £629 million for the year ended 31 March 2001.

Our recent operating losses are largely the result of consolidating the results of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands in our combined financial information in the 2001 financial year for the first time, and amortisation and write-down of goodwill recorded mainly on these acquisitions. O<sub>2</sub> Online has also contributed to Group operating loss.

### EBITDA

EBITDA is our earnings before interest, tax, depreciation, amortisation and exceptional items, excluding our share of operating profits and losses of our joint ventures and associates. EBITDA is not a measure of financial performance under UK or US GAAP and may not be comparable to similarly titled measures of other companies because EBITDA is not uniformly defined. EBITDA should not be considered by investors as an alternative to Group operating profit or profit on ordinary activities before taxation as an indication of operating performance, or as an alternative to cash flow from operating activities as an indication of cash flows.

O<sub>2</sub> UK, our more established business, has had positive EBITDA over the two financial years under review. Similarly, O<sub>2</sub> Ireland has had positive EBITDA since it has been included within our consolidated Group results. O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Online, our newer businesses, have had negative EBITDA. The following table shows contributions of our businesses to Group EBITDA.

	Year ended 31 March 2001	2000
	£m	£m
O <sub>2</sub> UK	555	431
O <sub>2</sub> Germany <sup>1</sup>	(15)	–
Other mobile telecommunication businesses <sup>2</sup>	(8)	–
O <sub>2</sub> Online	(143)	(25)
Other operations <sup>3</sup>	(72)	(21)
<b>Total</b>	<b>317</b>	<b>385</b>

<sup>1</sup>Included within our consolidated Group results from 20 February 2001.

<sup>2</sup>Includes the operations of O<sub>2</sub> Netherlands, from 30 June 2000, and O<sub>2</sub> Ireland from 30 March 2000.

<sup>3</sup>Other EBITDA includes Manx Telecom's EBITDA, as well as costs relating to initial development of our UMTS networks, Airwave and mmO<sub>2</sub>'s head office costs.

Group EBITDA decreased by 18 per cent from £385 million for the year ended 31 March 2000 to £317 million for the year ended 31 March 2001. The Group EBITDA decreased despite an increased EBITDA contributed by O<sub>2</sub> UK and the positive contribution from O<sub>2</sub> Ireland, both of which were offset by increased negative EBITDA for O<sub>2</sub> Online and the combined effect of the inclusion of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands.

### Net interest payable

Net interest payable relates to interest payable on our external loans net of interest received in respect of amounts invested. Net interest payable remained steady at £9 million in the 2001 financial year and £8 million in 2000. During both the financial years under review we were financed by BT, however we were not charged interest. The interest charged to the profit and loss account relates to other sources of external funding and principally relates to the interest payable on the O<sub>2</sub> UK loan notes.

### Tax on profit on ordinary activities

Tax on profit on ordinary activities for the Group increased from a credit of £9 million for the year ended 31 March 2000 to a charge of £70 million for the year ended 31 March 2001. The increase in the tax charge is principally a result of the profit of O<sub>2</sub> UK.

### Liquidity and capital resources

The following table sets forth our cash flows for each of the years in the three-year period ended 31 March 2002 extracted without adjustment from our consolidated financial statements. In the first year under review, the cash flow discussion relates principally to O<sub>2</sub> UK, because our overseas operations were not consolidated into the Group's results, whereas the cash flows for each of the two years ended 31 March 2002 reflect the Group as a whole.

	Year ended 31 March		
	2002	2001	2000
	£m	£m	£m
Net cash inflow from operating activities	457	318	369
Net cash outflow for returns on investments and servicing of finance	(9)	(11)	(6)
Tax (paid)/recovered	(4)	21	(30)
Net cash outflow for capital expenditures and financial investment	(1,231)	(5,234)	(538)
Net cash outflow for acquisitions and disposals	(864)	(12,574)	(3,489)
Cash outflow before management of liquid resources and financing	(1,651)	(17,480)	(3,694)
Management of liquid resources	(459)	–	–
Net cash inflow from financing	1,790	17,593	3,862
(Decrease)/increase in cash in the year	(320)	113	168

Our operating activities provided cash of £457 million, £318 million and £369 million during the three years ended 31 March 2002, 2001 and 2000 respectively. Our Group operating losses of £856 million, £3,164 million and an operating profit of £20 million in each of the years are offset by significant non-cash depreciation and amortisation charges totalling £1,139 million, £3,481 million, (including the exceptional £2,800 million impairment of O<sub>2</sub> Germany's goodwill) and £356 million respectively.

Net cash outflows for servicing of finance have remained relatively constant over the periods under review. The servicing of finance cash outflow for the year ended 31 March 2002 principally comprised £6 million interest paid on our revolving credit facility, capitalised financing costs of £14 million relating to the revolving credit facility and capitalised financing costs of £8 million relating to our long-term bonds issued during the year. As part of our management of our liquid resources, we have invested surplus cash in various short-term investments, on which we have received approximately £4 million in interest.

Total tax outflow for the Group in the year ended 31 March 2002, was a cash outflow of £4 million, compared to a cash inflow of £21 million in the 2001 financial year and an outflow of £30 million in the year ended 31 March 2000.

Cash outflow in respect of capital expenditure for the 2002 financial year was £1,231 million, which is significantly lower than our capital expenditure cash flow for the previous financial year. The capital expenditure in the year ended 31 March 2001 of £5,234 million primarily related to the purchase of our UK and Dutch UMTS licences. The capital expenditure during the financial year ended 31 March 2002 relates primarily to tangible fixed asset purchases across our footprint, related to network expansion and improvement, and expenditure on the UMTS network in the UK.

Across the Group, there are generally timing differences between the recognition of a new fixed asset in our financial statements, and the cash payment, because we are often able to secure delayed

non-interest bearing payment terms with our capital suppliers. The following table presents our actual capital additions for each of the years in the three-year period ended 31 March 2002:

	Year ended 31 March		
	2002	2001	2000
	£m	£m	£m
O <sub>2</sub> UK	556	721	496
O <sub>2</sub> Germany <sup>1</sup>	250	56	–
O <sub>2</sub> Netherlands <sup>2</sup>	97	112	–
O <sub>2</sub> Ireland <sup>3</sup>	85	127	–
O <sub>2</sub> Online	59	48	–
Other operations	95	69	23
UMTS Licences and other intangible assets	–	4,307	–
<b>Total</b>	<b>1,142</b>	<b>5,440</b>	<b>519</b>

<sup>1</sup>Included within our consolidated Group results from 20 February 2001.

<sup>2</sup>Included within our consolidated Group results from 30 June 2000.

<sup>3</sup>Included within our consolidated Group results from 30 March 2000.

Our capital expenditure for the year ended 31 March 2000 of £519 million was primarily related to upgrading O<sub>2</sub> UK's network.

Capital expenditure increased significantly from £519 million for the year ended 31 March 2000 to £5,440 million for the year ended 31 March 2001. This increase mainly results from O<sub>2</sub> Third Generation Limited's purchase of our UK UMTS licence, and O<sub>2</sub> Netherlands' purchase of our Dutch UMTS licence. Additionally, a portion of the increase is explained by the inclusion of capital expenditure from O<sub>2</sub> Germany, O<sub>2</sub> Netherlands, and O<sub>2</sub> Ireland in our consolidated financial statements in the 2001 financial year for the first time. Capital expenditure for these businesses related mainly to the expansion and further development of their mobile networks. The increase in the year ended 31 March 2001 also resulted from increased capital expenditure by O<sub>2</sub> UK, relating mainly to network expansion and improvement. O<sub>2</sub> UK also began expenditure on the new UK UMTS network in the third quarter of the 2001 financial year.

Capital expenditure for the year ended 31 March 2002 was £1,142 million, a significant decrease on the prior year expenditure of £5,440 million. The principal reason for this decrease is the purchase of the UMTS licences in the 2001 financial year. Tangible capital expenditure has remained approximately constant, decreasing slightly from £1,133 million for the year ended 31 March 2001, to £1,121 million for the current financial year, despite including a full year of capital expenditure relating to O<sub>2</sub> Germany and O<sub>2</sub> Netherlands for the first time in 2002.

Over the next five years we expect to incur capital expenditure of approximately £7 billion, a material portion of which relates to the roll-out of our UMTS networks. We expect to fund our future capital spend from our bank facilities and long-term bonds described below, and from net cash flows from operations.

The Group will maintain tight control of its investment programme, and in particular will aim to match the timing and quantum of capital expenditure on our UMTS network roll-out with the emerging demand for mobile data services. The Group currently anticipates providing services on its UMTS network from mid-2003, and capital

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expenditure in the current financial year is expected to be broadly in line with last year.

Cash outflow from acquisitions decreased significantly for the year ended 31 March 2002, from £12,574 million in the year ended 31 March 2001 to £864 million in the current financial year. The cash outflow in the 2001 financial year related to the acquisition of the remaining 55 per cent interest in O<sub>2</sub> Germany, the remaining 50 per cent interest in O<sub>2</sub> Netherlands, and acquiring a 50.5 per cent controlling interest in O<sub>2</sub> Ireland. In April 2001, the Group acquired the remaining 49.5 per cent interest in O<sub>2</sub> Ireland for a total consideration of £877 million including expenses of which £13 million is payable after 31 March 2002.

During the year ended 31 March 2002, the Group's cash inflow from financing was £1,790 million. This cash inflow may be analysed between cash inflow prior to our demerger from BT on 19 November 2001, and the financing cash inflow post demerger. Pre demerger, we received net funds from BT amounting to £847 million. In January 2002, we received £989 million in respect of our euro medium term bond issue. We repaid £74 million of our O<sub>2</sub> UK loan notes. Our financing activities are further described below.

### Sources of liquidity and capital resources

Prior to demerger our principal sources of liquidity were funding from BT and cash from operating activities. Since demerger our principal sources of liquidity are cash from operating activities, bank financing and the bond financing described below.

Upon demerger from BT, we had net debt of £506 million, of which approximately £444 million, net of cash remaining in our Group, was owed to the BT. This debt to BT was refinanced shortly after completion of the demerger out of the financing arrangements described below.

Total gross debt at 31 March 2002 amounted to £1,496 million (including the hire purchase obligations under the QTE leases, the obligations of which are fully offset by cash deposits held in trust) and net debt was £617 million. Included in the total gross debt were €1,000 million and £375 million of eurobonds issued in January 2002 and which have a five year and ten year term, respectively. Loan notes outstanding in aggregate amounted to £58 million, redeemable at any time at the option of the holder.

Prior to demerger we arranged a multi-currency revolving credit facility with a syndicate of banks, in two tranches, amounting in aggregate to £3,500 million. As at 31 March 2002 both tranches of the facility were undrawn. During the period, £1,025 million of the facility was cancelled following the issue of our inaugural eurobonds. As at 31 March 2002, the uncanceled portion of Tranche A of the

facility totalled £1,725 million maturing on 14 September 2006 and of Tranche B totalled £750 million maturing on 14 September 2002.

Interest on loans drawn under the bank facilities is calculated at a margin above LIBOR (or in the case of Euro advances, EURIBOR) from time to time. The margin varies according to the long-term credit rating assigned to mmO<sub>2</sub> plc by major credit rating agencies but is subject to a maximum of 1.50 per cent.

Interest on the bonds is at a fixed rate at 6.375 per cent per annum and 7.625 per cent per annum on the Euro and the Sterling bond issues, respectively. Interest on the €1,000 million bond issue has been swapped to floating rate. Interest on €500 million is calculated at a margin above Sterling LIBOR, having been swapped from Euro into Sterling and interest on the other €500 million is calculated at a margin above EURIBOR.

The Group's contractual obligations, including commitments for future payments under hire purchase contracts, and long- and short-term debt arrangements are summarised in the table below. Details of these obligations are fully disclosed in notes 16, 17 and 18 of the Group's financial statements.

### Treasury management and policies

Group Treasury ("Treasury") operates as a centralised service for the Group. The role of Treasury is to identify, monitor and manage financial risk within the framework of Board approved policies and delegated authorities. Treasury is not permitted to add to the financial risks inherent in the business and may not undertake speculative activity.

The principal financial risks to the Group are identified below.

### Funding and liquidity

It is our current policy to fully fund our business plan by access to the debt capital markets and other sources of funding. Borrowing is centralised and there are no material local facilities. The Group is committed to maintaining key financial ratios (including Group EBITDA to interest and net debt to Group EBITDA) consistent with maintaining or improving the Group's current investment grade status. As at 31 March 2002, actual ratios were Group EBITDA to interest of 17.3 times and net debt of 1.4 times Group EBITDA. The Group EBITDA to interest ratio is expected to fall next year as the current year's ratio reflects the period prior to demerger where a substantial portion of Group funding was provided by BT on a non-interest bearing basis. As at 31 March 2002, the Group's projected funding requirements were fully funded through a combination of bonds issued under the Group's bond financing programme (£375 million and €1 billion) and committed bank facilities (£2,475 billion).

Future commitments	Total (£m)	Payments due by period			
		Less than 1 year	1 to 2 years	2 to 5 years	After 5 years
Long-term bonds	982	–	–	610	372
Gross hire purchase obligations	406	36	31	88	251
Loan notes	58	58	–	–	–
Other Loans and Borrowings	50	7	7	22	14
<b>Total</b>	<b>1,496</b>	<b>101</b>	<b>38</b>	<b>720</b>	<b>637</b>

At 31 March 2002 we also have contracted capital commitments of £704 million (2001: £475 million).

### Foreign exchange management

The policy of the Group is to hedge (primarily by the use of foreign currency forward contracts) identified foreign exchange flows, although the current level of transaction risk exposure is low due to the fact that cash flows are primarily domestic in each Group company. The policy of the Group regarding foreign exchange translation risk is to manage material risk on the translation of future cash flows generated by overseas assets primarily by the use of natural offsets and the use of currency debt, cross-currency and foreign exchange swaps. Currently, overseas operations are not cash flow positive in aggregate. Therefore, as at 31 March 2002, all net debt was denominated in Sterling after taking account of the effect of derivative instruments.

### Interest rate management

The debt level within the Group is a key determinant of the impact of interest rates. It is current policy to fix or protect expected interest flows where Group profits or key financial ratios would be materially at risk from interest rate movements. Treasury maintains the proportion of fixed rate debt within a Board approved range of 25 to 75 per cent by the issuance of fixed rate debt and the use of derivative instruments (primarily interest rate swaps). As at 31 March 2002, and after taking into account the effect of derivative instruments, 34 per cent of gross borrowings (excluding the QTE lease which is fully defeased) were fixed for a period of at least three years. Based on the net debt as at 31 March 2002, a one per cent rise in market interest rates would have an adverse effect of approximately £2 million on Group profit before taxation.

### Credit risk management

It is our current policy to mitigate credit risk to our financial counterparties through the application of strict counter-party limits. Counter-party limits are based on credit ratings issued by the main credit rating agencies and outstanding transactions are weighted according to potential risk to the Group. Counter-party limits are reviewed on a regular basis by Treasury.

### Research and development, patents and licences

We have not engaged in any significant research and development activities during any of the last three financial years, although we have worked closely with BT Exact, suppliers and applications developers to create products suited to our markets.

### Outlook and prospects

Revenue in the 2003 financial year is expected to continue to grow, driven by a combination of further growth in the Group's customer base, a richer customer mix, and improving ARPU across the Group. Revenue generation from data services in the 2003 financial year is expected to continue to grow as a proportion of service revenues, driven by the launch of new products and services across the Group, including multi-media messaging and the xda from O<sub>2</sub> device.

The Group remains confident of its performance in the 2003 financial year. O<sub>2</sub> Germany remains on track to deliver positive EBITDA before the end of the year ended 31 March 2003, and O<sub>2</sub> Netherlands is expected to build on its positive EBITDA performance in the second half of the last financial year.

### US GAAP reconciliation

Our consolidated financial statements are prepared in accordance with UK GAAP, which differs in certain respects from US GAAP. A detailed description of the principal differences between UK GAAP and US GAAP as they relate to us and a reconciliation to US GAAP of net loss and shareholders' funds is given in the supplementary information for United States investors.

Our net loss determined in accordance with US GAAP was £1,463 million, £3,747 million and £386 million for the years ended 31 March 2002, 2001 and 2000, respectively, compared with our net loss determined under UK GAAP of £850 million, £3,533 million and £250 million, respectively. The principal differences affecting the determination of net loss under US GAAP for the year ended 31 March 2002 are:

- >> adjustments in relation to capitalisation of interest, net of related depreciation of £579 million (2001: £344 million, 2000: £(1) million);
- >> adjustments for interest on the notional debt with BT of £756 million (2001: £660 million, 2000: £90 million);
- >> adjustments for goodwill amortisation of £23 million (2001: £19 million, 2000: £6 million);
- >> adjustments for mobile licences, software and other intangible assets of £217 million (2001: £98 million, 2000: £69 million);
- >> adjustments for software impairment of nil (2001: £12 million, 2000: nil);
- >> recognition of compensation expense in respect of employee share plans of £1 million (2001: £8 million, 2000: £3 million);
- >> adjustments for the change in reporting period for equity investments of nil (2001: £51 million, 2000: nil);
- >> other adjustments related to employee compensation of £3 million (2001: £8 million, 2000: nil);
- >> adjustments for derivative instrument valuation of £19 million (2001: nil, 2000: nil);
- >> adjustments for restructuring costs of £21 million (2001: nil, 2000: nil); and
- >> adjustments for deferred taxation on US GAAP differences of £(240) million (2001: £134 million, 2000: £21 million).

### Recent accounting pronouncements

#### United Kingdom

In November 2000, the Accounting Standards Board issued FRS 17, "Retirement Benefits". Accounting for pensions in accordance with FRS 17 is mandatory for accounting periods ending on or after 22 June 2003. However, progressive footnote disclosures are required for June 2001 and June 2002 year-ends. The changes introduced by FRS 17 principally affect the way defined benefit pension schemes are accounted for and the Group is currently evaluating the effect it will have on its results and financial position. At each year-end the pension scheme assets should be measured at market value while pension scheme liabilities should be measured at a present value using a specified actuarial valuation method and discounted at a corporate bond rate. The resulting pension scheme surplus or deficit must be shown on the Group's balance sheet, and could be volatile because of the dependence on market conditions at the balance sheet date.



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### United States

In June 2001, the Financial Accounting Standards Board (FASB or the "Board") issued Statement of Financial Accounting Standards No. 141 (SFAS 141), Business Combinations, and No. 142 (SFAS 142), Goodwill and Other Intangible Assets, collectively referred to as the "Standards". SFAS 141 supersedes Accounting Principles Board Opinion (APB) No. 16, Business Combination. The provisions of SFAS 141 (1) require that the purchase method of accounting be used for all business combinations initiated after 30 June 2001; (2) provide specific criteria for the initial recognition and measurement of intangible assets apart from goodwill; and (3) require that unamortised negative goodwill be written off immediately as an extraordinary gain instead of being deferred and amortised. SFAS 141 also requires that upon adoption of SFAS 142 the Group reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria. SFAS 142 supersedes APB 17, Intangible Assets, and is effective for fiscal years beginning after 15 December 2001. SFAS 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS 142 (1) prohibit the amortisation of goodwill and indefinite-lived intangible assets; (2) require that goodwill and/or indefinite-lived intangible assets be tested annually for impairment (and in interim periods if certain events occur indicating that the carrying value of goodwill and/or indefinite-lived intangible assets may be impaired); (3) require that reporting units be identified for the purpose of assessing potential future impairments of goodwill; and (4) remove the 40-year limitation on the amortisation period of intangible assets that have finite lives.

The provisions of the Standards also apply to equity-method investments made both before and after 30 June 2001. SFAS 141 requires that the unamortised deferred credit related to an excess over cost arising from an investment that was accounted for using the equity method (equity-method negative goodwill), and that was acquired before 1 July 2001, must be written-off immediately and recognised as the cumulative effect of a change in accounting principle. Equity-method negative goodwill arising from equity investments made after 30 June 2001 must be written-off immediately and recorded as an extraordinary gain, instead of being deferred and amortised. SFAS 142 prohibits amortisation of the excess of cost over the underlying equity in the net assets of an equity-method investee that is recognised as goodwill.

The Group will adopt the provisions of SFAS 142 in the first half of the financial year ending 31 March 2003. The Group is in the process of preparing for its adoption of SFAS 142 and is making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets, and liabilities should be allocated to those reporting units. In connection with the adoption of SFAS 142, the Group expects to reclassify approximately £125 million of its intangible assets and the related deferred tax liabilities to goodwill. The Group expects that it will no longer record approximately £300 million of amortisation relating to its existing goodwill and indefinite-lived

intangibles, as adjusted for the reclassifications just mentioned. The Group will also evaluate the useful lives assigned to its intangible assets.

SFAS 142 requires that goodwill be tested annually for impairment using a two-step process. The first step is to identify a potential impairment and, in transition, this step must be measured as of the beginning of the fiscal year. However, an entity has six months from the date of adoption to complete the first step. The Group expects to complete that first step of the goodwill impairment test during the first half of the financial year ending 31 March 2003. The second step of the goodwill impairment test measures the amount of the impairment loss (measured as of the beginning of the year of adoption), if any, and must be completed by the end of the Group's financial year. Intangible assets deemed to have an indefinite life will be tested for impairment using a one-step process which compares the fair value to the carrying amount of the assets as of the beginning of the fiscal year, and pursuant to the requirements of SFAS 142 will be completed during the first half of the financial year ending 31 March 2003. Any impairment loss resulting from the transitional impairment tests will be reflected as the cumulative effect of a change in accounting principle in the first half of the financial year ending 31 March 2003. The Group has not yet determined what effect these impairment tests will have on the Group's earnings and financial position.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes SFAS No. 121. SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognising and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS No. 121. Unlike SFAS No. 121, an impairment assessment under SFAS No. 144 will never result in a write-down of goodwill. Rather, goodwill will be evaluated for impairment under SFAS No. 142, as discussed above. The Group is required to adopt SFAS No. 144 on 1 April 2003. Management does not expect the adoption of SFAS No. 144 for long-lived assets held for use to have a material impact on the Group's consolidated financial statements because the impairment assessment under SFAS No. 144 is largely unchanged from SFAS No. 121.

In July 2001, the FASB issued SFAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets". SFAS No. 143 is effective for companies with fiscal years beginning after 30 June 2002; early adoption is permitted. The standard provides the accounting requirements for retirement obligations associated with tangible long-lived assets. The standard requires that the obligation associated with the retirement of the tangible long-lived assets be capitalised into the asset cost at the time of initial recognition. The liability is then discounted to its fair value at the time of recognition using the guidance provided by the standard. The Group already applies this accounting principle under UK GAAP and does not expect a significant impact for US GAAP purposes.

### **European economic and monetary union**

The Euro was introduced on 1 January 1999 as the new currency within 11 Member States of the European Union, excluding the United Kingdom, in accordance with the treaty on European Economic and Monetary Union, or EMU. Although the United Kingdom does not currently participate in the EMU, it could do so at a later stage. The current policy of the UK government is that any decision to join the EMU will only be taken after a national referendum of the people. If the Euro is introduced in the United Kingdom, we will incur costs in making changes in our information technology and other systems in order to accommodate the use of the Euro in our products, systems and operations. We currently believe we will be able to convert our information technology and other systems to the Euro in the time between a definitive decision by the United Kingdom to join EMU and the actual introduction of the Euro as legal tender in the United Kingdom.

Our businesses in Germany, Netherlands and Ireland have been using the Euro in their products, systems and operations since the introduction of the currency in January 2002.

## risk factors

### **Our O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Online businesses are currently loss making. These businesses will require significant further investment and may prove unsuccessful**

As new businesses, O<sub>2</sub> Germany, O<sub>2</sub> Netherlands and O<sub>2</sub> Online, have incurred operating losses since inception and we expect them to continue to incur operating losses as they continue to expand their customer bases. O<sub>2</sub> Germany and O<sub>2</sub> Netherlands will need considerable financial resources to enhance their GSM networks and build new UMTS networks. O<sub>2</sub> Online is also at an early stage in its development and has required and continues to require substantial investment.

Our combined financial statements include a significant amount of intangible assets, including goodwill and licence fees related to our recent acquisitions and purchases of UMTS licences, a significant proportion of which relates to our newer businesses. A change in the estimated useful life of goodwill or licence fees, or the full or partial write-down of a portion of goodwill or licence fee, for these newer businesses or our other businesses, would negatively affect our operating results and net assets.

At 31 March 2002, goodwill totalled £6,361 million, and licence fees totalled £9,631 million, compared to total assets of £22,160 million and net assets of £18,834 million. At that date, goodwill relating to the acquisition of O<sub>2</sub> Germany and O<sub>2</sub> Netherlands stood at €2,374 million, with licence fees relating to these businesses amounting to €8,876 million. We have estimated the useful life associated with goodwill and licence fees to be 20 years. Subsequent changes in the mobile telecommunications industry, including advances in technology, or changes in the performance of our businesses, as a result of competitive pressures or otherwise, or potential difficulties in implementation of our UMTS networks may in the future shorten the estimated useful lives of goodwill and/or licence fees, and/or result in the further write-off of a portion of goodwill or licence fees.

### **The development costs of our UMTS mobile networks will be substantial, the demand for UMTS services is uncertain and we may not make an economic return on our investment**

Our UMTS licences in the United Kingdom, Germany and the Netherlands are required to enable us to provide advanced mobile voice and data services to our customers. Under the terms of these licences, we are obliged to build a UMTS mobile network infrastructure to give a certain level of population coverage in these countries. In addition, we have applied for a UMTS licence in Ireland, which, if granted, will entail further licence and rollout costs. A substantial portion of the approximately £8 billion of capital expenditures we expect to incur over the next five years will relate to building our UMTS networks in these countries.

The size of the market for UMTS services is as yet unknown. We cannot be certain that the demand for such services will justify the related costs. Developing UMTS technology may take longer than we anticipate and prove not to be superior to existing or emerging technologies or UMTS may not gain market acceptance. In some locations, the investment, although required under the licences, may prove not to be commercially justifiable. Ceasing our

investment could lead to penalties such as our UMTS licence being revoked without compensation in that jurisdiction.

We may face difficulties in acquiring new sites necessary for our UMTS networks or in utilising existing sites. We are also reliant upon certain suppliers, of which there are a limited number, to manufacture and supply functional network equipment and software as well as handset devices in our markets which will allow us to develop and our customers to take advantage of our GPRS and UMTS networks.

We cannot give an assurance that we will make an economic return from investments in UMTS licences and networks nor as to the timing of our doing so. In the event that we fail to generate significant revenue from our planned UMTS mobile services or fail to do so in the timescale we envisage, our business, financial condition and results of operations may suffer.

We may have to incur increased operational costs or modify or upgrade our information systems in order to respond to possible accounting, billing and other logistical problems resulting from the introduction of UMTS services. Also, any shift from "per second" billing for mobile services may affect the returns which we can make on the provision of UMTS services. Moreover, the competition for premium content may mean that we are obliged to contract for such content on unfavourable terms. Also, mobile electronic commerce, commonly referred to as m-commerce, may not experience growth if there are customer concerns about security of mobile networks.

### **We face intense and increasing competition from existing providers of mobile services and new market entrants, which could result in decreases in our customers, revenues and profitability**

There is intense competition in all of our markets. We are competing increasingly with other mobile operators, virtual network operators, mobile local area network operators and resellers of mobile services. New competitors are also likely to enter into certain of our markets as a result of the recent UMTS auctions and may continue to do so as additional bands of spectrum and licences for mobile communications may be auctioned or otherwise offered or sold by governmental authorities or traded by spectrum licence holders.

### **Our roaming revenues have fallen due to economic conditions and an EU investigation of roaming charges may result in further regulation**

Following the events in the US on 11 September 2001, there has been a marked fall in roaming revenues associated with, amongst other things, the decrease in business travel. We have no assurance that we will identify new revenue streams to replace this.

The Competition directorate of the European Commission is conducting an inquiry into competition in the markets for mobile roaming services in the European Economic Area, or the EEA, pursuant to Articles 81 and 82 of the EC Treaty following a number of complaints including purported high roaming charges, lack of competition in roaming offerings and anti-competitive practices. The European Commission's initial findings raised a number of competition and market structure concerns including excessive

pricing and price collusion in both the level of wholesale rates and the mark-ups applied in retail markets as well as concerns that the structural characteristics of the market may contribute to possible collective dominance. If as a result, the European Commission imposes a new regulation, this regulation could have a negative impact on our business and results of operations.

#### **We may fail to achieve synergy benefits from integration of our businesses**

We are in the process of improving our financial and management controls, reporting systems and hiring procedures to enable us to continue to manage our operations efficiently as an independent group. In particular, we are in the process of developing new systems at O<sub>2</sub> Germany and O<sub>2</sub> Netherlands to achieve this. We may face difficulties in integrating our businesses and achieving the synergy benefits that we wish to derive from operating our businesses as a cohesive group.

#### **The value of our intellectual property may be reduced, and our business negatively impacted, if we are unable to protect our intellectual property rights; our ability to compete could also be harmed if we are unable to use all intellectual property needed for our business**

Our intellectual property rights are valuable assets. We rely on a combination of copyright, trademark and patent laws and practices, trade secrets, confidentiality procedures and contractual provisions to protect our intellectual property. For example, we have taken significant steps designed to protect our rights in our new O<sub>2</sub> brand. In some circumstances, however, these measures afford limited protection. As a result, the value of our intellectual property may be reduced and our business may be negatively impacted. Moreover, we can give no assurance that we will be able to obtain all intellectual property needed to conduct our business.

#### **Non-delivery of key systems architecture may inhibit the integration of our business and inhibit our efforts to decrease risks**

We have launched a major initiative to build a common infrastructure to support the development of services and applications across our networks. The deployment of a common network architecture will be essential to bring economies of scale, support pan-European services and enable tailoring for local market requirements. We may not achieve the full range of benefits expected from this initiative.

In addition, the flexibility and functionality of our information systems will be critical to our strategy and to the successful operation of our businesses. If this initiative is unsuccessful, it could have a materially adverse effect on our business, financial condition and results of operation.

#### **Data products and services offered through UMTS and GPRS networks may not earn an economic return**

We cannot give an assurance that we will make an economic return from investments in UMTS licences and networks nor as to the timing of our doing so. In the event that we fail to generate significant revenue from our planned UMTS mobile services or fail to

do so in the timescale we envisage, our business, financial condition and results of operations may suffer.

Network equipment manufacturers may not be able to offer certain equipment to all participants equally or on desirable terms. The simultaneous roll-out of UMTS networks and GPRS services by network operators may also lead to shortages of functional handsets and other devices and we may not be able to secure contracts with suppliers of handsets and other devices to meet our needs. This may result in a reduced number of connections to, or delays in connections to, our networks.

#### **Our business will be materially impaired if we are unable to satisfy our substantial liquidity and capital resource requirements**

Our capital resource requirements relate, among other things, to the following:

- >> acquisition or construction of additional network capacity for existing networks;
- >> development of new services and products for, and roll-out of, our UMTS networks;
- >> acquisition of a UMTS licence in Ireland, if our expected bid for such licence succeeds;
- >> roll-out of the Airwave network; and
- >> development and implementation of new mobile technologies.

We expect our capital expenditures for these and other purposes to approximate £7 billion over the next five years. This capital expenditure figure has been reduced from the £8.3 billion total announced when we demerged from BT on 19 November 2001. A significant proportion of such expenditures will relate to rolling out our UMTS networks and we expect other expenditures of an amount we cannot predict with certainty. Our capital expenditures excluding UMTS licences for the three years ended 31 March 2000, 2001 and 2002 were £519 million, £1,134 million and £1,197 million, respectively. In addition, in the year ended 31 March 2001 BT incurred capital expenditures on purchasing UMTS licences in the United Kingdom and the Netherlands in an aggregate of £4,306 million. The cost of the UMTS licence held by O<sub>2</sub> Germany was included in the costs of acquisition of O<sub>2</sub> Germany.

Because of the nature of these requirements, we expect to incur substantial expenditure before any related revenue is realised. Capital expenditures and other operating expenditures will result in negative cash flow and operating losses for certain of our businesses unless and until we develop an adequate customer base and revenue stream from them. For the years ended 31 March 2000, 2001 and 2002 our net losses were £340 million, £4,009 million and £850 million, respectively. The net loss for the year ended 31 March 2001 includes an exceptional charge of £2,800 million relating to the write-down of goodwill. Moreover, there is a risk that we may never generate sufficient positive cash flow for our investment to make an economic return.

We have put in place borrowing facilities and issued bonds to meet our expected capital resource requirements. If our capital resource requirements are greater than anticipated, further debt and/or other financing may be required, and in any event our existing facilities

## risk factors

may require refinancing over time. The cost of capital may increase as telecommunications operators seek increasing amounts of financing. As our levels of debt increase, our businesses may not be able to generate sufficient cash flow to service our debt and/or continue our investment programme.

Our gross debt was £1,496 million and our net debt was £617 million as at 31 March 2002, consisting primarily of debt due to bondholders. See "Operating and Financial Review and Prospects – Liquidity and Capital Resources – Sources of Liquidity and Capital Resources."

Increased levels of debt could have negative effects on us, including:

- >> high debt service costs that could adversely affect our results of operations;
- >> allocation of increasing amounts of cash flow for debt service;
- >> increased difficulty in obtaining future financing;
- >> increased exposure to interest and exchange rate fluctuations;
- >> restrictions on our Company's capital resources or operations imposed by lenders; and
- >> reduced flexibility to take advantage of, or pursue, business opportunities.

If increased levels of debt or any other matter were to lead to a reduction of any credit ratings issued by ratings agencies in respect of our debt, this could lead to a significant change in the terms, including the cost, of our existing financing and affect the availability of further financing. If we are unable to satisfy our substantial liquidity and capital resource requirements, our business, financial condition and operating results will be materially adversely affected.

### **Alleged health risks associated with mobile telecommunications could lead to decreased usage of our services and products, increased difficulty in obtaining transmitter sites or potential liability**

We are aware of alleged health risks associated with mobile communications and the siting of transmitter masts and take these alleged risks seriously.

Public concern about the actual or perceived health risks of mobile communications could have a detrimental impact on us through negative customer perception of our brands, services or products, difficulties in retaining or attracting customers, reduced usage times per customer of our mobile telecommunications services or increased difficulty in obtaining transmitter sites. Such concerns may also expose us to potential litigation or other liability.

In addition, regulators may reduce the prescribed limits for exposure to electromagnetic radiation in the countries in which we operate, which would mean that the exclusion areas around our antennas in those countries may have to increase in some situations. In this event we may suffer additional costs associated with repositioning our network equipment and we may experience delays in the roll-out of our networks. The German Ministry of the Environment is currently working on an amendment of the ordinance defining exposure limits for electromagnetic radiation in Germany, the outcome of which is uncertain but we believe the current agreement is that the limits will remain unchanged, at the levels set by International Commission on Non-Ionising Radiation Protection (ICNIRP).

### **O<sub>2</sub> UK may grow more slowly than it has**

As a market with significant penetration, we expect that the increase in the number of new connections in the UK may slow. However, we expect the UK market to remain active, with operators focusing on retention and upgrade, rather than acquisition, of customers.

### **BT has agreed to carry out our sales and distribution activities to the business market of our services and we cannot guarantee this arrangement will be successful. BT may also compete with us in the future**

BT has agreed, for a three-year period commencing from the date of our demerger from BT, to continue to supply us with sales and distribution services in the UK business market. This agreement is subject to certain termination events, including, amongst other things, failure to meet certain performance levels and on 12 months' notice following a change of control. We cannot guarantee that this arrangement will be successful, or that it will be renewed after expiry of the initial term. If the arrangement is not successful, or does not continue as we would wish, this may have an adverse impact on the size and quality of our corporate and small to medium enterprise customer base. A substantial amount of our earnings derive from these customers. Upon termination of this agreement, BT may use its access to this important element of our customer base to market its own services or services of our competitors to these business customers.

Although the agreements we have reached with BT preclude BT from promoting competing mobile products to business customers in the UK for the three-year period referred to above, they do not prevent BT from sourcing mobile services from other network operators to supplying consumer customers in the United Kingdom. BT has undertaken not to use their brand in the UK in competition with O<sub>2</sub>, there is a limited right for BT to use their own brand in the mobile area to offer branded fixed and mobile goods and services to UK consumers and, in certain circumstances, to co-brand with another licensed mobile operator to sell mobile goods and services to UK consumers. BT is also free to acquire or create its own mobile telecommunications network or virtual mobile telecommunications network for the provision of mobile products and services in the UK consumer market.

BT Group may also carry on business as a provider of mobile services in other countries.

If BT competes with us in any of these ways, its knowledge of our business and products may allow it a competitive advantage in the marketplace. If this were to occur, it could have a materially adverse effect on our business, financial condition and results of operation.

### **Regulation of call termination charges may increase**

We are subject to a price cap of RPI-9 per cent on the charges we make to other telecommunications operators for terminating calls from mobiles and fixed lines on our network in the United Kingdom (termination charges). Broadly this requires that termination charges must fall by 9 per cent for each year of the control (imposed in 1998) after allowing for changes in the UK Retail Prices Index.

The Director General of Telecommunications (the DGT) has proposed modifying our licence (and the licences of Vodafone, Orange and

One2One) to impose a price cap on termination charges of RPI-12 per cent for four years from 1 April 2002 in place of the RPI-9 per cent control. However, following the mobile operators' objection to this proposal, on 7 January 2002 the matter was referred to the Competition Commission (the CC) for investigation. The RPI-9 price cap will remain in existence pending the outcome of the CC's investigation.

The CC has been asked to investigate whether, in the absence of a price cap, the respective termination charges of the mobile phone operators are against the public interest (too high) and if so whether this could be remedied or prevented by modifications to the operators' respective licences. At the end of its investigation (for which the deadline is January 2003), the CC will submit a report to the DGT. If the CC's report finds termination charges to be too high in the absence of a price control (i.e. there is an adverse public interest finding), the CC may recommend that the licences be changed to remedy the situation.

The DGT will then consider the CC's recommendations and make such changes to the licences as he considers necessary, having regard to (but not bound by) the CC's recommendations. If the CC does not make an adverse public interest finding, the DGT cannot make such licence modifications under the current procedure.

#### **Legal and other proceedings involving our businesses could have a material adverse effect upon our results of operations and financial condition**

Certain of our businesses are involved in legal proceedings including:

- >> debitel, a German service provider, has filed an action in the courts of Munich against O<sub>2</sub> Germany, claiming that there is a statutory obligation upon O<sub>2</sub> Germany to allow service providers the ability to market its services. The court's decision is still pending. However, a preliminary finding requires O<sub>2</sub> Germany and debitel to attempt to negotiate a contractual settlement. If O<sub>2</sub> Germany and debitel are unable to reach a negotiated settlement, then further legal proceedings are possible. If debitel succeeds in its claim, O<sub>2</sub> Germany will be obliged to grant them, and subsequently other service providers, the ability to market its services. In this event, O<sub>2</sub> Germany would be obliged to service additional customers which would lead to additional revenue for O<sub>2</sub> Germany, but potentially at relatively low margins. debitel may also be entitled to damages. Certain other telecommunications operators in Germany are required to allow service providers to market their GSM services. There is, however, no such clause in O<sub>2</sub> Germany's GSM licence.
- >> Versatel, a Dutch telecommunications company, has filed appeals with the District Court at Rotterdam against several decisions of the Dutch State Secretary responsible for telecommunications in relation to the recent auction of UMTS licences in the Netherlands. Versatel has appealed on the grounds that the rules governing the UMTS auction violated European and Dutch law and that O<sub>2</sub> Netherlands' alleged tortious behaviour towards Versatel during the auction process warranted its expulsion from the auction process by the State Secretary. Versatel is seeking, amongst other things, the repeal of all five UMTS licence awards made during the auction process. Although not without risk, O<sub>2</sub> Netherlands has been

advised that it has a strong defence to Versatel's appeal. Versatel's appeal was heard in January and we expect a decision soon. If Versatel is successful, O<sub>2</sub> Netherlands may be permitted to reapply for a UMTS licence or seek to purchase another UMTS licence or enter into other arrangements to offer UMTS services, failing which it would be unable to provide UMTS services.

If we do not prevail in these and other such proceedings, our operations and financial condition could be materially impaired. Additionally, proceedings which we do not consider to be material on an individual basis could have a material adverse effect on our financial condition and results of operations when accumulated.

#### **The proceedings of the Moriarty tribunal in Ireland may have a direct or indirect effect on our operations**

In 1997 a tribunal of inquiry (known as the Moriarty Tribunal) was established in Ireland to investigate suggestions of corruption relating to decisions made by two former members of Government, including Mr Michael Lowry, the minister responsible for the process by which O<sub>2</sub> Ireland's mobile telecommunications licence was originally issued in 1996. The tribunal is currently continuing its investigations and examining evidence that suggests that a former chairman of O<sub>2</sub> Ireland may have made payments, directly or indirectly, to Mr Lowry. It is also investigating a contribution to the political party of which Mr Lowry was a member, which appears to have been made by, or at the behest of, one or more former shareholders of O<sub>2</sub> Ireland. We cannot predict the future course of the investigations, which are ongoing. BT first acquired an interest in O<sub>2</sub> Ireland in January 2000 and is co-operating with the tribunal. We have taken legal advice with regard to these proceedings. While no assurance can be given, the Directors believe, based on the information available to them and having considered the advice that has been given to them, that the outcome of the tribunal proceedings will not lead to the loss of O<sub>2</sub> Ireland's entitlement to hold its licence or affect its ability to conduct its business. We may, however, suffer negative publicity as a result of the proceedings and be subject to more stringent regulatory scrutiny in the future.

## board of directors

### DAVID VARNEY (56) – CHAIRMAN (2) (4) (5)

David Varney was appointed to the Board on 31 August 2001. Mr Varney is Chairman of the Company and has extensive experience both in the UK and overseas markets gained during his four years as Chief Executive Officer of BG Group (formerly British Gas) from 1996 to 2000. Prior to joining BG Group, he held a variety of senior roles in Shell including the position of Managing Director of AB Svenska Shell in Sweden and Director of Shell International with responsibility for Shell's Oil Products business in Europe. He is also Chairman of Business in the Community.

### Executive Directors

#### PETER ERSKINE (50) – CHIEF EXECUTIVE OFFICER (2) (3) (4)

Peter Erskine was appointed to the Board on 31 August 2001. Mr Erskine is the Company's Chief Executive Officer. He joined the Company from BT where, since March 1993, he held a number of senior positions including Director of BT Mobile, President and Chief Executive of Concert, and, from 1998, Managing Director of BT Cellnet. He has over 11 years' experience in the telecommunications industry, including eight years in the mobile industry. Prior to joining BT he was European Vice President of Sales and Customer Service for Mars and Senior Vice President Sales and Marketing for UNITEL.

#### DAVID FINCH (46) – CHIEF FINANCIAL OFFICER (2) (3) (4)

David Finch was initially appointed to the Board on 31 August 2001. Mr Finch is the Company's Chief Financial Officer and has extensive experience in financial management having previously held senior finance positions at Exel, Novar (formerly Caradon) and Grand Metropolitan. In addition to Group Finance, he has direct responsibility for the Group Treasury and Investor Relations functions.

### Non-Executive Directors

#### STEPHEN HODGE (60) (1) (5) (6)

Stephen Hodge was initially appointed to the Board on 1 October 2001. Mr Hodge was Director of Finance of the Royal Dutch/Shell Group, prior to his retirement on 30 September 2001, where he had responsibility for all financial and investor relations issues for the Shell Group and its parent companies. He has extensive knowledge of the financial management of international companies, having worked throughout the world including Australia, the Netherlands, Venezuela and Argentina in a variety of financial positions. He is Chairman of Shell Pensions Trust Limited.

#### NEELIE KROES (60) (1) (5) (6)

Neelie Kroes was initially appointed to the Board on 31 August 2001. Ms Kroes was most recently President of Nijenrode University in the Netherlands. Before this she served as Adviser to the European Transport Commissioner and also served two periods as Cabinet Minister of Transport and Public Works, and was Secretary of State for Transport and Public Works, in the Netherlands. She was also a member of Parliament and a member of the Rotterdam Municipal Council. She is a member of the Supervisory Boards of a number of companies.

#### IAN MEAKINS (45) (1) (5) (6)

Ian Meakins was appointed to the Board on 20 December 2001. Mr Meakins is currently President, European Major Markets and Global Supply of Diageo. He has held a number of senior marketing and operational directorships since joining United Distillers in 1992 from strategic management consultants, The Kalchas Group, where he was a founding partner. Prior to this, he worked at Bain & Company and Procter & Gamble.

#### PAUL MYNERS (54) (1) (5) (6)

Paul Myners was initially appointed to the Board on 31 August 2001. Mr Myners is Chairman of the Guardian Media Group and a non-executive Director of The Bank of New York, Gartmore Global Trust and Marks and Spencer. He completed a review of Institutional Investment for HM Treasury in 2001 and is a member of the Financial Reporting Council. He was Chairman of Gartmore Investment Management until 30 November 2001 and has previously held directorships at National Westminster Bank, Coutts & Co., the Investment Management Regulatory Organisation, the Lloyd's Market Board, Celltech Group, the Scottish National Trust and Orange.

#### ANDREW SUKAWATY (46) (1) (5) (6)

Andrew Sukawaty was initially appointed to the Board on 31 August 2001. Mr Sukawaty is the non-executive Deputy Chairman of the Company and senior independent Director. He is President and Chief Operating Officer of Callahan Associates International LLC which operates communications businesses and cable television services worldwide. He has 15 years' experience in the mobile telephone industry and 23 years' experience in telecommunications in the United States and Europe having at different times in those periods held the offices of Chief Executive and President of Sprint PCS, Chief Executive Officer of NTL, Chief Operating Officer of Mercury One2One, where he launched the world's first digital Personal Communications Services company, and he is a former Chairman of the Cellular Telephone and Internet Association (CTIA) in the United States.

Key to membership of Board Committees:

- (1) Audit Committee
- (2) Chairman's Committee
- (3) Executive Committee
- (4) Finance Committee
- (5) Nomination Committee
- (6) Remuneration Committee

All of the non-executive Directors are considered independent of the management of the Company.

Jeffrey Fisher and Stephen Prior were Directors from incorporation of the Company to 31 August 2001.

Sir Christopher Bland, Sir Peter Bonfield and Philip Hampton were appointed as interim Directors on 16 November 2001 and retired on 19 November 2001.

## executive management team

mmO<sub>2</sub>'s Executive Committee comprises Messrs Erskine and Finch and the following senior executives:

### PHILIP BRAMWELL (45) – COMPANY SECRETARY AND GENERAL COUNSEL

Philip Bramwell joined the Company from BT, where he was employed since April 1998, initially as Legal Manager, Group Strategy and Development and then as Chief Counsel, Corporate Development. He has over 12 years' experience in the telecommunications industry. Before joining BT, he was a partner in DDV, a European specialist telecommunications consultancy firm. Prior to this, he held the position of Vice President and General Counsel at BellSouth with responsibility for the European operations of the Air Call and Dataserv groups and working on cellular and mobile data licence bids and start-ups throughout Europe.

### DANUTA GRAY (43) – CEO O<sub>2</sub> IRELAND

Danuta Gray joined the Company from BT, where she was employed since 1984. Ms Gray has over 17 years' experience in the telecommunications industry. Before transferring to her present role in July 2001, she was Senior Vice President of BT Wireless's businesses in Europe. Prior to this, she was a general manager of BT Mobile, Leeds from 1994 to 1999, Sales Manager and Deputy General Manager of BT Global Communications from 1992 to 1994 and Account Director for BT Global Communications, Commercial Sector from 1990 to 1992. Ms Gray also worked in various departments as a manager and consultant for BT.

### RUDOLF GRÖGER (47) – CEO O<sub>2</sub> GERMANY

Rudolf Gröger joined the Company in October 2001 as Chief Executive Officer of Viag Interkom. Prior to this Mr Gröger was Managing Director of T-Systems International GmbH, a subsidiary of Deutsche Telekom, from 1999 to 2001. He played a key role in the acquisition of Debis Systemhaus GmbH and its integration into Deutsche Telekom. He has also worked for Siemens and was head of its German information and communication product operations.

### ANDREW HARLEY (41) – GROUP HR DIRECTOR

Andrew Harley joined the Company from BT, where he had worked since August 1980. Before being appointed as Senior Vice President, HR, BT Wireless in February 2001, Mr Harley was Senior Vice President, Human Resources BTopenworld, BT's fixed internet service provider, and before that he was Human Resources Director for BT Cellnet. Mr Harley was also Human Resources Director for Telenordia in Sweden. He is a Fellow of the Chartered Institute of Personnel and Development.

### DAVID MCGLADE (41) – CEO O<sub>2</sub> UK

David McGlade joined BT Cellnet in October 2000. Mr McGlade has 19 years' experience in the communications industry. Before being appointed as Managing Director of BT Cellnet, Mr McGlade was Chairman and Chief Executive Officer of PureMatrix, a mobile webnet software company based in Colorado. He was also President and Chief Executive Officer of Catch TV, President West Region of Sprint PCS where he launched the first Code Division Multiple Access network outside Asia and a Vice President of TCI.

### RICHARD POSTON (42) – DIRECTOR CORPORATE COMMUNICATIONS

Richard Poston joined the Company in September 2001. Previously he was the Director of Communications for TI Group from 1999 to 2001 and prior to this Director of Corporate Communications for Racal Electronics (now part of Thales) from 1994 to 1999. He held a number of corporate communications and public affairs roles in Racal Electronics where he worked for 14 years. During this time, he was closely involved with the early growth of Vodafone leading to its demerger from Racal and the formation of Camelot Group, operator of the National Lottery, in which Racal was a major shareholder. Mr Poston started his career in the Royal Navy where he served from 1978 to 1986.

### SOHAIL QADRI (41) – PRESIDENT BUSINESS DEVELOPMENT & STRATEGY

Sohail Qadri joined BT Cellnet in 1993 as Director of Operations and Strategy. In 1997 he became Director of Mobility, Group Strategy and Development for BT before taking on his current role. Prior to joining BT Cellnet, Mr Qadri was a Principal Consultant at Coopers & Lybrand, now PricewaterhouseCoopers. He has also been a BT nominated Director at Maxis Communications, SFR and Rogers Wireless.

### JOHN SAMARRON (49) – CHIEF TECHNOLOGY OFFICER

John Samarron joined the Company from BT. Mr Samarron joined BT in 1997 and was appointed Chief Technology Officer for BT Wireless in July 2000. Prior to this Mr Samarron was Managing Director of Mobile Networks for Viag Interkom. Mr Samarron has over 27 years' experience in the telecommunications industry. Prior to joining BT, Mr Samarron was Chief Technical Officer at Pocket Communications Inc. and Executive Vice President and Chief Technical Officer at Chase Telecommunications Inc. He was also Chief Technical Officer at Airtel (Airtouch International).

### TON AAN DE STEGGE (46) – CEO O<sub>2</sub> NETHERLANDS

Ton aan de Stegge joined Telfort in December 1999. Prior to joining Telfort, he worked for Ericsson with his most recent function being President and CEO, Ericsson Nederland BV. He has also worked in a number of management positions at Volmac, Getronics and Computer Sciences Corporation. He is also Chairman of ICT Telecom, a telecoms industry association in the Netherlands.

### KENT THEXTON (39) – CHIEF MARKETING AND DATA OFFICER

Kent Thexton joined BT Cellnet in 1998 as Marketing Director before becoming Managing Director of Genie in 2000. He was appointed Chief Marketing and Data Officer for the Company in July 2001. He has over 12 years' experience in the telecommunications industry. Before joining BT Cellnet, he spent eight years in the Canadian mobile industry, holding the position of Chief Operating Officer and Executive Vice President of Rogers Cantel (now Rogers Wireless). Prior to this he held management positions at Northern Telecom and Bell Canada.



## report of the directors

The Directors of mmO<sub>2</sub> plc have pleasure in presenting to shareholders their first report and the audited financial statements for the year ended 31 March 2002.

mmO<sub>2</sub> plc was incorporated and registered in England and Wales as a private company limited by shares on 30 March 2001 under the Companies Act 1985 under the name Newgate Wireless Limited. By virtue of special resolutions dated 11 September 2001, effective on 12 September 2001, the Company was re-registered under section 43 of the Companies Act 1985 as a public limited company and changed its name to mmO<sub>2</sub> plc.

On 16 November 2001, the Company became the parent company of the mmO<sub>2</sub> group of companies, pursuant to a scheme of arrangement under section 425 of the Companies Act 1985 and as part of a series of steps involved in the demerger from BT of its previous BT Wireless business.

### Principal activity

mmO<sub>2</sub> plc is a leading provider of mobile communications services in Europe trading through its wholly-owned subsidiaries in the UK, Germany, Ireland, the Netherlands and the Isle of Man. The Group also operates a mobile internet business through O<sub>2</sub> Online (formerly known as Genie).

The business review on pages 6 to 21 and the operating and financial review and prospects on pages 24 to 41 contain a review of the business during the year and an indication of future developments and form part of this report.

### Results

The audited financial statements are presented on pages 62 to 88. The Directors do not recommend the payment of a dividend for the year ended 31 March 2002.

### Directors

On 31 August 2001, David Varney (Chairman), Peter Erskine and David Finch were appointed to the Board as executive Directors and Neelie Kroes, Paul Myners and Andrew Sukawaty were appointed as non-executive Directors. Stephen Hodge and Ian Meakins joined the Board on 1 October 2001 and 20 December 2001 respectively as non-executive Directors.

On 16 November 2001, upon the section 425 scheme of arrangement becoming fully effective, all of the existing Directors other than Messrs Varney and Erskine (the "Continuing Directors") resigned from their positions on the Board, and Sir Christopher Bland, Sir Peter Bonfield and Philip Hampton (the "Interim Directors") were appointed. On 19 November 2001, upon the demerger becoming effective, the Interim Directors retired from the Board and the Continuing Directors were re-appointed.

The Company's Articles of Association state that any person appointed by the Directors shall retire at the first General Meeting after their appointment for election by shareholders. Accordingly, Mr Meakins will retire and, being eligible, will offer himself for election at the forthcoming Annual General Meeting.

In addition, the Company's Articles of Association state that Directors are subject to re-election by shareholders every three years. Although all the Directors (other than Mr Meakins) were appointed by shareholders of the Company as part of the demerger process, the opportunity is being taken for all Directors, except for Mr Meakins, who is seeking election, to retire by rotation at the forthcoming Annual General Meeting, and, being eligible, to offer themselves for re-election.

The current Directors' biographies, and Directors who served during the year, are given on page 46.

Details of the Directors' service contracts, emoluments and share interests can be found in the report on directors' remuneration on pages 53 to 60.

### Share capital

Details of the authorised and issued share capital of the Company at 31 March 2002 are given in note 21 of the financial statements.

The authorised share capital of the Company on incorporation was £100 divided into 100 ordinary shares of £1 each, of which two were issued fully paid at par to the subscribers to the Company's Memorandum and Articles of Association. By ordinary resolutions of the shareholders dated 11 September 2001, each ordinary share of £1 each was sub-divided into 1,000 ordinary shares of 0.1 pence each and the authorised share capital of the Company was increased to £20,050,040 by the creation of 19,999,900,000 further ordinary shares of 0.1 pence each, 40 deferred shares of £1 each and one redeemable preference share of £50,000.

The redeemable preference share and the deferred shares were allotted and treated as paid up in full on 11 September 2001, and 8,670,031,916 ordinary shares were allotted and issued on 16 November 2001 to BT shareholders at that time pursuant to the section 425 scheme of arrangement and demerger process. In addition, on 19 November 2001, a further 15,500 ordinary shares were allotted and issued in connection with the distribution of "one founding share" to each eligible employee in the Group. On 20 December 2001 the one redeemable preference share was duly redeemed and converted into 50,000,000 ordinary shares in the Company.

By an ordinary resolution of the shareholders dated 17 September 2001, the Company was authorised to make market purchases of up to 870,000,000 of its own ordinary shares. This authority will expire at the 2002 Annual General Meeting and a similar authority will be sought at that meeting for a further year, based on approximately 10 per cent of the Company's issued share capital as at 31 March 2002. The Company has no current intention to utilise the authority.

### Substantial shareholdings

At 21 May 2002, no notification under Part VI of the Companies Act 1985 had been received by the Company in respect of a holding of 3 per cent or more of the Company's issued share capital, other than CGNU plc which has notified an interest in 268,611,279 ordinary shares representing 3.10 per cent.

### Interest of management in certain transactions

During and at the end of the 2002 financial year, none of the Company's Directors had a significant interest in any material transaction in relation to the Group's business.

### Employees

During the year, the Company introduced a number of employee share schemes, including Group savings-related schemes and an all employee share ownership plan in the UK, which encourage regular saving and enable employees to acquire options or shares in the Company.

The Company is committed to providing effective communication with its employees to ensure that they fully understand the Group's objectives and its operational and financial performance. Particular emphasis is placed on two-way communication through face-to-face meetings, team briefings, audios and the use of the comprehensive Company intranet, which includes the distribution of the Company's O<sub>2</sub> newsletter. In addition, the Company conducts an annual attitude survey and maintains a constructive dialogue with unions, employee representative bodies and works councils.

The energy, innovation and creativity of our people add value to the Group. The Company is committed to the development of all people in the organisation and actively promotes this through many training and development initiatives. People are encouraged and supported in maintaining personal development plans.

The Group is committed to employment policies that follow best practice, based on equal opportunities for all, and recognises the diversity of its people. This approach extends to the fair treatment of people with disabilities in relation to their recruitment, training and development. Full consideration and every effort is given to the retention of people who become disabled during employment. O<sub>2</sub> UK is a member of the Employers Forum on Disability.

### Policy on the payment of suppliers

The Group aims to pay all of its creditors promptly. The payment terms for major contracts are agreed at the same time as other terms are negotiated with individual suppliers. It is the Group's policy to make payments for other purchases within 30 working days of the invoice date, provided that the relevant invoice is presented in a timely fashion and is complete.

The Group had 37 days' purchases outstanding as at 31 March 2002 based on the average daily amount invoiced by suppliers during the year.

### Corporate governance

A report on corporate governance is set out on pages 50 to 52.

### Community involvement

During the year, the sum of £207,000 was donated to charitable and community organisations within the UK. No payments were made to political parties. Further details regarding the Company's involvement in the community are set out on pages 22 and 23.

### Auditors

A resolution to appoint PricewaterhouseCoopers as auditors of the Company and authorise the Directors to settle their remuneration will be proposed at the 2002 Annual General Meeting.

### Annual General Meeting

The resolutions to be proposed at the Annual General Meeting to be held on Tuesday, 23 July 2002, together with explanatory notes, appear in the separate Notice of Annual General Meeting sent to all shareholders.

By Order of the Board

PHILIP BRAMWELL COMPANY SECRETARY AND GENERAL COUNSEL

28 MAY 2002

REGISTERED OFFICE: 5 LONGWALK ROAD, STOCKLEY PARK EAST, UXBRIDGE, MIDDLESEX UB11 1TT

REGISTERED NUMBER: 4190833

## report on corporate governance

Before the demerger became effective, the Group complied with the corporate governance regime of BT. Since the demerger on 19 November 2001, the Board has sought compliance with corporate governance best practice and supports high standards in corporate governance. The application of the principles in Section 1 of the Combined Code are described in the appropriate sections of this statement and in the report on directors' remuneration on pages 53 to 60. The Directors consider that, since the demerger, the Company has fully complied with the provisions set out in Section 1 of the Combined Code.

### The Board

The Board comprises the Chairman, Chief Executive Officer, Chief Financial Officer and five independent non-executive Directors, one of whom, Andrew Sukawaty, the Deputy Chairman, is recognised as the senior independent Director to whom concerns can be conveyed independently of the Chairman.

The Board has regular scheduled meetings throughout the year together with an annual off-site conference to review and discuss corporate strategy. Additional meetings are held as necessary. Whilst not actively involved in the day-to-day management of the Company, the non-executive Directors play an important role in bringing their independent judgement and considerable knowledge and experience to the Board's deliberations. The Directors' biographies appear on page 46.

The Board is responsible for the overall Group strategy and competent management of the affairs of the Group. The Board has a formal schedule of matters specifically reserved to it for decision, including the approval of strategic plans and the annual operating plan, significant investments and capital projects, and treasury and risk management policies.

Guidelines are in place concerning the content, presentation and delivery of papers by management to Directors for each Board meeting, so that the Directors have enough information to be properly briefed. Where issues arise at Board meetings, the Chairman ensures that all Directors are properly briefed and, where necessary, appropriate further enquiries are made.

All Directors have access to the advice and services of the Company Secretary who is responsible to the Board for ensuring that Board procedures are followed and maintaining compliance with all applicable rules and regulations. The removal of the Company Secretary is a matter for the Board as a whole. There is an agreed procedure for Directors to take, if necessary, independent professional advice at the Company's expense.

At the time of a Director's appointment to the Board, an internal induction programme is provided on the Group's strategic and business plans and developments to date. The content of this induction programme and, where appropriate, any additional training which may be required by the Director, is kept under review. Directors are also advised of their legal and other obligations as a Director of a listed company.

Non-executive Directors are appointed initially for three years. Towards the end of that period, the Board will consider whether to

continue their appointment, which will then become terminable on 12 months' notice from either the Company or the Director.

In accordance with the Combined Code and the Company's Articles of Association, all Directors submit themselves for re-election at least every three years.

As part of the demerger process, the Board adopted appropriate governance policies dealing with the conduct of Board affairs and delegations.

### Board Committees

The Board has delegated authority to the following committees on specific matters. All of the committees have formal terms of reference. Minutes of meetings are formally recorded.

#### Chairman's Committee. Chairman: David Varney

The Chairman's Committee advises and assists the Chairman in the preparation for Board meetings. The committee also acts on behalf of the Board between scheduled Board meetings, in exceptional circumstances, where it is not possible or practicable to convene a meeting of the Board. In addition to the Chairman, Peter Erskine and David Finch are members of the committee.

#### Audit Committee. Chairman: Stephen Hodge

Comprising all of the non-executive Directors, the Audit Committee monitors the adequacy of the Group's accounting policies and financial reporting; reviews the half-yearly and annual financial statements before they are presented to the Board; monitors internal financial and non-financial controls, including the system for maintaining these controls; maintains a liaison with the internal and external auditors, keeping under review the scope and results of the audit, its cost effectiveness and the independence and objectivity of the auditors and matters relating to the provision of, including the extent of, their non-audit services. The committee focuses primarily on compliance with legal requirements, accounting standards and the rules of the UK Listing Authority and other regulators. The committee also receives formal reports from the Head of Internal Audit who attends meetings.

The committee meets at least four times a year, with part of each meeting currently being held between the committee members and the external auditors in private.

#### Finance Committee. Chairman: David Varney

The Finance Committee considers financing and investment decisions concerning the Group. The committee normally meets four times a year. In addition to the Chairman, Peter Erskine and David Finch are members of the committee.

#### Nomination Committee. Chairman: David Varney

Comprising the Chairman and all of the non-executive Directors, the Nomination Committee is responsible for reviewing the structure, size and composition of the Board and for recommending candidates for the approval of the Board for Board membership.

#### Remuneration Committee. Chairman: Andrew Sukawaty

Comprising all of the non-executive Directors, the Remuneration Committee is responsible for determining the framework and policy for the remuneration of the Chairman, all executive Directors and

members of the Executive Committee and for determining, within agreed terms of reference, specific remuneration packages for each of the executive Directors and members of the Executive Committee, including any pension rights, any compensation payments and the implementation of executive incentive schemes. The committee will operate on the principle that members of the executive management should be provided with appropriate incentives to encourage superior performance and should, in a fair and responsible manner, be rewarded for their individual contributions to the success of our Group. The report on directors' remuneration is set out on pages 53 to 60.

The Chief Executive Officer, Peter Erskine, together with his senior executive team, is responsible for the executive day-to-day running of the Company. He chairs the **Executive Committee**, which is responsible for the preparation and maintenance of strategic plans for the Group and for monitoring the performance of the Group as a whole.

### Internal Control Responsibility

The Board has overall responsibility for the Group's systems of internal control and risk management and for reviewing the effectiveness of those systems. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives; any system can provide only reasonable and not absolute assurance against material misstatement or loss.

The Board sets the policy on Internal Control and Risk Management that is implemented by management. This policy is in accordance with the Turnbull Guidance "Internal Control: Guidance for Directors on the Combined Code".

Review of this policy, Risk Management and Internal Audit are the responsibility of separate functions within the Company but they operate holistically to deliver an effective internal control system.

### Risk management

The Group has a detailed on-going risk management process, for identifying, evaluating and managing the significant risks faced by the Company. This process has been reviewed and updated following demerger of the Company.

Risk assessment and evaluation take place as an integral part of the Group's annual strategic planning cycle and this includes the consideration of major business risks by senior management.

The risk management process comprises the following key elements:

- >> Group operating companies carry out risk assessments, using CRSA (Control Risk Self Assessment) workshop techniques, to determine the nature and extent of risks facing the Company.
- >> the Executive Committee undertake a formal Group-wide risk assessment, which is reviewed by the Board.
- >> registers are produced which detail significant risks and indicate likelihood, impact, and the level of controls, together with mitigating actions.
- >> senior management are accountable and responsible for managing risks within the Group, supported by dedicated risk managers. These risk managers assist in embedding risk

management within the business culture, via risk forums, team meetings, training sessions and online websites.

- >> the Internal Audit function also promotes effective risk management in the business' operations.
- >> a fast track process for identifying and responding to evolving risks and significant changes to existing risks so that they are reported to an appropriate level of management and corrective action is taken.

### Control environment

The Audit Committee, on behalf of the Board, considers the effectiveness of the operation of internal control procedures in the Group during the financial year. The Audit Committee, which meets quarterly, reviews reports from the Executive Committee, from the internal auditors, Head of Corporate Governance and from the external auditors, keeping under review the scope and results of the audit and the cost effectiveness, independence and objectivity of the auditors and reports its conclusions to the Board. The Audit Committee has carried out these actions since the demerger became effective. Prior to this, the Group complied with the corporate governance regime of BT.

Senior management report each quarter to the Chief Financial Officer on the operation of internal controls in their area of responsibility and report any significant control failings or weaknesses.

### Annual assessment

The Chief Executive Officer receives annual reports from senior executives responsible for major Group operations with their opinions on the effectiveness of the operation of internal controls during the financial year.

The Board have reviewed the nature, extent and changes to the significant risks to the business. The Group's current key risks are summarised in **risk factors** on pages 42 to 45.

Following demerger the Internal Control and Risk Management policy has been benchmarked against other FTSE companies and updated.

The Group's internal auditors have carried out a six monthly and annual assessment of the quality of the Internal Control and Risk Management process.

Corporate Social Responsibility information, in accordance with the Disclosure Guidelines on Social Responsibility issued by the Association of British Insurers, is disclosed in the **corporate social responsibility** section of this report, see pages 22 and 23.

These processes have been in place for the whole of the 2002 financial year and have continued up to the date on which this document was approved.

### Business ethics

To reinforce our commitment to achieve best practice in our standards of business integrity, mmO<sub>2</sub> has a written Statement of Business Practice. The statement reflects mmO<sub>2</sub>'s European operations and the increasing expectations in the areas of corporate governance and business practice standards. A copy of the statement is available on the Company's intranet site.

## report on corporate governance

These high-level principles are supported by a confidential helpline and email facility which are available to employees who have questions regarding the application of these principles. The Company also continues to require our agents and contractors to apply these principles when representing mmO<sub>2</sub>.

### Investor relations

The Company is committed to ongoing development of open and effective communications with shareholders. The Chief Executive Officer and the Chief Financial Officer regularly meet with institutional shareholders and analysts and the Company's Annual General Meeting will be used as an opportunity to communicate with private investors and encourage their participation. At the Annual General Meeting the number of proxy votes to be cast for or against each resolution, together with the number of proxy abstentions, will be indicated after it has been dealt with on a show of hands. All substantial issues, including the adoption of the annual report and financial statements, will be proposed at the Annual General Meeting on separate resolutions. It is our intention that the Chairman of the Audit, Nomination and Remuneration Committees will be available to answer questions at the Annual General Meeting.

### Going concern

The Directors have reviewed the Group's liquid resources and borrowing facilities and the Group's budget and cash flow forecast for the year to 31 March 2003 and outline projections for the subsequent year. On the basis of this review, the Directors are satisfied that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors adopt the going-concern basis in the preparation of the financial statements.

## report on directors' remuneration

This report has been prepared by the remuneration committee ("the committee") and has been approved by the Board.

It sets out the Board's statement of how it has applied the principles of good governance set out in the Combined Code. The committee has followed the requirements set out in Schedule A of the Combined Code when considering the remuneration packages of executive Directors and has followed the provisions of Schedule B of the Combined Code when preparing this report. The Report of the Auditors on the financial statements set out on page 61 confirms that the scope of this report covers the disclosures that are specified for their examination by the UK Listing Authority. Details of each individual Director's remuneration and their holdings of the Company's shares, share awards and share options are set out on pages 58 and 59. Since demerger, the Company has complied with the provisions of the Combined Code in relation to Directors' remuneration.

### Membership and responsibilities of the remuneration committee

The committee was formed on 31 August 2001 and became formally responsible for mmO<sub>2</sub> executive remuneration on demerger. Prior to the demerger, the remuneration committee of BT was responsible for executive remuneration policy across BT, including the businesses that now constitute mmO<sub>2</sub>.

The committee consists exclusively of independent non-executive Directors who are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. No member of the committee has any personal financial interest, other than as a shareholder, in the matters to be decided by the committee.

The committee is chaired by Andrew Sukawaty, and its other members are Stephen Hodge, Neelie Kroes, Ian Meakins and Paul Myners. The Chairman, Chief Executive Officer and other persons are invited to attend from time to time when appropriate, but are not present when matters of their own remuneration are being discussed. Biographies can be found on page 46.

As a fully constituted Board committee, the committee is responsible for determining policy on the remuneration and performance of executive Directors and members of the executive committee as set out on page 47, and for determining, within agreed terms of reference, specific remuneration packages for each of the executive Directors and members of the executive committee, including:

- >> service contracts;
- >> salaries;
- >> benefits;
- >> pension rights;
- >> any compensation payments; and
- >> the operation of the mmO<sub>2</sub> Executive Share Portfolio ("the Portfolio").

The committee has responsibility for agreeing any awards or options granted under the Portfolio. It also has responsibility for determining how the Portfolio should be operated, including agreeing performance targets and which employees should be invited to participate in the Portfolio. All employees of the mmO<sub>2</sub> Group,

including executive Directors, are eligible to be invited to participate at the discretion of the committee. Details of the Portfolio and the basis of awards granted under it are set out on pages 54 and 55.

The committee met five times between its formation and 31 March 2002.

The committee has access to advice from independent executive remuneration consultants on all aspects of executive remuneration as well as from the Group HR Director and remuneration professionals within the business.

### Remuneration policy

The committee operates on the principle that executive Directors and members of the executive committee should be provided with appropriate incentives to encourage superior performance and should, in a fair and responsible manner, be rewarded for their contribution to the success of our Group.

As a newly listed company we are committed to developing and maintaining appropriate remuneration strategies which attract, retain and motivate our key people. We are committed to aligning the remuneration of senior executives across the whole business who may have different remuneration histories. In addition, the committee considers it vital to align the interests of the leadership team with those of shareholders, and to link a significant proportion of the package to shareholder value.

In determining individual packages for the executive Directors and members of the executive committee, the committee takes into account comparable roles in comparable organisations, primarily companies of equivalent size, and UK and European telecommunications companies. For the executive Directors, and members of the executive committee, remuneration is based on the following principles:

- >> base pay will be positioned at the median of the relevant market, and with consideration to the pay and employment conditions of all employees in the Group; and
- >> emphasis will be placed on providing a total cash and total compensation package that has potential to be upper quartile for high performance.

The committee will review the total remuneration of the executive Directors and executive committee members annually to ensure adherence to the above.

The committee believes that it is in the interests of all employees across the business to be given the opportunity to own mmO<sub>2</sub> shares, and wishes to encourage this by taking advantage of favourable tax treatment where available for employee shareholdings. The mmO<sub>2</sub> all-employee plans are:

- >> the mmO<sub>2</sub> Sharesave Plan, under which the Directors can grant options to all employees across the business to acquire shares at an exercise price set at a discount of up to 20 per cent to the market value of a share at the time of invitation;
- >> the mmO<sub>2</sub> Profit Sharing Plan, which can only be operated before 31 December 2002; and
- >> the mmO<sub>2</sub> Share Ownership Plan, under which the Directors can award shares to UK employees on a variety of tax-favoured terms.

## report on directors' remuneration

### Elements of executive remuneration

The following comprised the principal elements of executive remuneration for the period under review:

- >> base salaries;
- >> annual incentives;
- >> long-term incentives;
- >> pensions; and
- >> benefits.

### Base salary

Base salaries for all executive Directors and other executive committee members are reviewed (but not necessarily increased) annually by the committee. Salary increases are made when the committee believes that this would result in a better reflection of past and future contribution, level of responsibility, competitiveness and criticality to the business. In considering base salaries the committee makes reference to market information and data for comparable positions in comparable businesses.

As at 31 March 2002, David Varney received an annual salary of £500,000. The annual salaries payable to Peter Erskine, the Chief Executive Officer, and David Finch, the Chief Financial Officer, were £500,000 and £350,000 respectively as at 31 March 2002.

### Annual incentives

Annual incentives for the year to 31 March 2002 were paid in accordance with bonus plans in place prior to demerger.

In respect of the year to 31 March 2002, the targets for Peter Erskine and David Finch were based on corporate performance, against a combination of targets including Group financials, customer metrics and employee satisfaction indicators. David Varney does not participate in annual incentive arrangements.

The annual bonus arrangements for the forthcoming financial year will be based on a balance of key performance indicators, including EBITDA, revenue and customer satisfaction targets. Targets are determined at the start of the financial year and agreed by the committee.

The on-target and maximum bonus potentials are determined by the committee. The bonus payable for on-target performance is 65 per cent of salary for the Chief Executive Officer with a maximum of 100 per cent. For the Chief Financial Officer, the percentages are 50 per cent and 75 per cent respectively. Bonuses are not pensionable.

In the year to 31 March 2002, Peter Erskine earned an annual bonus of £250,000. This included an exceptional payment of £25,000, awarded at the discretion of the committee, in respect of Peter Erskine's contribution to the successful completion of the demerger. David Finch earned a bonus of £145,000. Peter Erskine also received a payment of £186,880 in respect of notional shares vested under a cash-based long-term incentive plan operated for O<sub>2</sub> UK executives, which he was required to reinvest in mmO<sub>2</sub> shares under the terms of his restricted share award (see page 55).

Shortly after demerger David Varney was paid a discretionary bonus of £150,000 by BT Group plc in respect of his contribution to the successful demerger.

### Long-term incentives

The primary vehicle for aligning the interests of key employees and executive Directors with those of shareholders is the Portfolio.

Approved by BT's shareholders at the EGM in October 2001 to approve the demerger, it comprises three elements:

- >> share options;
- >> restricted shares; and
- >> performance shares.

The committee will actively review the most appropriate elements of the Portfolio to use from time to time to incentivise participants. In the year to 31 March 2002 only the share option and restricted share elements were operated. It is the committee's intention that no Director or employee should participate in all three elements in the same year. Participation is solely at the discretion of the committee, and all employees of the mmO<sub>2</sub> Group, including executive Directors, are eligible to be invited to participate.

Awards and options are not pensionable and may not be assigned or transferred except on a participant's death, when they may be assigned to the participant's personal representatives. The committee will consider whether an ongoing personal shareholding requirement should be introduced for executive Directors and senior executives.

### Share options

It is the Company's policy to use share options as a mechanism for retaining and motivating key employees. Since demerger, options have been granted for nil consideration under the share option element to 1,157 employees, based on their past and anticipated future contribution to the business. The maximum face value of shares granted under option was four times salary although most grants were at 50 per cent to 75 per cent of salary. The exercise price for such options is not set at a discount to the market value of shares under option at the time of grant.

The majority of these options were granted on terms that they normally only become exercisable on the third anniversary of grant, subject to a demanding performance condition being met. This relates to the Total Shareholder Return (TSR) performance of the Company, when compared with the TSR performance of the constituent companies in the FTSE 100 Index at the date of grant (the "Comparator Group").

These options will only become exercisable in full if, at one of the test dates described below, the Company's TSR performance places it at or above the upper quartile of the Comparator Group. No part of the option will become exercisable if the Company's TSR performance places it below the median of the Comparator Group. If the Company's TSR performance places it at the median, 50 per cent will become exercisable. If the Company's TSR performance is between the median and upper quartile, the option will become exercisable on a sliding scale.

This performance target will first be tested on the third anniversary of grant; if the target is not satisfied in full after this period, it can be retested on two subsequent occasions, on the fourth and fifth anniversaries of grant, extending the length of the performance period at each test. The proportion of options that can be exercised will increase if the Company's TSR performance improves between

the test dates. The first performance test is expected to be November 2004, three years from demerger. TSR performance from demerger to 31 March 2002 places mmO<sub>2</sub> at 93rd position within the Comparator Group. In view of the short history of mmO<sub>2</sub> it is not felt appropriate to include graphs of our performance in this report. Compared with the telecommunications companies in the FTSE All-Share Index over the period from demerger to 31 March 2002 and with TSR calculated on the same basis, mmO<sub>2</sub> was ranked fifth out of 14.

Following demerger, and as anticipated in the Listing Particulars, each of the executive Directors was made a grant of share options with an aggregate exercise price equal to three times salary.

Around 20 per cent of options granted have no reference to an additional corporate performance measure for exercise. These options granted without additional performance conditions relate to specific written recruitment promises, or one-off circumstances where retention of key individuals was critical to the future success of the business. None of these options were granted to executive Directors.

It is anticipated for the forthcoming year that grants of options will be subject to a TSR performance condition and the committee will consider whether it would be appropriate to use a smaller peer group for comparison purposes, rather than the constituents of the FTSE 100 Index.

Subject to the approval of the committee, it is the Company's intention to make annual grants on a basis similar to that set out above.

In any 10-year period, not more than 10 per cent of the issued ordinary share capital of the Company from time to time may be issued or issuable under the share option element of the Portfolio and the mmO<sub>2</sub> All-Employee Share Plans.

#### Restricted shares

Restricted share awards were granted to a small group of senior executives (including executive Directors) shortly after demerger. Most of these awards were granted on terms that they will normally only vest on the third anniversary of grant if the participant builds up a significant personal shareholding in the Company, and remains in employment with the mmO<sub>2</sub> Group.

This arrangement is designed to align the interests of shareholders and executives by encouraging our senior executives and managers to make a significant investment in the Company. In the majority of cases, these restricted share awards were between 25 per cent to 100 per cent of salary. Vesting of the awards is usually subject to the participant building up an equivalent personal shareholding within 18 months from demerger and retaining this shareholding until the vesting date. The restricted share award will vest on a pro rata basis if the participant builds up a lower personal investment. Participants may purchase mmO<sub>2</sub> shares to satisfy their obligation to build up their personal shareholding, or may hold mmO<sub>2</sub> shares derived from previous holdings of BT shares.

On 23 November 2001, Peter Erskine and David Finch were each made a restricted share award, of 100 per cent and 150 per cent of base salary respectively, with a requirement to build up a personal

shareholding by the first anniversary of demerger. Peter Erskine is required to build up a personal shareholding equal to the number of shares under award, and David Finch is required to build up a personal shareholding equal to one-third of the shares under award. As at 31 March 2002 both Peter Erskine and David Finch had met their shareholding requirement, and are required to maintain that shareholding until the third anniversary of award in order for their restricted share awards to vest in full.

Participants who were members of the cash-based BT Cellnet Executive incentive plan as described on pages 56 and 57, which vested early as a result of the demerger, were required to invest the after-tax amount payable under this plan in our shares for the purpose of satisfying part of their obligation to build up a personal shareholding. Peter Erskine purchased shares on this basis in respect of the amount payable to him under this plan.

Some of the restricted share awards to certain senior executives were granted in order to satisfy commitments made by the Company in connection with their recruitment or retention circumstances. The vesting of these restricted share awards is subject to a specified period of continued service with the mmO<sub>2</sub> Group, but not an obligation to build up a personal shareholding.

Further awards under this plan will be solely at the discretion of the committee. There are currently no plans to make further awards to existing participants of this plan in the forthcoming financial year.

#### Performance shares

Under this element of the Portfolio, shares are awarded and vest subject to the satisfaction of a predetermined performance target and continued employment. The committee will set the performance period which will not be less than three years, and the maximum value of shares under award which will not normally exceed twice salary in any year.

This element of the Portfolio has not yet been operated.

#### Contracts and notice periods

It is the committee's policy that contracts and service agreements for executive Directors will have the following provisions:

- >> the notice period required by the Company to terminate will be 12 months for executive Directors.
- >> if the Company terminates without notice the individual is entitled to a payment in lieu of notice of up to 12 months' pay, the value of employer's pension contributions, benefits, and a bonus payment of not less than the previous year's bonus. This may be paid in a lump sum, or in monthly instalments until the end of the notice period or, if earlier, such time as the Director obtains qualifying alternative employment.
- >> in the event of termination for unsatisfactory performance of duties or for reasons of misconduct, no compensation is payable.
- >> on termination of the Directors' employment within 12 months of a change of control, mmO<sub>2</sub> is obliged to make a liquidated damages payment equal to the basic salary and benefits for the notice period, plus additional payments generally equal to the annual bonus potential for that year, and in respect of the loss of rights under share incentive schemes.



## report on directors' remuneration

These terms are reflected in the contracts of Peter Erskine and David Finch.

The Chairman entered into a service agreement with BT on 18 June 2001. This was replaced by a similar service agreement with mmO<sub>2</sub>. The service agreement is for an initial period ending on 18 June 2003. At the end of the initial period Mr Varney's time commitment will be reduced to an average of between two and three days per week. At this time the annual salary payable to Mr Varney will be reduced to such a sum as the remuneration committee determines is commensurate with the revised time commitment.

### All-employee share plans

In common with all other eligible employees, executive Directors may participate in the mmO<sub>2</sub> Sharesave Plan, the mmO<sub>2</sub> Share Ownership Plan and the mmO<sub>2</sub> Profit Sharing Plan as set out on page 53.

### Former long-term incentives

#### BT legacy share awards

As stated in the Listing Particulars, a number of key employees (including the Chief Executive Officer) of mmO<sub>2</sub> were participants prior to demerger in BT share plans. It was agreed by the BT remuneration committee and endorsed by the mmO<sub>2</sub> Board that share awards under certain BT executive share plans held by mmO<sub>2</sub> employees would continue to subsist following demerger. The awards have been adjusted so that they relate solely to mmO<sub>2</sub> shares, and any performance measure has been translated into a measure of mmO<sub>2</sub> performance from demerger to the end of the performance period. Therefore, where relevant, the vesting of these share awards is dependent on the performance of BT prior to demerger, and mmO<sub>2</sub> performance thereafter. On maturity these awards will be satisfied in existing mmO<sub>2</sub> shares held by an employee trust which has already been funded by BT.

In accordance with the rules of these plans the awards were converted into awards over mmO<sub>2</sub> shares on the basis of an adjustment factor, derived from the average prices of BT Group and mmO<sub>2</sub> shares in the 20 dealing days following demerger. As such, based on average share prices of BT Group and mmO<sub>2</sub> of 267.9125 pence and 85.6875 pence respectively, the adjustment factor used was 4.1266.

No further awards will be made under these plans to mmO<sub>2</sub> employees.

Details of Peter Erskine's shares under award from these plans are set out on page 59, and a short description of each is set out below.

#### BT Deferred Bonus Plan (BT DBP)

Under the BT DBP, established in 1998, awards of BT shares were made to executives based on their performance in the preceding financial year. The awards were generally equivalent in value to 50 per cent of the annual bonus. Awards vest after three years. Awards made prior to February 2001 will be preserved until the end of the deferred period if a participant leaves employment other than for gross misconduct. Peter Erskine currently has 127,656 mmO<sub>2</sub> shares under award which will vest in 2004.

#### BT Incentive Share Plan (BT ISP)

Under this plan, established in July 2000, participants are awarded shares which will normally vest at the end of a three-year period provided a predetermined TSR target is met. Peter Erskine has 312,750 mmO<sub>2</sub> shares under award which will normally vest in 2003, subject to performance.

#### BT Executive Share Plan (BT ESP)

The BT ESP was introduced in 1994. Awards under the BT ESP normally vest at the end of five years provided a predetermined TSR target is met. Awards of shares were granted in each of the years from 1994 to 1999.

The demerger triggered the end of the performance period for the 1997 BT ESP award. BT's TSR performance relative to the other companies in the FTSE 100, was such that 32.5 per cent of the shares subject to a performance condition will vest in August 2002 subject to participants' continued employment. A portion of the shares awarded will vest in full. As such, 107,939 mmO<sub>2</sub> shares will vest to Peter Erskine in August 2002. A further 154,057 mmO<sub>2</sub> shares will normally vest in 2004, and 144,198 in 2005, subject to performance.

Based on performance to 31 March 2002, none of the awards under the BT ISP and BT ESP would vest.

#### mmO<sub>2</sub> Legacy Option Plan

Subsisting options over BT shares granted under BT executive share option plans have been replaced with options over mmO<sub>2</sub> shares, granted under the mmO<sub>2</sub> Legacy Option Plan, for those participants now employed by mmO<sub>2</sub>. The replacement options were granted on the same terms, and are exercisable between the same dates, as the options for which they were exchanged. Therefore, the terms of this exchange ensured that the total amount payable on exercise, and any gain or loss arising had the options been exercised at the time of the exchange, was the same before and after the exchange. As anticipated in the Listing Particulars, the adjustment factor of 4.1266 (as set opposite) was used to calculate the number of mmO<sub>2</sub> shares under option to be granted.

There are no performance conditions relating to the vesting of these options other than continued employment with the mmO<sub>2</sub> Group. The legacy options will be satisfied using new issue shares and, as set out in the Listing Particulars prior to demerger, options granted under this plan do not count towards the dilution limits established for mmO<sub>2</sub> share option plans.

David Varney was granted 491,272 shares under option under this plan, details of which can be found on page 59.

#### Cash-based incentives

Prior to demerger a variety of cash-based incentive plans operated in the mmO<sub>2</sub> businesses in the UK, Germany, the Netherlands and Ireland and also within O<sub>2</sub> Online. mmO<sub>2</sub> has taken steps during the year to terminate some plans early and does not intend to renew the others when they reach the end of their performance periods. Each of the incentive plans is briefly described below.

Previous O<sub>2</sub> UK executives (including the Chief Executive Officer, based on his previous role of Managing Director of O<sub>2</sub> UK)

participated in a cash-based plan under which awards over notional BT shares normally vested by reference to the performance of O<sub>2</sub> UK. Awards granted in 1999 and 2000 vested early in full as a result of the demerger, and payments were made to participants shortly after, including a payment to Peter Erskine of £186,880. Peter Erskine has no further awards under this plan.

Awards granted in respect of 2001 did not vest early as a result of the demerger, and these awards were adjusted so as to relate to notional mmO<sub>2</sub> ordinary shares; the level of vesting will continue to relate to the performance of O<sub>2</sub> UK.

Under a plan introduced by O<sub>2</sub> Germany in November 2000, eligible employees are entitled, no earlier than 2004, to a payment based on the value of the goodwill of O<sub>2</sub> Germany at that time. Payment is only made if O<sub>2</sub> Germany achieves positive EBITDA in the financial year prior to payment.

Under a plan operated by O<sub>2</sub> Netherlands, key employees and management are entitled to payments determined by reference to O<sub>2</sub> Netherlands' achievement of business targets.

Under a plan operated by O<sub>2</sub> Ireland, key employees and management are entitled to cash payments in 2002 and 2003 by reference to the performance of O<sub>2</sub> Ireland up to the date of payment. A substantial part of the plan (also cash-based), related to the growth in value of O<sub>2</sub> Ireland, has been replaced with grants and awards under the mmO<sub>2</sub> Executive Share Portfolio.

A plan operated for O<sub>2</sub> Online's management team was terminated in July 2001 by reference to O<sub>2</sub> Online's achievement of pre-set performance conditions up to that date. The crystallised cash amounts will be paid to participants in instalments between 30 November 2001 and 31 March 2003, subject to their continued employment up to the relevant date.

### Pensions

There are pension arrangements in place in the main jurisdictions in which the mmO<sub>2</sub> Group operates. Schemes vary in accordance with local market practices in each jurisdiction, and as such there are several arrangements in place for executive Directors and executive committee members, including 401k plans and final salary schemes.

Each of the executive Directors is entitled to final salary related pension benefits up to the statutory earnings cap. In addition, they are entitled to supplementary pension benefits in respect of earnings above the statutory earnings cap (comprising unfunded final salary related benefits in the case of Peter Erskine and funded defined contribution benefits in the case of David Finch). Peter Erskine's pension arrangements provide for a total pension of two-thirds of final salary at age 60, inclusive of any retained benefits from his previous employment, and a widow's pension of two-thirds of his pension. David Finch's pension arrangements provide for an annual accrual of 1/30 of the earnings cap subject to any restriction due to retained benefits. In addition, he is entitled to a supplementary defined contribution benefit, the level of which is determined on an annual basis. For the year to 31 March 2002 this was equal to 30 per cent of base salary; 18.5 per cent paid to a Funded Unapproved Retirement Benefit Scheme (FURBS), and 11.5 per cent

paid as a cash supplement. David Varney has no contractual entitlement to participation in pension arrangements.

The pension arrangements provide for life cover of four times salary. This is arranged separately for David Varney.

The committee will consider the policy for executive pension provision in light of the launch of the new mmO<sub>2</sub> pension scheme on 1 July 2002.

Details of pension arrangements within mmO<sub>2</sub> are set out in note 7 to the financial statements.

### Other benefits

The main benefit provisions in the contracts of executive Directors are 25 days holiday per annum, rising to 30 after five years' service; a company car or cash equivalent; healthcare for family; dental care for the executive and spouse; and personal tax and financial planning costs reimbursed to a maximum of £5,000 per annum.

### Policy on outside appointments

It is the Company's policy to support the undertaking of external directorships or similar roles by executive Directors and senior managers where it is beneficial for both the individual concerned and the Company. Appointments relating to executive Directors and executive committee members require the prior approval of the Board. Appointments relating to other senior managers require the prior approval of the Chairman.

### Non-executive Directors' letters of appointment

The fees of non-executive Directors are determined by the Chairman and Chief Executive Officer who have access to independent advice.

Each non-executive Director has entered into a letter of appointment with mmO<sub>2</sub>, which covers, amongst other items, their terms of appointment and a general statement of their role and duties. The appointment is for an initial term of three years from demerger (or until 20 December 2004 in the case of Ian Meakins), but may be renewed on expiry of that initial term. Each of the non-executive Directors (other than Andrew Sukawaty) is entitled to a fee of £30,000 per annum (plus an additional fee of £3,000 per annum for membership of each Board committee in excess of one committee). Mr Sukawaty is entitled to a fee of £100,000 per annum as non-executive Deputy Chairman of the Company and was paid £17,648 for advice given in the period from his appointment on 27 June 2001 to 31 August 2001, at which time he was appointed Deputy Chairman. The non-executive Directors will not participate in any of mmO<sub>2</sub>'s share or cash-based incentive arrangements.

## report on directors' remuneration

Directors' remuneration (excluding pension arrangements) was as follows:

	Salary and fees		Annual and special bonuses		Benefits excluding pensions <sup>10</sup>		Total 2001
	2002	2001	2002	2001	2002	2001	
	£	£	£	£	£	£	£
David Varney	393,056 <sup>1</sup>	–	150,000 <sup>7</sup>	–	24,537	–	567,593
Peter Erskine <sup>11</sup>	449,464	390,000	250,000 <sup>8</sup>	306,000 <sup>9</sup>	31,350	25,000	730,814
David Finch	235,215 <sup>2</sup>	–	145,000	–	13,388	–	393,603
Andrew Sukawaty	76,256 <sup>3</sup>	–	–	–	–	–	76,256
Stephen Hodge	18,000 <sup>4</sup>	–	–	–	–	–	18,000
Neelie Kroes	21,099 <sup>5</sup>	–	–	–	–	–	21,099
Ian Meakins	10,184 <sup>6</sup>	–	–	–	–	–	10,184
Paul Myners	21,099 <sup>5</sup>	–	–	–	–	–	21,099

<sup>1</sup>From date of initial appointment 18 June 2001. Appointed to the Board 31 August 2001.

<sup>2</sup>From date of initial appointment 1 August 2001. Initially appointed to the Board 31 August 2001.

<sup>3</sup>Includes a payment of £17,648 in respect of consultancy services provided to mmO<sub>2</sub> for the period 27 June 2001 to 31 August 2001. Initially appointed as Deputy Chairman 31 August 2001.

<sup>4</sup>Initially appointed 1 October 2001.

<sup>5</sup>Initially appointed 31 August 2001.

<sup>6</sup>Appointed 20 December 2001.

<sup>7</sup>£150,000 paid by BT Group in respect of David Varney's contribution to the successful demerger.

<sup>8</sup>In addition, Peter Erskine received a payment of £186,880 resulting from the BT Cellnet Long-Term Incentive Plan which vested on demerger, and £28,669 in BT shares in respect of the vesting of the 1998 BT Deferred Bonus Plan.

<sup>9</sup>Includes £131,000 in BT shares awarded in respect of the BT Deferred Bonus Plan. These shares vest in the summer of 2004 subject to continued employment with mmO<sub>2</sub>.

<sup>10</sup>Benefits include car provision or cash allowance, healthcare, financial planning, home security, dental care and life cover.

<sup>11</sup>Highest paid Director. Appointed to the Board 31 August 2001. Figures for 2002 relate to the period 1 April 2001 to 31 March 2002.

From the period 1 April 2001 to 31 August 2001, Jeffrey Fisher and Stephen Prior were also Directors of the Company but received no emoluments.

From the period 16 November 2001 to 19 November 2001, Sir Christopher Bland, Sir Peter Bonfield and Philip Hampton acted as interim Directors of the Company but received no emoluments.

### Pension provisions

Directors' contributions	Increase in accrued pension during year		Total accrued pension at 31 March 2002 <sup>1</sup>	Transfer value of increase in accrued benefit <sup>3,4</sup>		Transfer value of accrued benefit <sup>4</sup>	
	£	2002 £000	2001 £000	2002 £000	2001 £000	At 31 March 2002 £000	At 1 April 2001 £000
Peter Erskine	14,310	32	25	146	403	276	1,899
David Finch	–	2	–	2 <sup>2</sup>	20	–	20

<sup>1</sup>The accrued annual pension represents the maximum defined benefit liability for mmO<sub>2</sub>. The amounts will be reduced by any retained benefits from previous employment.

<sup>2</sup>Part year figure. For the year ended 31 March 2002 in respect of David Finch, £43,167 was paid to a Funded Unapproved Retirement Benefit Scheme (FURBS) and £26,833 was paid as a cash supplement.

<sup>3</sup>The transfer values have been calculated on the basis of actuarial advice and exclude Directors' contributions. The transfer values of the Inland Revenue approved benefits have been calculated in accordance with Actuarial Guidance Note GN11 using the assumptions adopted by the BT Pension Scheme Actuary. The unapproved element of pension benefits have been valued using assumptions appropriate to the FRS17 accounting standard, which are consistent with GN11 principles.

<sup>4</sup>These figures represent liabilities of the Company, not sums paid or due to the individual.

### Beneficial interests

The beneficial interests of the Directors and their immediate families in mmO<sub>2</sub> ordinary shares of 0.1p each as at 31 March 2002 are set out in the table below. Figures include share options to subscribe for ordinary shares and ordinary shares awarded under the Portfolio and BT Legacy Share Awards.

	As at 31 March 2002	mmO <sub>2</sub> ordinary shares	Options over mmO <sub>2</sub> shares	mmO <sub>2</sub> sharesave options	mmO <sub>2</sub> shares under award
		As at demerger (or date of appointment if later) <sup>1</sup>			
David Varney	274,019 <sup>2,5</sup>	113,000	2,215,409	12,978	–
Peter Erskine	405,444 <sup>5</sup>	71,968	1,724,137	12,978	1,570,613 <sup>3</sup>
David Finch	304,211 <sup>5</sup>	–	1,206,896	12,978	604,606 <sup>4</sup>
Andrew Sukawaty	–	–	–	–	–
Stephen Hodge	60,000	–	–	–	–
Neelie Kroes	–	–	–	–	–
Ian Meakins	–	–	–	–	–
Paul Myners	200,000	1,040	–	–	–

<sup>1</sup>Directors' dates of appointment are set out in the table of Directors' remuneration.

<sup>2</sup>Includes 100 mmO<sub>2</sub> American Depositary Shares (ADSs) (1 ADS = 10 ordinary shares).

<sup>3</sup>Includes 575,815 shares awarded under the mmO<sub>2</sub> Restricted Share Plan. Vesting is subject to the satisfaction of a personal shareholding requirement as set out on page 55. 994,798 relate to BT Legacy Share Awards as set out overleaf.

<sup>4</sup>Shares awarded under the mmO<sub>2</sub> Restricted Share Plan. Vesting is subject to the satisfaction of a personal shareholding requirement as set out on page 55.

<sup>5</sup>Includes shares held by the trustee in respect of the mmO<sub>2</sub> Share Ownership Plan.

### Executive share options

The table below shows the options granted under the share option element of the Portfolio held by Directors during the year. Vesting is subject to the satisfaction of corporate performance criteria as detailed on pages 54 and 55.

	Grant date	Number of shares under option <sup>1</sup>	Exercise price	Date exercisable
David Varney	23 November 2001	<b>1,724,137</b>	87p	23 November 2004 – 23 November 2011
Peter Erskine	23 November 2001	<b>1,724,137</b>	87p	23 November 2004 – 23 November 2011
David Finch	23 November 2001	<b>1,206,896</b>	87p	23 November 2004 – 23 November 2011

<sup>1</sup>As at date of grant and as at 31 March 2002.

No share options granted to Directors lapsed or were exercised during the year.

Unrealised gains on executive share options were nil as at 31 March 2002.

Prior to demerger David Varney held options over BT shares. These were re-granted over mmO<sub>2</sub> shares as follows:

Original grant date	Number of mmO <sub>2</sub> shares under option <sup>1</sup>	mmO <sub>2</sub> exercise price	Date exercisable
22 June 2001	<b>491,272</b>	101.7p	2004-2011

<sup>1</sup>As at 31 March 2002. The options were re-granted on 20 December 2001.

The closing market price of mmO<sub>2</sub> shares at 28 March 2002 was 68.25p and the range from date of demerger to that date was 60p to 93p.

### Sharesave options

The table below shows the sharesave options over mmO<sub>2</sub> ordinary shares held by Directors during the year:

	Grant date	Number of shares under option <sup>1</sup>	Exercise price
David Varney	21 December 2001	<b>12,978</b>	73.2p
Peter Erskine	21 December 2001	<b>12,978</b>	73.2p
David Finch	21 December 2001	<b>12,978</b>	73.2p

<sup>1</sup>mmO<sub>2</sub> shares under option, usually exercisable from 14 February 2005 and usually lapsing on 14 August 2005.

In addition, Peter Erskine has the following mmO<sub>2</sub> shares under award from BT Legacy Share Awards, a description of which can be found on page 56. Following demerger, these awards were adjusted to relate solely to mmO<sub>2</sub> shares, and any performance measure has been translated into a measure of mmO<sub>2</sub> performance from demerger to the end of the performance period.

	Year of award	Number of mmO <sub>2</sub> shares <sup>1</sup>	Vesting	Value at 31 March 2002 <sup>3</sup>	
				Minimum	Maximum
BT Executive Share Plan	1997	<b>256,137</b>	2002 <sup>2</sup>		
	1998	<b>154,057</b>	2004	–	<b>£105,143</b>
	1999	<b>144,198</b>	2005	–	<b>£98,415</b>
<b>Total</b>		<b>554,392</b>			
BT Incentive Share Plan	2000	<b>312,750</b>	2003	<b>£53,363</b>	<b>£213,452</b>
<b>Total</b>		<b>312,750</b>			
BT Deferred Bonus Plan <sup>4</sup>	2001	<b>127,656</b>	2004		
<b>Total</b>		<b>127,656</b>			

<sup>1</sup>As at demerger and 31 March 2002.

<sup>2</sup>The demerger triggered the end of the performance period for the 1997 BT ESP award. As such, 107,939 mmO<sub>2</sub> shares will be transferred to Peter Erskine in August 2002.

<sup>3</sup>Based on the market value of the Company's shares at 31 March 2002. The minimum figure represents those shares which would transfer to the Director under the ESP or ISP at the end of the five- or three-year performance period respectively, providing the minimum performance criteria have been satisfied. The maximum figure represents those shares which would transfer to the Director under the ESP or ISP at the end of the five- or three-year performance period respectively, providing the performance criteria have been satisfied in full.

<sup>4</sup>Vesting of shares awarded under the BT Deferred Bonus Plan is subject only to the continued employment of the Director with the Company.

## report on directors' remuneration

### Non-beneficial interests

At 31 March 2002, Peter Erskine had a non-beneficial interest in 6,455,291 mmO<sub>2</sub> ordinary shares held in trust by Ilford Trustees (Jersey) Limited as trustee of the BT Deferred Bonus Plan, BT Incentive Share Plan, BT Retention Share Plan and BT Executive Share Plan.

At 31 March 2002, Peter Erskine and David Finch had a non-beneficial interest in 4,838,772 mmO<sub>2</sub> ordinary shares and 86,564 mmO<sub>2</sub> American Depositary Shares held in trust by Computershare Trustees (C.I.) Limited as trustee of the mmO<sub>2</sub> Restricted Share Plan.

Since 31 March 2002 David Varney, Peter Erskine and David Finch have each acquired 469 additional ordinary shares under the terms of the mmO<sub>2</sub> Share Ownership Plan. There have been no other changes in the Directors' beneficial and non-beneficial interests in the share capital, including options to subscribe for shares, or in the debentures of the Company and its subsidiaries between 31 March 2002 and 28 May 2002.

### Executive committee

The aggregate remuneration of members of the executive committee, other than executive Directors, for services in all capacities during the 2002 financial year was £6.3 million. In addition, loans outstanding to senior officers of the Company as at 31 March 2002 were £150,000.

The members of the executive committee beneficially own less than 1 per cent of the Company's outstanding ordinary shares.

By Order of the Board

ANDREW SUKAWATY DEPUTY CHAIRMAN AND CHAIRMAN OF THE REMUNERATION COMMITTEE

## statement of directors' responsibility

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period.

In preparing these financial statements the Directors are required to:

- >> select suitable accounting policies and then apply them consistently;
- >> make judgements and estimates that are reasonable and prudent;
- >> state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors confirm that they have complied with the above requirements in preparing the financial statements. The financial statements have complied with UK disclosure requirements in this report in order to present a consistent picture to all shareholders.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Group website. The Directors understand that uncertainty regarding legal requirements is compounded as information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements.

By Order of the Board

PHILIP BRAMWELL COMPANY SECRETARY AND GENERAL COUNSEL

## report of the auditors

### Independent auditors' report to the members of mmO<sub>2</sub> plc

We have audited the financial statements on pages 62 to 88, and additional disclosures on pages 58 to 60, relating to the remuneration of the Directors of mmO<sub>2</sub> plc which have been prepared under the historical cost convention, and the accounting policies set out on pages 65 to 68.

### Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities above.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the corporate governance statement on pages 50 to 52 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the

Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

### Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 March 2002 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PRICEWATERHOUSECOOPERS

CHARTERED ACCOUNTANTS AND REGISTERED AUDITORS

## group profit and loss account

Year ended 31 March 2002

	Note	2002 £m	2001 £m	2000 £m
<b>Turnover: group and share of joint ventures and associates</b>	2	<b>4,407</b>	3,712	2,982
Group's share of joint ventures' turnover		–	(337)	(146)
Group's share of associates' turnover		<b>(131)</b>	(175)	(218)
<b>Group turnover</b>	2	<b>4,276</b>	3,200	2,618
<b>Net operating expenses (including exceptional items)</b>	3	<b>(5,132)</b>	(6,364)	(2,598)
<b>EBITDA<sup>1</sup> before exceptional items</b>		<b>433</b>	317	385
Depreciation before exceptional items		<b>(747)</b>	(362)	(250)
Amortisation		<b>(392)</b>	(298)	(68)
Operating (loss)/profit before exceptional items		<b>(706)</b>	(343)	67
Exceptional items	4	<b>(150)</b>	(2,821)	(47)
<b>Group operating (loss)/profit</b>	3,4	<b>(856)</b>	(3,164)	20
Group's share of operating loss of joint ventures		–	(303)	(281)
Group's share of operating profit of associates		<b>8</b>	17	11
<b>Total operating loss</b>		<b>(848)</b>	(3,450)	(250)
Net interest payable and similar charges	8	<b>(25)</b>	(9)	(8)
<b>Loss on ordinary activities before taxation</b>		<b>(873)</b>	(3,459)	(258)
Tax on loss on ordinary activities	9	<b>23</b>	(70)	9
<b>Loss on ordinary activities after taxation</b>		<b>(850)</b>	(3,529)	(249)
Minority interests		–	(4)	(1)
<b>Retained loss for the financial year</b>	22	<b>(850)</b>	(3,533)	(250)
Basic and diluted loss per share (pence)	10	<b>(9.8)</b>	(40.7)	(2.9)

In all three years all profits and losses arise from continuing operations.

<sup>1</sup>EBITDA is our earnings before interest, tax, depreciation, amortisation and exceptional items, excluding our share of operating profits and losses of our associates and joint ventures. EBITDA is not a measure of financial performance under UK or US GAAP and may not be comparable to similarly titled measures of other companies, because EBITDA is not uniformly defined. EBITDA should not be considered by investors as an alternative to Group operating (loss)/profit or loss on ordinary activities before taxation as an indication of operating performance, or as an alternative to cash flow from operating activities as an indication of cash flows.

## group statement of total recognised gains and losses

Year ended 31 March 2002

	Note	2002 £m	2001 £m	2000 £m
<b>Loss for the financial year</b>		<b>(850)</b>	(3,533)	(250)
<b>Currency translation differences arising on foreign currency net investment in:</b>				
Subsidiaries	22	<b>161</b>	(21)	–
Joint ventures		–	10	(1)
<b>Total recognised losses relating to the year</b>		<b>(689)</b>	(3,544)	(251)

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

# group balance sheet

As at 31 March 2002

	Note	2002 £m	2001 £m
<b>Fixed assets</b>			
Intangible assets	11	<b>15,992</b>	15,624
Tangible assets	12	<b>4,094</b>	3,727
Investments	13	<b>37</b>	33
		<b>20,123</b>	19,384
<b>Current assets</b>			
Stocks		<b>68</b>	157
Debtors	14	<b>1,090</b>	959
Investments	15	<b>859</b>	280
Cash at bank and in hand		<b>20</b>	389
		<b>2,037</b>	1,785
<b>Creditors:</b> amounts falling due within one year	16	<b>(1,521)</b>	(1,504)
<b>Net current assets</b>		<b>516</b>	281
<b>Total assets less current liabilities</b>		<b>20,639</b>	19,665
<b>Creditors:</b> amounts falling due after more than one year	17	<b>(1,403)</b>	(399)
<b>Provisions for liabilities and charges</b>	20	<b>(402)</b>	(206)
<b>Net assets</b>		<b>18,834</b>	19,060
<b>Capital and reserves</b>			
Called up share capital	21	<b>9</b>	–
Other reserves	22	<b>22,656</b>	–
Profit and loss account	22	<b>(3,831)</b>	–
Owners' net investment	22	<b>–</b>	19,068
Equity shareholders' funds		<b>18,834</b>	19,068
Equity minority interests		<b>–</b>	(8)
		<b>18,834</b>	19,060

The Company balance sheet is shown in note 29.

These financial statements were approved by the Board of Directors on 28 May 2002 and were signed on its behalf by:

P ERSKINE CHIEF EXECUTIVE OFFICER

D FINCH CHIEF FINANCIAL OFFICER

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



## reconciliation of operating profit to operating cash flows

Year ended 31 March 2002

	2002 £m	2001 £m	2000 £m
Group operating (loss)/profit	<b>(856)</b>	(3,164)	20
Depreciation and amortisation charges	<b>1,139</b>	3,481	356
Loss on disposal of fixed assets	<b>9</b>	4	1
Decrease/(increase) in stocks	<b>89</b>	(31)	(32)
(Increase)/decrease in debtors	<b>(38)</b>	151	(232)
Increase/(decrease) in creditors	<b>24</b>	(130)	255
Increase in provisions	<b>90</b>	7	1
<b>Net cash inflow from operating activities</b>	<b>457</b>	318	369

## consolidated cash flow statement

Year ended 31 March 2002

	Note	2002 £m	2001 £m	2000 £m
<b>Net cash inflow from operating activities</b>		<b>457</b>	318	369
Returns on investments and servicing of finance	23	<b>(9)</b>	(11)	(6)
Taxation	23	<b>(4)</b>	21	(30)
Capital expenditure and financial investment	23	<b>(1,231)</b>	(5,234)	(538)
Acquisitions and disposals	23	<b>(864)</b>	(12,574)	(3,489)
<b>Cash outflow before management of liquid resources and financing</b>		<b>(1,651)</b>	(17,480)	(3,694)
Management of liquid resources	23	<b>(459)</b>	–	–
Financing	23	<b>1,790</b>	17,593	3,862
<b>(Decrease)/increase in cash in the year</b>	24	<b>(320)</b>	113	168

## group net debt

As at 31 March 2002

	Note	2002 £m	2001 £m
Cash at bank and in hand		<b>20</b>	389
Current asset investments	15	<b>859</b>	280
Bank overdrafts		–	(49)
		<b>879</b>	620
Euro medium-term notes (net of issue costs)	17	<b>(982)</b>	–
Loan notes	16	<b>(58)</b>	(132)
Obligations under hire purchase contracts	18	<b>(406)</b>	(282)
Other loans and borrowings		<b>(50)</b>	–
<b>Net (debt)/funds</b>		<b>(617)</b>	206

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

# notes to the financial statements

## 1. Accounting policies

### Accounting conventions

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards in the United Kingdom ("UK GAAP"). A summary of the more important group accounting policies is set out below, together with an explanation of the basis of preparation used in order to present a true and fair view. These differ in certain significant respects from accounting standards in the United States of America and a reconciliation to generally accepted accounting principles in the United States of America ("US GAAP") is included in the "Supplementary information for United States investors".

The Group has adopted FRS 18 "Accounting Policies" and FRS 19 "Deferred Tax" in these financial statements but this did not give rise to any adjustments. The Group has also applied the transitional disclosure arrangements set out in FRS 17 "Retirement Benefits" which are given in note 7.

All subsidiary undertakings' financial years are coterminous with those of mmO<sub>2</sub> plc. O<sub>2</sub> Germany has been accounted for as a subsidiary from February 2001. Prior to this date O<sub>2</sub> Germany had an accounting reference date of 31 December. It has not been practicable for O<sub>2</sub> Germany to prepare audited carve-out financial statements for the year ended 31 March 2000. Accordingly, the results presented for the year ended 31 March 2000 include the Group's share of O<sub>2</sub> Germany's turnover, net losses and net liabilities for year ended on the preceding 31 December. Consequently, the results presented for the year ended 31 March 2001 include the Group's share of O<sub>2</sub> Germany's turnover, net losses and net liabilities for the period from 1 January 2000 to 19 February 2001, together with consolidated financial results for the period from 20 February 2001 to 31 March 2001.

### Basis of preparation

#### Merger accounting

mmO<sub>2</sub> plc was incorporated on 30 March 2001 as Newgate Wireless Limited. On 12 September 2001 it changed its name to mmO<sub>2</sub> plc. On 19 November 2001, its ordinary shares were listed on the London Stock Exchange and the New York Stock Exchange. This was the culmination of a group reorganisation undertaken by British Telecommunications plc ("BT") to demerge its wireless business.

The financial statements have been prepared as if the mmO<sub>2</sub> Group had been demerged from BT prior to 1 April 1999. This presents information which more accurately reflects the ongoing operations of the Group. Accordingly the demerger and related transactions have been accounted for using merger accounting principles as applicable to group reorganisations.

The financial statements have been prepared using accounting policies which differ in certain respects to those used in the preparation of the financial information contained within the Listing Particulars of mmO<sub>2</sub> plc dated 18 September 2001. In the Listing Particulars, a portion of BT's short- and long-term loans and other borrowings were allocated to the mmO<sub>2</sub> Group. The basis of preparation adopted for these financial statements shows the results and financial position of the Group with no allocations of loans and other borrowings from BT. Loans and other borrowings previously allocated to the Group for the purpose of the Listing Particulars of £16,140 million and the related interest payable, net of taxation, of £476 million, have not been allocated to the Group for the purpose of these financial statements. This is consistent with the debt structure of the Group following the completion of its demerger from BT and reflects the fact that these notional loans and other borrowings were not passed down to the Group on demerger. The impact of this difference in presentation on the balance sheet at 31 March 2001 is to increase equity shareholders' funds from £2,452 million to £19,068 million. The actual interest charge for the Group contained in the financial statements reflects the interest on the Group's actual borrowings in the year. In addition, certain amounts in the prior year financial statements have been reclassified to conform to current year presentation.

The financial statements include the results of mmO<sub>2</sub> plc and its subsidiaries. All intercompany accounts and transactions have been eliminated.

### Acquisitions

Acquisitions completed in the periods reported in these financial statements are accounted for using the acquisition method of accounting. Therefore, the results and the cashflows relating to acquired businesses are included from the date of acquisition and not on a pro-forma basis.

### Company

The Company balance sheet of mmO<sub>2</sub> plc is presented as at 31 March 2002 only, as this is the first period of account of the Company. Section 227 of the Companies Act 1985 requires that the mmO<sub>2</sub> Group profit and loss account for the period from incorporation on 30 March 2001 to 31 March 2002 is presented. This period includes two extra days compared to the profit and loss account for the year ended 31 March 2002. However, the statutory group profit and loss account and supporting notes for the period from incorporation on 30 March 2001 to 31 March 2002 are not presented as the Directors believe that they would not provide any additional meaningful information to the shareholders.

# notes to the financial statements

## 1. Accounting policies continued

### Turnover

Group turnover, which excludes value added tax and other sales taxes, comprises the value of services provided and equipment sales.

Mobile service turnover is recognised in the profit and loss account based on minutes of airtime processed over the Group's networks. Turnover from connection charges is deferred and recognised over the estimated customer relationship period. Turnover from subscription fees is recognised evenly throughout the periods to which they relate. Turnover from the sale of handsets is recognised at the point of sale. Prepaid call card sales are deferred until the customer uses the stored value in the card to pay for relevant calls.

### Subscriber acquisition costs

Subscriber acquisition costs, which include the commission costs associated with acquiring new subscribers and other incremental costs of customer acquisition, are charged to the profit and loss account as incurred.

### Research and development

Expenditure on research and development is written off in the year in which it is incurred.

### Advertising

Advertising costs are included in operating expenses. Such costs are expensed as incurred.

### Foreign currencies

Transactions denominated in foreign currencies are translated at the exchange rates ruling at the dates of the transactions, adjusted for the effects of any hedging arrangements. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated at the rates ruling at that date.

The balance sheets of foreign subsidiaries are translated into sterling at the closing rates of exchange and the differences arising from the translation of the opening net investment in subsidiaries at the closing rate are taken direct to reserves and are reported in the statement of total recognised gains and losses. The profit and loss and cash flows for the year of foreign subsidiaries are translated at the average rates of exchange for the year.

All other exchange gains or losses are dealt with in the profit and loss account.

### Goodwill

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired.

For all acquisitions arising on or after 1 April 1998, the goodwill arising is capitalised as an intangible asset. The goodwill is amortised on a straight-line basis from the time of acquisition over a period estimated by the Directors to be its useful economic life. The economic life is normally between 10 and 20 years, subject to review if and when an event or change occurs which affects the asset life.

For acquisitions made before the adoption of FRS 10 "Goodwill and Intangible Assets", on 1 April 1998, the goodwill was written off directly to reserves. The goodwill written off directly to reserves will be charged to the profit and loss account on the subsequent disposal of the business to which it relates.

### Other intangible fixed assets

Licence fees paid to governments, which permit telecommunication activities to be operated for defined periods, are capitalised at cost and are amortised from the later of the start of the licence period or launch of service to the end of the licence period on a straight-line basis, which is normally 20 years. Other licences are amortised over the period of the licence on a straight-line basis.

### Tangible fixed assets

Tangible fixed assets are stated at historical cost less depreciation. The cost of tangible fixed assets include directly attributable incremental costs incurred in their acquisition and installation.

Depreciation is provided on tangible fixed assets from the date they are brought into use, in equal instalments over their estimated useful lives, taking into account any residual values. The lives assigned to tangible fixed assets are:

Freehold buildings	40 years
Leasehold land and buildings	Unexpired portion of lease or 40 years, whichever is the shorter
Network assets	5 to 15 years
Plant and machinery	2 to 5 years
Computers, software and office equipment	2 to 6 years
Motor vehicles	5 years

No depreciation is provided on freehold land or assets in course of construction.

## 1. Accounting policies continued

### Fixed asset investments

Investments in associates and joint ventures are included in the consolidated financial statements using the equity method of accounting. The profit and loss account includes the Group's share of profits or losses of associates and joint ventures.

Other investments held as fixed assets comprise equity shareholdings and other interests and are stated at cost less provisions for impairment.

### Own shares

The Group partially hedges its future obligations under certain share awards by holding its own shares in the mmO<sub>2</sub> Employee Share Trust. The cost of shares expected to be awarded under each plan is amortised evenly over the period from the original date of grant of the particular award to the time of vesting.

Own shares are held at cost less amortisation charged to date.

### Asset impairment

Intangible and tangible fixed assets are tested for impairment when an event that might affect asset values has occurred or at the end of the first full year following acquisition. Such events or changes in circumstances may include continuing operating losses, technological obsolescence or significant adverse changes in the business or the market. An impairment loss is recognised to the extent that the carrying amount cannot be recovered either by selling the asset or by the discounted future earnings from operating the asset.

### Stocks

Stocks consist mainly of handsets and are stated at the lower of cost and net realisable value (which reflects the value to the business of the handset in the hands of the subscriber) on a first-in, first-out basis, after provisions for obsolescence.

### Debtors

Debtors are stated at estimated net realisable value. Net realisable value is the invoiced amount less provisions for bad and doubtful debtors. Provisions are made specifically against debtors where there is evidence of a dispute or an inability to pay. An additional provision is made based on an analysis of balances by age, previous losses experienced and general economic conditions.

### Post retirement benefits

The Group participates in or operates a number of pension schemes as disclosed in note 7 to the financial statements.

The Group participates in a number of multi-employer pension schemes providing benefits based on final pensionable salary, where the assets of the schemes are held separately from those of the participating employers. In its capacity as a participating employer, the Group is required to pay to the pension schemes a predetermined percentage of the pensionable payroll costs of those employees who are members of the scheme. These costs are charged to the profit and loss account in the period to which they relate.

The Group is also the principal employer for certain pension schemes. For these funded and unfunded defined benefit schemes, the expected costs of providing pensions and other post retirement benefits, as calculated periodically by professionally qualified actuaries, are charged to the profit and loss account so as to spread the cost over the service lives of employees in the schemes in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll. For the funded schemes, the assets of the schemes are held separately from those of the principal employer. For the unfunded schemes, no contributions are made by either employees or the employer to a separate pension fund but a provision is recorded on the balance sheet to recognise the accrued liability of the Group to date.

The Group also supports a number of defined contribution pension schemes where the benefits are based on the level of contributions paid. Costs arising from these schemes are charged to the profit and loss account in the period to which they relate.

### Deferred taxation

Deferred tax is provided in full on all timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

### Financial instruments – Debt instruments

Debt instruments are stated at the amount of net proceeds received. Financing costs are amortised over the term of the debt to ensure a constant rate of charge.

## notes to the financial statements

### 1. Accounting policies continued

#### Criteria to qualify for hedge accounting

The Group considers its derivative financial instruments to be hedges when certain criteria are met. For foreign currency derivatives, the instrument must be related to actual foreign currency assets or liabilities or a probable commitment and whose characteristics have been identified. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. For interest rate derivatives, the instrument must be related to assets or liabilities or a probable commitment, such as a future bond issue, and must also change the interest rate or the nature of the interest rate by converting a fixed rate to a variable rate or vice versa.

#### Accounting for derivative financial instruments

Interest differentials, under interest rate swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of interest payable.

The forward exchange contracts used to change the currency mix of net debt are revalued to balance sheet rates with net unrealised gains and losses being shown as part of debtors or creditors. The difference between spot and forward rate for these contracts is recognised as part of net interest payable over the term of the contract.

The forward exchange contracts hedging transaction exposures are revalued at the prevailing forward rate on the balance sheet date with net unrealised gains and losses being shown as debtors and creditors.

#### Leases

Rentals under operating leases are charged to the profit and loss account in equal annual amounts over the periods of the leases.

Assets held under hire purchase contracts are capitalised at their fair value on the inception of the leases and depreciated over the shorter of the period of the lease and the estimated useful economic lives of the assets. The finance charges are allocated over the period of the lease in proportion to the capital amount outstanding and are charged to the profit and loss account.

#### Provisions for site restoration costs

Provision is made in full for the costs of the restoration of sites where appropriate, on a discounted basis, and the resultant asset is depreciated over the estimated average remaining lease period to which the provision relates.

## 2. Segmental analysis

The Group's operations have been divided internally into three classes of business, in line with day to day managerial and budgetary control:

- 1) the supply of mobile telecommunications services and products;
- 2) the provision of mobile internet services, and
- 3) other businesses, which comprises Airwave, a terrestrial trunked radio business, and Manx Telecom, the fixed and mobile business in the Isle of Man.

Mobile telecommunications services mainly derives its turnover from the calls made and received by its customers using mobile telephones, from subscription fees charged to its contract customers and from handset equipment sales. Mobile internet services generate revenues through advertising, provision of content and application and from e-commerce and m-commerce activities.

		Total turnover £m	Group turnover £m	Depreciation and amortisation £m	Operating profit/(loss) of associates and joint ventures £m	Total operating profit/(loss) £m
<b>Year ended 31 March 2002</b>						
Mobile telecommunications	UK	2,887	2,756	398	8	194
	Germany	875	875	235	–	(430)
	Other countries	595	595	132	–	(73)
Total mobile telecommunications		4,357	4,226	765	8	(309)
Mobile internet services	UK	100	100	25	–	(103)
Other businesses	UK	54	54	9	–	(22)
Central overheads and adjustments		–	–	340	–	(414)
Inter-segment eliminations		(104)	(104)	–	–	–
<b>Group total</b>		<b>4,407</b>	<b>4,276</b>	<b>1,139</b>	<b>8</b>	<b>(848)</b>
<b>Year ended 31 March 2001</b>						
Mobile telecommunications	UK	2,881	2,706	281	17	291
	Germany	390	65	43	(285)	(344)
	Other countries	411	399	86	(18)	(109)
Total mobile telecommunications		3,682	3,170	410	(286)	(162)
Mobile internet services	UK	15	15	5	–	(148)
Other businesses	UK	47	47	5	–	(17)
Central overheads and adjustments <sup>1</sup>		(14)	(14)	3,061	–	(3,105)
Inter-segment eliminations		(18)	(18)	–	–	(18)
<b>Group total</b>		<b>3,712</b>	<b>3,200</b>	<b>3,481</b>	<b>(286)</b>	<b>(3,450)</b>
<b>Year ended 31 March 2000</b>						
Mobile telecommunications	UK	2,800	2,582	302	11	132
	Germany	111	–	–	(217)	(217)
	Other countries	35	–	–	(64)	(64)
Total mobile telecommunications		2,946	2,582	302	(270)	(149)
Mobile internet services	UK	1	1	–	–	(25)
Other businesses	UK	49	49	4	–	11
Central overheads and adjustments		(14)	(14)	50	–	(87)
<b>Group total</b>		<b>2,982</b>	<b>2,618</b>	<b>356</b>	<b>(270)</b>	<b>(250)</b>

<sup>1</sup>Includes exceptional charge of £2,800 million in respect of impairment of goodwill related to O<sub>2</sub> Germany.

Turnover is based on the country of invoice origination, which is not materially different to turnover by destination. Other countries include the Netherlands and Ireland. Central overheads and adjustments includes goodwill arising on consolidation, other consolidation adjustments and central overheads.

## notes to the financial statements

### 2. Segmental analysis continued

		Capital expenditure <sup>1</sup> £m	Tangible fixed assets £m	Net operating assets/ (liabilities) <sup>2</sup> £m	Associates and joint ventures £m
<b>Year ended and as at 31 March 2002</b>					
Mobile telecommunications	UK	611	2,219	6,210	34
	Germany	248	1,065	6,342	–
	Other countries	180	540	888	–
<hr/>					
Total mobile telecommunications		1,039	3,824	13,440	34
Mobile internet services	UK	42	65	46	–
Other businesses	UK	95	202	161	–
Corporate assets and adjustments <sup>3</sup>		–	3	6,131	–
<hr/>					
<b>Group total</b>		<b>1,176</b>	<b>4,094</b>	<b>19,778</b>	<b>34</b>
<hr/>					
<b>Year ended and as at 31 March 2001</b>					
Mobile telecommunications	UK	720	2,012	6,317	33
	Germany	56	1,071	6,482	–
	Other countries	240	485	860	–
<hr/>					
Total mobile telecommunications		1,016	3,568	13,659	33
Mobile internet services	UK	48	44	12	–
Other businesses	UK	70	115	232	–
Corporate assets and adjustments <sup>3</sup>		–	–	5,788	–
<hr/>					
<b>Group total</b>		<b>1,134</b>	<b>3,727</b>	<b>19,691</b>	<b>33</b>
<hr/>					
<b>Year ended and as at 31 March 2000</b>					
Mobile telecommunications	UK	496	1,584	1,474	19
	Germany	–	–	–	347
	Other countries	–	136	106	27
<hr/>					
Total mobile telecommunications		496	1,720	1,580	393
Mobile internet services	UK	–	–	(11)	–
Other businesses	UK	23	50	90	–
Corporate assets and adjustments <sup>3</sup>		–	–	3,393	–
<hr/>					
<b>Group total</b>		<b>519</b>	<b>1,770</b>	<b>5,052</b>	<b>393</b>

<sup>1</sup>Capital expenditure comprises tangible fixed asset additions.

<sup>2</sup>Net operating assets comprise tangible and intangible fixed assets, stock, debtors, creditors (excluding debt) and provisions (excluding deferred tax).

<sup>3</sup>Including goodwill.

### Joint ventures

The Group's share of the turnover, operating profits/(losses) and net operating assets/(liabilities) of joint ventures included in the above geographical analysis is as follows:

		2002 £m	2001 £m	2000 £m	
Share of turnover	Germany	–	325	111	
	Other	–	12	35	
<hr/>					
<b>Total</b>		<b>–</b>	<b>337</b>	<b>146</b>	
<hr/>					
Share of operating losses	Germany	–	(285)	(217)	
	Other	–	(18)	(64)	
<hr/>					
<b>Total</b>		<b>–</b>	<b>(303)</b>	<b>(281)</b>	
<hr/>					
Share of net operating assets/(liabilities)	Germany	–	–	347	
	Other	–	–	27	
<hr/>					
<b>Total</b>		<b>–</b>	<b>–</b>	<b>374</b>	

The Group's share of turnover and operating losses of joint ventures for the year ended 31 March 2001 includes the results of the German operations for the 14 months ended 20 February 2001. For the three months ended 31 March 2000 the Group's share of O<sub>2</sub> Germany's turnover and operating loss was £61 million and £39 million, respectively.

## 2. Segmental analysis continued

<b>Group turnover</b>		<b>2002</b>	<b>2001</b>	<b>2000</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>
Mobile telecommunications				
Service turnover	UK	<b>2,426</b>	2,207	1,874
	Germany	<b>696</b>	45	–
	Other	<b>550</b>	216	–
<b>Total service turnover</b>		<b>3,672</b>	2,468	1,874
Equipment turnover				
	UK	<b>136</b>	222	314
	Germany	<b>127</b>	13	–
	Other	<b>28</b>	27	–
<b>Total equipment turnover</b>		<b>291</b>	262	314
Other turnover				
	UK	<b>194</b>	277	394
	Germany	<b>52</b>	7	–
	Other	<b>17</b>	156	–
<b>Total other turnover</b>		<b>263</b>	440	394
<b>Total mobile telecommunications turnover</b>		<b>4,226</b>	3,170	2,582
Mobile internet services	UK	<b>100</b>	15	1
Other businesses	UK	<b>54</b>	47	50
Less segmental eliminations		<b>(104)</b>	(32)	(15)
<b>Group turnover</b>		<b>4,276</b>	3,200	2,618

## 3. Net operating expenses

	<b>2002</b>	<b>2001</b>	<b>2000</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Group turnover	<b>4,276</b>	3,200	2,618
Cost of sales	<b>(2,714)</b>	(1,814)	(1,410)
Gross profit	<b>1,562</b>	1,386	1,208
Administrative expenses	<b>(2,418)</b>	(4,550)	(1,188)
Administrative expenses before exceptional items	<b>(2,268)</b>	(1,729)	(1,141)
Exceptional items	<b>(150)</b>	(2,821)	(47)
<b>Group operating (loss)/profit</b>	<b>(856)</b>	(3,164)	20

Net operating expenses comprise cost of sales and administrative expenses (including exceptional items) and total £5,132 million in 2002 (2001: £6,364 million, 2000: £2,598 million).



## notes to the financial statements

### 4. Group operating (loss)/profit

Group operating (loss)/profit is stated after charging/(crediting):	2002 £m	2001 £m	2000 £m
Depreciation of tangible fixed assets:			
Owned	677	358	247
Held under hire purchase contracts	70	4	3
Amortisation of intangible fixed assets:			
Goodwill	369	287	67
Other	23	11	1
Rentals under operating leases:			
Hire of plant and machinery	64	1	1
Other operating leases	108	14	35
Advertising costs	198	92	59
Staff costs (note 6)	570	342	189
Own work capitalised	(121)	(63)	(13)
Loss on disposal of fixed assets	9	6	1
Research and development	8	3	7
Exceptional items:			
Costs relating to demerger from BT	27	–	–
Costs relating to business closure and reorganisation	123	–	–
Closure of the O <sub>2</sub> UK analogue network	–	–	47
Goodwill impairment (note 11)	–	2,800	–
Write-off of O <sub>2</sub> Germany IT systems relating to integration	–	21	–
Auditors' remuneration			
Group audit fees – UK	0.5	0.6	0.6
Group audit fees – non-UK	0.4	0.6	0.6
Other services – UK	0.3	0.2	0.5
Other services – non-UK	0.2	–	–

Exceptional items shown above for 2002 relate to the restructuring of the UK and German operations post demerger and include £87 million in respect of redundancy costs. The exceptional items charged in 2002 gave rise to a cash outflow of £27 million in the year. The goodwill impairment charge in 2001 did not result in any cash flows.

The audit fees for the Company were £10,000.

### 5. Directors' emoluments

The emoluments of the Directors for the year ended 31 March 2002 and the benefits received under long-term incentive plans were, in summary, as follows:

	2002 £000	2001 £000	2000 £000
Salaries	1,078	390	340
Performance related bonus <sup>1</sup>	545	306	120
Awards under long-term incentive plans <sup>2</sup>	–	–	240
Other benefits	69	25	20
	1,692	721	720
Payments to non-executive Directors	147	–	–
<b>Total emoluments</b>	<b>1,839</b>	<b>721</b>	<b>720</b>

<sup>1</sup>Includes £150,000 paid by BT in respect of David Varney's contribution to the successful demerger in the year ended 31 March 2002.

<sup>2</sup>£186,880 was paid as a result of the early vesting of the BT Cellnet long-term incentive plan, as a result of the demerger.

More detailed information concerning Directors' remuneration, shareholdings, pension entitlement, share options and other long-term incentive plans is shown in the report on Directors' remuneration from pages 53 to 60.

## 6. Employees

	2002 No.	Year ended 31 March	
		2001 No.	2000 No.
Average number of full time employee equivalents (including executive Directors) by class of business:			
Mobile telecommunications	13,999	13,731	6,804
Mobile internet services	307	138	19
Other businesses	810	474	376
<b>Total employees</b>	<b>15,116</b>	<b>14,343</b>	<b>7,199</b>
Average number of full time employee equivalents (including executive Directors) by geographic area:			
UK	8,750	7,746	6,945
Germany	4,084	4,046	–
Other	2,282	2,551	254
<b>Total employees</b>	<b>15,116</b>	<b>14,343</b>	<b>7,199</b>
The costs incurred in respect of these employees were:			
	2002 £m	2001 £m	2000 £m
Wages and salaries	483	291	160
Social security costs	59	26	15
Employee share ownership scheme	2	2	3
Pension costs (note 7)	26	23	11
<b>Total staff costs</b>	<b>570</b>	<b>342</b>	<b>189</b>

At 31 March 2002, the Group employed 14,300 full time employee equivalents.

The Group operates a number of employee incentive schemes including a sharesave plan, a share ownership plan and various executive and employee option schemes. Full details are disclosed in the supplementary information for United States investors on pages 91 to 99.

## 7. Pension costs

	2002 £m	2001 £m	2000 £m
Contributions to the BT Pension Scheme	20	20	10
Other defined benefit schemes	4	2	1
Defined contribution schemes	2	1	–
	<b>26</b>	<b>23</b>	<b>11</b>

### BT Pension Scheme

The Group is a participating employer in the BT Pension Scheme (BTPS), a funded defined benefit pension scheme.

The BTPS is the principal pension scheme of BT. Prior to the demerger from BT, certain employees of the Group were eligible to participate in this scheme. The scheme is now closed to new members.

A new pension scheme will be established by the Group in the first half of the financial year ending on 31 March 2003 to replace the BTPS. Any active member of the BTPS employed by the Group who elects to transfer their past service liability to the new scheme may do so. The benefits of all deferred and pensioner members will remain in the BTPS. A share of BTPS plan assets, allocated on the basis of the past service liability of Group employees who elect to transfer their benefits, will be transferred to the new scheme. On demerger, it was stated in the Separation Agreement that BT would use its best endeavours to ensure that the full transfer amount be paid to the new scheme. At the date of signing of these financial statements, the number of employees electing to transfer their benefits and therefore the quantum and composition of the assets to be transferred to the new scheme is not known.

The expected liabilities of the new scheme at the date of transfer have been calculated assuming that all eligible employees elect to transfer using the projected unit method. The actuarial assumptions under FRS 17 "Retirement benefits" that have been used are as follows:

	At 31 March 2002 %
Nominal rate of increase in salaries	4.2
Nominal rate of increase of pensions in payment	2.7
Discount rate	6.0
Inflation assumption	2.7

## notes to the financial statements

### 7. Pension costs continued

In the UK, the Group has 6,231 employees who were active members of the BTPS as at 31 March 2002. If all eligible employees elect to transfer their past service liabilities to the new scheme, the fair value of scheme assets, as at 31 March 2002, would have been £299 million calculated under FRS 17. On these assumptions the new scheme is not expected to have either a significant surplus or a deficit.

Following the restructuring of the retail division, announced in February 2002, it is expected that approximately 1,050 of these members will have left the Group prior to the transfer and accordingly their deferred benefits will remain in the BTPS.

The last formal actuarial valuation of the BTPS was performed as at 31 December 1999. Details of this valuation and further information regarding the scheme are contained in the financial statements of BT Group plc.

#### Other defined benefit pension schemes

The Group operates funded defined benefit pension schemes in the Netherlands and in the Isle of Man. The combined cost charged in the year for both schemes was £2 million. At 31 March 2002, the Netherlands scheme had 851 members, all of whom were active, and the Isle of Man scheme had 403 members of whom 274 were active.

The market value of the assets for these schemes as at 31 March 2002 was £25 million. Liabilities determined in accordance with FRS 17 are estimated to be £27 million at the same date.

The Group operates an unfunded defined benefit pension scheme in the UK.

A provision, determined in accordance with SSAP 24 "Pension Costs", is recorded on the balance sheet to recognise the accrued liability to date for this scheme. The provision recorded at 31 March 2002 was £4.4 million (2001: £4.0 million). At 31 March 2002, the scheme had 24 members, all of whom were active.

At the start of the year, an unfunded defined benefit scheme was also operated at O<sub>2</sub> Germany. During the year a new defined contribution scheme was set up to replace the existing unfunded arrangement. The total cost incurred during the year in respect of these schemes was £2 million.

#### Defined contribution schemes

In the UK, the BT Retirement Plan (BTRP), a defined contribution scheme, was established by BT with effect from 1 April 2001 for employees and certain employees of its subsidiaries who were not eligible to join the BTPS. Following the demerger from BT, the O<sub>2</sub> Group participates in this scheme. It is expected that the Group will establish a new defined contribution scheme for employees who are currently members of the BTRP in the first half of the financial year ending on 31 March 2003. The Group operates a defined contribution scheme in Ireland. The assets of both schemes are held separately from those of the Group in an independently administered fund. There were no contributions outstanding or pre-paid at the year end.

### 8. Net interest payable and similar charges

	2002 £m	2001 £m	2000 £m
<b>Group</b>			
Interest receivable and similar income	9	74	3
Net interest receivable on sale and leaseback transaction (note 18)	2	–	–
Interest payable and similar charges:			
Bank loans and overdrafts	(6)	(2)	(1)
Amortisation of debt issue costs	(4)	–	–
Debentures	(12)	–	–
Other borrowings	(15)	(11)	(9)
Group net interest (payable)/receivable	(26)	61	(7)
<b>Share of joint ventures</b>			
Interest receivable and similar income	–	2	2
Interest payable and similar charges	–	(72)	(4)
<b>Share of associates</b>			
Interest receivable and similar income	1	–	1
Share of joint ventures and associates net interest receivable/(payable)	1	(70)	(1)
Net interest payable	(25)	(9)	(8)

## 9. Tax on loss on ordinary activities

	2002 £m	2001 £m	2000 £m
<b>Current tax</b>			
United Kingdom corporation tax at 30 per cent	(13)	21	–
Tax on Group's share of results of associates	2	7	–
Adjustments in respect of prior periods	(2)	1	–
Non-UK tax	2	–	1
<b>Total current tax (credit)/charge</b>	<b>(11)</b>	29	1
<b>Deferred tax (credit)/charge at 30 per cent</b>			
Origination and reversal of timing differences	(6)	49	(1)
Adjustments in respect of prior periods	(6)	(8)	(9)
<b>Total deferred tax (credit)/charge</b>	<b>(12)</b>	41	(10)
<b>Tax (credit)/charge on loss on ordinary activities</b>	<b>(23)</b>	70	(9)

During the year ended 31 March 2001, the Group adopted the provisions of FRS 19 (Deferred tax) which requires full provision for deferred tax in respect of all timing differences that have originated but not reversed by the balance sheet date. There is no restatement of any deferred tax on the balance sheet as a result of implementing FRS 19 since the Group had effectively provided for deferred tax in full under the former accounting standard.

In the year ended 31 March 2002, the loss on ordinary activities before taxation was £873 million (2001: £3,459 million after charging goodwill impairment of £2,800 million, 2000: £258 million).

The tax assessed for the year varied from the amount computed by applying the corporation tax rate to loss on ordinary activities before taxation. The differences were attributable to the following factors:

	2002 £m	2001 £m	2000 £m
UK corporation tax on loss at standard rate	(262)	(1,038)	(77)
Non-deductible depreciation, amortisation and impairment	124	929	23
Non-deductible non-UK losses	44	178	87
UK and non-UK tax rate differences	(3)	(1)	(4)
Capital allowances for period in excess of depreciation	(21)	(57)	(24)
Losses carried forward	33	17	15
Pre-demerger losses	74	–	–
Other timing differences and adjustments	–	1	(19)
<b>Current tax (credit)/charge for year</b>	<b>(11)</b>	29	1

### Factors that may affect future tax charges

The Group expects to continue to be able to claim capital allowances in excess of depreciation in future years. The future tax charges will also continue to be affected by the fact that relief is not available for goodwill amortisation and by the inability to offset non-UK tax losses against taxable profits in the UK and other jurisdictions.

The deferred taxation credit/(charge) was mainly the result of the tax effect of timing differences as follows:

	2002 £m	2001 £m	2000 £m
Excess capital allowances	44	61	24
Other timing differences	(50)	(12)	(25)
Adjustments in respect of prior periods <sup>1</sup>	(6)	(8)	(9)
<b>Total deferred tax (credit)/charge</b>	<b>(12)</b>	41	(10)

<sup>1</sup>Reclassification between deferred and current taxation on the loss on ordinary activities for prior years.

## 10. Loss per share

Basic and diluted loss per share has been calculated by dividing the loss for the financial year of £850 million (2001: £3,533 million, 2000: £250 million) by 8,670 million shares (2001: 8,670 million, 2000: 8,670 million), being the weighted average number of ordinary shares in issue since demerger. For 2001 and 2000 the number of ordinary shares is based on the issued share capital of BT at the date of demerger and a one for one allotment at this date.

## notes to the financial statements

### 11. Intangible assets

	Goodwill £m	Licences and other intangible assets £m	Total £m
<b>Cost</b>			
At 1 April 2001	9,052	9,766	18,818
Additions	884	21	905
Currency movements	(101)	(92)	(193)
<b>At 31 March 2002</b>	<b>9,835</b>	<b>9,695</b>	<b>19,530</b>
<b>Amortisation</b>			
At 1 April 2001	3,154	40	3,194
Change for the year	369	23	392
Currency movements	(49)	1	(48)
<b>At 31 March 2002</b>	<b>3,474</b>	<b>64</b>	<b>3,538</b>
<b>Net book value</b>			
<b>At 31 March 2002</b>	<b>6,361</b>	<b>9,631</b>	<b>15,992</b>
At 31 March 2001	5,898	9,726	15,624

The goodwill additions in the year of £884 million relate to the acquisition of the remaining 49.5 per cent interest in O<sub>2</sub> Ireland. Further details are disclosed in note 25.

A review in accordance with the principles of FRS 11 (Impairment of fixed assets and goodwill) was performed as at 31 March 2002 and 31 March 2001. The carrying values of the goodwill and other assets of the Group's subsidiary undertakings in Germany, Ireland, the Netherlands and the UK have therefore been compared with their value in use to the Group.

The value in use has been derived from discounted cash flow projections which cover the ten years from 1 April 2002. The projections cover a ten year period as management of the Group consider that the growth in these businesses will exceed the average growth rate for the countries concerned over ten years. Also, the development of the technology and assets required for such growth means ten year projections would more fairly reflect their long-term values. After the ten year period, the projections use a long-term growth rate compatible with projections for the countries concerned. The discount rate used to arrive at this calculation was 9 per cent which is the Group's estimated risk adjusted cost of capital.

In calculating the value in use there is considerable uncertainty as to the discounted future earnings used. In assessing the future value of the assets, assessments have been made using the best estimates available and reflect growth rates projected ten years into the future, long-term growth rates beyond year ten, the discount rate, the competitive landscape, take up and charge rate of data services and the timing of the available, functioning, technological infrastructure to support their roll-out. The actual outcome is uncertain and these estimates may change over time as subsequent changes in the mobile telecommunications industry, including advances in technology or changes in the performance of our business, as a result of competitive pressure or otherwise, or potential difficulty in the implementation of the UMTS network, may in the future shorten the estimated useful lives of the intangible assets or result in the further write-off of a portion of these assets.

Based on the review performed in 2002, no impairment charge has been made. The review in 2001 resulted in an exceptional charge to operating costs of £2,800 million in respect of O<sub>2</sub> Germany. This charge is included in the exceptional line item of the profit and loss account. The charge has been allocated to the goodwill arising on the acquisition of remaining 55 per cent interest in O<sub>2</sub> Germany that was purchased during the year ended 31 March 2001. The remaining goodwill of £918 million will be amortised over 20 years in accordance with the Group's accounting policies.

## 12. Tangible assets

	Land and buildings £m	Plant and equipment £m	Assets in course of construction £m	Total £m
<b>Cost</b>				
At 1 April 2001	201	4,495	455	5,151
Additions	54	520	602	1,176
Transfers	–	487	(487)	–
Disposals	(32)	(38)	–	(70)
Currency movements	(1)	(35)	(1)	(37)
<b>At 31 March 2002</b>	<b>222</b>	<b>5,429</b>	<b>569</b>	<b>6,220</b>
<b>Depreciation</b>				
At 1 April 2001	55	1,369	–	1,424
Charge for the year	25	722	–	747
Disposals	(1)	(32)	–	(33)
Currency movements	–	(12)	–	(12)
<b>At 31 March 2002</b>	<b>79</b>	<b>2,047</b>	<b>–</b>	<b>2,126</b>
<b>Net book value</b>				
<b>At 31 March 2002</b>	<b>143</b>	<b>3,382</b>	<b>569</b>	<b>4,094</b>
<b>At 31 March 2001</b>	<b>146</b>	<b>3,126</b>	<b>455</b>	<b>3,727</b>

The net book value of land and buildings comprises:

	2002 £m	2001 £m
Freehold	29	1
Long leases	16	–
Short leases	98	145
<b>Net book value</b>	<b>143</b>	<b>146</b>

The net book value of assets held under hire purchase contracts comprises:

Cost	698	510
Accumulated depreciation	(314)	(179)
<b>Net book value</b>	<b>384</b>	<b>331</b>

## 13. Fixed asset investments

Group	Interests in associates £m	Other investments other than loans £m	Own shares £m	Total £m
<b>Cost</b>				
At 1 April 2001	79	5	–	84
Additions	–	–	4	4
Profit retained for the year	6	–	–	6
<b>At 31 March 2002</b>	<b>85</b>	<b>5</b>	<b>4</b>	<b>94</b>
<b>Provisions</b>				
At 1 April 2001	51	–	–	51
Charge for the year	–	5	1	6
<b>At 31 March 2002</b>	<b>51</b>	<b>5</b>	<b>1</b>	<b>57</b>
<b>Net book value</b>				
<b>At 31 March 2002</b>	<b>34</b>	<b>–</b>	<b>3</b>	<b>37</b>
<b>At 31 March 2001</b>	<b>28</b>	<b>5</b>	<b>–</b>	<b>33</b>

## notes to the financial statements

### 13. Fixed asset investments continued

Parent company	Shares in subsidiary undertakings £m	Own shares £m
<b>Cost</b>		
On incorporation	–	–
Additions	18,498	4
<b>At 31 March 2002</b>	<b>18,498</b>	<b>4</b>
<b>Provisions</b>		
On incorporation	–	–
Charge for the year	–	1
<b>At 31 March 2002</b>	<b>–</b>	<b>1</b>
<b>Net book value</b>		
<b>At 31 March 2002</b>	<b>18,498</b>	<b>3</b>

The Directors consider that disclosing full particulars of all subsidiary undertakings would lead to a statement of excessive length. A list of principal subsidiary undertakings is given in note 28. A full list of subsidiary undertakings at 31 March 2002 will be annexed to the Company's next Annual Return.

### 14. Debtors

	Group 2002 £m	2001 £m	Parent company 2002 £m
Trade debtors	584	520	–
Amounts due from Group undertakings	–	–	705
Other debtors	166	103	10
Prepayments	237	259	–
Accrued income	103	77	–
	<b>1,090</b>	<b>959</b>	<b>715</b>

Trade debtors are stated after deducting £105 million as at 31 March 2002 (2001: £73 million) for doubtful debts. The amount charged to the Group's profit and loss account for doubtful debts for the year ended 31 March 2002 was £61 million (2001: £32 million).

DeTeMobil Deutsche Telekom MobilNet GmbH (T-Mobil) provides national roaming capacity to O<sub>2</sub> Germany in areas where O<sub>2</sub> Germany has not developed its own network. The cost of the contract is determined based on a fixed number of minutes available to O<sub>2</sub> Germany. The price is renegotiable at the point at which all minutes have been used by O<sub>2</sub> Germany. Amounts due to T-Mobil are payable in instalments over the period of the contract. Amounts already paid for minutes, which have not yet been used of £172 million (2001: £193 million), are included in prepayments at 31 March 2002. Outstanding contractual payments due to T-Mobil at 31 March 2002 are £nil (2001: £48 million).

### 15. Current asset investments

	Group 2002 £m	2001 £m	Company 2002 £m
Money market deposits	131	–	131
Money market funds	328	–	328
Other deposits	384	264	–
Certificates of tax deposit	16	16	–
	<b>859</b>	<b>280</b>	<b>459</b>

All current asset investments mature within one year, except for £384 million disclosed as other deposits (2001: £264 million) relating to the O<sub>2</sub> UK hire purchase contract which is receivable in more than one year.

## 16. Creditors: amounts falling due within one year

	Group		Parent company
	2002 £m	2001 £m	2002 £m
Bank loans and overdrafts (note 18)	–	49	<b>190</b>
Loan notes (note 18)	<b>58</b>	132	–
Obligations under hire purchase contracts (note 18)	<b>36</b>	2	–
Trade creditors	<b>384</b>	336	–
Corporation tax	<b>2</b>	21	–
Other taxation and social security	<b>52</b>	35	–
Other creditors	<b>170</b>	88	–
Accrued expenses	<b>649</b>	653	<b>12</b>
Deferred income	<b>170</b>	188	–
	<b>1,521</b>	1,504	<b>202</b>

## 17. Creditors: amounts falling due after more than one year

	Group		Parent company
	2002 £m	2001 £m	2002 £m
Debentures (note 18)	<b>982</b>	–	<b>982</b>
Obligations under hire purchase contracts (note 18)	<b>370</b>	280	–
Other creditors	<b>51</b>	119	–
	<b>1,403</b>	399	<b>982</b>

## 18. Debentures and other borrowings

	Group		Parent company
	2002 £m	2001 £m	2002 £m
<b>Analysis of loan repayments:</b>			
Within one year or on demand	<b>65</b>	49	<b>190</b>
Between one and two years	<b>7</b>	132	–
Between two and five years	<b>632</b>	–	<b>610</b>
After five years	<b>386</b>	–	<b>372</b>
	<b>1,090</b>	181	<b>1,172</b>

### Obligations under finance leases and hire purchase contracts

	Group	
	2002 £m	2001 £m
Within one year	<b>51</b>	2
Between two and five years	<b>203</b>	94
After five years	<b>335</b>	330
	<b>589</b>	426
Less: finance charges allocated to future periods	<b>(183)</b>	(144)
	<b>406</b>	282

In January 2002 mmO<sub>2</sub> plc issued two debentures in the form of a €1,000 million 6.375% fixed rate bond and a £375 million 7.625% fixed rate bond which have a five and ten year term respectively.

Loan notes of £132 million were issued by O<sub>2</sub> UK between March 1999 and April 2000 for the purchase of various businesses. At 31 March 2002 loan notes totalling £58 million were outstanding and repayable on demand.

Obligations under hire purchase contracts are mainly in respect of leases of plant and equipment. On 30 March 2001 and 9 April 2001 hire purchase financing contracts were signed between O<sub>2</sub> UK and a number of US leasing trusts. Under the contracts O<sub>2</sub> UK sold and repurchased material portions of its GSM radio and switching equipment. O<sub>2</sub> UK has deposited sufficient funds with a trust company to meet the future hire purchase obligations. The deposit account is included in current asset investments. The hire purchase agreement is for 16 years with an early buy out option after 12 years. In accordance with the Separation Agreement signed on demerger, BT continues to guarantee all future hire purchase obligations of the trust company, and has provided bank guarantees totalling £63 million to cover specific risks under this hire purchase transaction. O<sub>2</sub> UK has provided a cross indemnity to BT for this specific amount.



## notes to the financial statements

### 19. Financial instruments and risk management

Prior to the demerger of the Group from BT, the financial risks faced by the Group were identified and managed by BT Group Treasury. On demerger, the Group established a new Group Treasury department to take over this function. The Group's treasury policy, including details of the nature, terms and credit risk associated with financial instruments with off-balance sheet risk are described in the Treasury Management and Policies section of the operating and financial review and prospects on pages 38 and 39.

Short-term debtors and creditors, where permitted by FRS 13 "Derivatives and Other Financial Instruments: Disclosures", have been excluded from the following disclosures, which are after taking account of interest rate and currency swaps where applicable.

The Group holds or issues financial instruments mainly to finance its operations, for the temporary investment of short-term funds and to manage currency and interest rate risks arising from its operations. Further details on the financing of operations is contained in the Source of Liquidity and Capital Resources section in the operating and financial review and prospects.

The Group uses derivative financial instruments to manage its exposure to market risks such as changes in interest rates and foreign exchange rates. The objective is to match the profile and characteristics of Group funding (equity and debt) to that of the assets funded and to mitigate foreign exchange risk under the guidelines approved by the Board of Directors in the Treasury Policy document.

#### Fair value of financial instruments

The Group held the following financial assets and financial liabilities at 31 March 2002. The book and fair values of the assets are presented below.

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than a forced or liquidation sale and excludes accrued interest. Book values are stated before deducting any unamortised issue costs.

	31 March 2002 Book value £m	31 March 2002 Fair value £m	31 March 2001 Fair value <sup>1</sup> £m
<b>Liabilities</b>			
Short-term borrowings	–	–	(49)
Long-term borrowings	(987)	(951)	–
Hire purchase contracts	(406)	(406)	(282)
Loan notes	(58)	(58)	(132)
Other loans and borrowings	(50)	(50)	–
	<b>(1,501)</b>	<b>(1,465)</b>	<b>(463)</b>
<b>Assets</b>			
Hire purchase contracts	384	384	264
Short-term deposits	344	344	16
Money market funds	131	131	–
Cash at bank and in hand	20	20	389
	<b>879</b>	<b>879</b>	<b>669</b>
<b>Derivative financial instruments held to manage the interest rate and currency profile of the Group</b>			
Interest rate swaps	–	(9)	–
Cross-currency swaps	(2)	(13)	–
Forward foreign exchange contracts	–	1	–
	<b>(2)</b>	<b>(21)</b>	<b>–</b>

<sup>1</sup>Fair value as at 31 March 2001 is not materially different to the book value.

#### Summary of methods and assumptions

For interest rate swaps, currency swaps and forward foreign exchange contracts, the fair value is based upon market price of comparable instruments where available and if not available by the discounting of future cash flows to net present values using appropriate interest and currency rates.

For short-term deposits and borrowings and cash at bank, the fair value of the short-term deposits, money market funds and cash at bank approximate to the carrying value due to the short-term/on demand maturity of these instruments.

## 19. Financial instruments and risk management continued

For long-term borrowings the fair value of the Sterling and Euro denominated bonds have been estimated using quoted market prices.

For other borrowings the fair value of other short-term borrowings approximate to the carrying value due to the short-term/on demand maturity of these instruments.

### Hedges

Under the Group's accounting policy as detailed in "Basis of preparation and Accounting policies", gains and losses on derivative instruments used for hedging are not recognised in the financial statements. The gains and losses are as follows:

	Gains £m	Losses £m	Total net gains/(losses) £m
Gains and losses on hedges maturing within one year	1	–	1
Gains and losses on hedges maturing after more than one year	–	(20)	(20)
<b>Gains and losses on hedges outstanding as at 31 March 2002</b>	<b>1</b>	<b>(20)</b>	<b>(19)</b>

As at 31 March 2001, no derivative instruments or external debt financing had been entered into by the Group. Accordingly all gains and losses arose during the current year.

### Currency exposures

The table below shows the extent to which Group companies have monetary assets and liabilities in currencies other than their local currencies.

Functional currency of Group operation	Net foreign currency monetary assets/(liabilities)			
	Sterling £m	US dollars £m	Euro £m	Total £m
Sterling	–	3	1	4
Other currencies	1	–	–	1
<b>Total</b>	<b>1</b>	<b>3</b>	<b>1</b>	<b>5</b>

Taking into account the effect of forward instruments, the Group's identified exposure to foreign currency risk of expected future sales and expenditure is immaterial as at 31 March 2002.

### Financial instruments held for trading purposes

The Group does not trade in financial instruments.

### Financial assets

Financial assets consist of sterling and euro denominated cash at bank, short-term money market deposits and investments in a AAA-rated money market fund. Money market deposits have a maturity profile between overnight and three months and earn interest at market rates. Investments in the money market fund can be called on either a same day or next day basis and yield income/interest on the basis of performance of the underlying assets measured against one week and three month LIBOR/EURIBOR benchmarks.

	Cash at bank and in hand £m	Hire purchase related assets £m	Short-term deposits and money market funds £m	2002		2001		
				Total £m	Cash at bank and in hand £m	Hire purchase related assets £m	Short-term deposits £m	Total £m
<b>Currency:</b>								
Sterling	(17)	–	265	248	340	–	16	356
Euro	34	–	210	244	49	–	–	49
Other currencies	3	384	–	387	–	264	–	264
<b>At 31 March 2002</b>	<b>20</b>	<b>384</b>	<b>475</b>	<b>879</b>	<b>389</b>	<b>264</b>	<b>16</b>	<b>669</b>

At 31 March 2002, the Group had no fixed rate financial assets.

The effect of the Group's €200 million foreign exchange swap was to re-classify €200 million assets into £124 million, until its maturity in September 2002.

## notes to the financial statements

### 19. Financial instruments and risk management continued

#### Foreign exchange risk management

Forward foreign exchange contracts have been entered into to reduce the impact of foreign exchange movements on Group's investments. As at 31 March 2002 the Group had outstanding forward foreign exchange contracts relating to investments with a total principal of £124 million.

#### Financial liabilities

	Fixed rate financial liabilities £m	Floating rate financial liabilities £m	2002		2001	
			Total £m	Fixed rate financial liabilities £m	Floating rate financial liabilities £m	Total £m
<b>Currency:</b>						
Sterling	373	414	787	–	185	185
Euro	–	303	303	–	–	–
US Dollar	406	–	406	278	–	278
<b>Total</b>	<b>779</b>	<b>717</b>	<b>1,496</b>	<b>278</b>	<b>185</b>	<b>463</b>

The effect of the Group's interest rate swaps are to classify €500 million of Euro borrowings in the above table as floating rate. The Group also has cross-currency swaps, which effectively classify €500 million of Euro borrowings in the above table as floating rate in sterling. This impact of the cross-currency swap on the above table is to reduce the Euro borrowings and increase sterling borrowings by £309 million respectively.

#### Borrowing facilities

The Group has the following undrawn committed floating rate borrowing facilities available at 31 March 2002 in respect of which all conditions precedent had been met at that date:

	2002 Total £m
Expiring within one year	750
Expiring between one and two years	–
Expiring in more than two years	1,725
	<b>2,475</b>

The facility expiring within one year is the 364 day tranche of the Revolving Credit Facility (RCF). The facility expiring in more than two years is the five year tranche of the RCF, which matures in September 2006. Both of these facilities incur commitment fees at market rates.

#### Average interest rates on financial liabilities

After taking into account the interest rate and currency swaps used to manage the interest and currency profile of the Group, the interest rate profile of the Group's fixed rate financing liabilities as at 31 March 2002 was:

Currency	Fixed rate financial liabilities weighted average interest rate %	Fixed rate financial liabilities weighted average period for which rate is fixed (years)
Sterling – Financial liabilities	7.625	9.8
US dollar – Financial liabilities	6.68	7.3
<b>At 31 March 2002</b>	<b>7.13</b>	<b>8.5</b>

Floating rate financial liabilities bear interest at rates, based on relevant national LIBOR/EURIBOR equivalents, which are fixed in advance for periods of six months.

## 20. Provisions for liabilities and charges

	Deferred taxation £m	Restructuring £m	Other provisions £m	Total £m
At 1 April 2001	180	–	26	206
(Credited)/charged against loss for the year	(12)	81	9	78
Transfers to corporation tax creditors	22	–	–	22
Arising on demerger	96	–	–	96
<b>At 31 March 2002</b>	<b>286</b>	<b>81</b>	<b>35</b>	<b>402</b>

### Deferred taxation

The elements of deferred taxation provided for in the financial statements, are as follows:

	2002 £m	2001 £m
Accelerated capital allowances	358	218
Other	(20)	(21)
Unrelieved tax losses carried forward	(52)	(17)
<b>Total provision for deferred taxation</b>	<b>286</b>	<b>180</b>

### Restructuring

The provision for restructuring relates to the restructuring of the UK and German operations as disclosed in note 4. This provision is expected to be utilised within the next year.

### Other provisions

Other provisions as at 31 March 2002 comprise £20 million (2001: £19 million) in respect of mast site restoration costs and £9 million (2001: £7 million) in respect of pensions provisions.

## 21. Called up share capital

	Number of shares	£m
<b>Authorised</b>		
Ordinary shares of 0.1 pence each	20,050,000,000	20
Deferred shares of £1 each	40	–
	<b>20,050,000,040</b>	<b>20</b>
<b>Called up, allotted and fully paid</b>		
Ordinary shares of 0.1 pence each	8,670,049,416	9
Deferred shares of £1 each	40	–
	<b>8,670,049,456</b>	<b>9</b>

The Company was incorporated with an authorised share capital of 100 ordinary shares of £1 each and an issued share capital of 2 ordinary shares of £1 each. On 11 September 2001, each ordinary share of the Company was subdivided into 1,000 ordinary shares of 0.1 pence each. The authorised share capital of the Company was also increased to £20,050,040 by the creation of 19,999,900,000 further ordinary shares of 0.1 pence, 40 deferred shares of £1 and 1 redeemable preference share of £50,000.

On demerger, 8,670,031,916 ordinary shares of 0.1 pence each were issued to the shareholders of BT on the basis of a one-for-one allotment. Immediately following demerger, a further 15,500 ordinary shares of 0.1 pence each were allotted and issued to eligible employees.

The redeemable preference share of £50,000 was issued on 11 September 2001 and redeemed at par on 20 December 2001. It carried no right to vote and the right to receive dividends at the cumulative fixed rate of 0.04% of its nominal value per annum but not otherwise to participate in the profits of mmO<sub>2</sub> plc and its subsidiary undertakings. On redemption the authorised redeemable preference share capital was subdivided and redesignated as 50,000,000 ordinary shares of 0.1 pence each.

On 11 September 2001, the Company also issued 40 deferred shares of £1 each. The holders of the deferred shares have no right to attend or vote at any general meeting of the Company. The deferred shares do confer the right to receive a cumulative dividend of 1% of the nominal value of the deferred shares each year. On a return of capital on the winding-up of the Company, the holders are entitled to receive any accumulated unpaid dividends and, subject to all other classes of shares being repaid, the amount paid up on the deferred shares. The deferred shares are classified as non-equity.

## notes to the financial statements

### 22. Reconciliation of movements in shareholders' funds

Group	Called up share capital £m	Other reserves £m	Profit and loss account £m	Owners' net investment £m	Total equity shareholders' funds £m
At 1 April 1999	–	–	–	1,271	1,271
Retained loss for the financial year	–	–	–	(250)	(250)
Currency translation differences	–	–	–	(1)	(1)
Funding flows with BT	–	–	–	4,021	4,021
At 31 March 2000	–	–	–	5,041	5,041
Retained loss for the financial year	–	–	–	(3,533)	(3,533)
Currency translation differences	–	–	–	(11)	(11)
Funding flows with BT	–	–	–	17,571	17,571
At 31 March 2001	–	–	–	19,068	19,068
Funding flows with BT	–	–	(474)	446	(28)
Transfer on demerger	9	23,189	(3,675)	(19,514)	9
Retained loss for the period after demerger	–	–	(376)	–	(376)
Transfer from profit and loss account	–	(533)	533	–	–
Currency translation differences	–	–	161	–	161
<b>At 31 March 2002</b>	<b>9</b>	<b>22,656</b>	<b>(3,831)</b>	<b>–</b>	<b>18,834</b>

Other reserves arose on demerger. They relate to the difference between the carrying value of the Group held by BT prior to demerger (representing BT's investments and funding in the Group) and amounts settled with BT on demerger to acquire the assets and liabilities of the Group.

Aggregate goodwill as at 31 March 2001 in respect of acquisitions completed prior to 1 April 1998 of £62 million (2001: £62 million) has been written off against reserves in accordance with the accounting policy existing prior to the adoption of FRS 10 "Goodwill and intangible assets".

Company	Called up share capital £m	Other reserves £m	Profit and loss account £m	Total equity shareholders' funds £m
On incorporation	–	–	–	–
Issue of shares	9	–	–	9
Arising on demerger from BT	–	18,488	–	18,488
Retained loss for the year	–	–	(6)	(6)
<b>At 31 March 2002</b>	<b>9</b>	<b>18,488</b>	<b>(6)</b>	<b>18,491</b>

The Company has taken advantage of s.230 of the Companies Act 1985 not to present the Company's own profit and loss account. The loss attributable to shareholders of the Company for the year was £6 million.

### 23. Analysis of cash flows for heading netted in the cash flow statement

	2002 £m	2001 £m	2000 £m
<b>Returns on investments and servicing of finance</b>			
Interest received	31	2	3
Finance costs	(22)	–	–
Interest paid	(18)	(13)	(9)
	(9)	(11)	(6)
<b>Taxation</b>			
UK corporation tax (paid)/recovered	(4)	21	(30)
	(4)	21	(30)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets	(1,240)	(990)	(545)
Purchase of intangible fixed assets	(21)	(4,306)	–
Sale of tangible fixed assets	30	62	7
	(1,231)	(5,234)	(538)

### 23. Analysis of cash flows for heading netted in the cash flow statement continued

	2002 £m	2001 £m	2000 £m
<b>Acquisitions and disposals</b>			
Purchase of subsidiary undertakings (acquired net of: 2001: £96 million cash, 2000: £13 million overdraft)	(864)	(9,410)	(3,059)
Investments in joint ventures and associated undertakings	–	(3,168)	(430)
Disposal of associated undertaking	–	4	–
	<b>(864)</b>	<b>(12,574)</b>	<b>(3,489)</b>
<b>Management of liquid resources</b>			
Increase in money market deposits and funds	(459)	–	–
	<b>(459)</b>	<b>–</b>	<b>–</b>
<b>Financing</b>			
Net cash contributions from BT	847	17,738	3,872
Debentures issued	989	–	–
Other loans issued	28	–	–
Loan repayments	(74)	(145)	(10)
	<b>1,790</b>	<b>17,593</b>	<b>3,862</b>

Liquid resources comprise money market deposits and funds (note 15).

### 24. Analysis of net debt

	At 1 April 2001 £m	Cash flow prior to demerger £m	Other non-cash movements prior to demerger £m	Balances on demerger £m	Cash flows after demerger £m	Other non-cash movements after demerger £m	At 31 March 2002 £m
Cash at bank and in hand	389	(268)	–	121	(101)	–	20
Overdraft	(49)	49	–	–	–	–	–
	340	(219)	–	121	(101)	–	20
Current asset investments	280	–	110	390	459	10	859
Debt due after one year	–	–	–	–	(1,010)	(15)	(1,025)
Debt due within one year	(132)	(842)	356	(618)	561	(8)	(65)
Finance leases	(282)	(4)	(113)	(399)	–	(7)	(406)
	206	(1,065)	353	(506)	(91)	(20)	(617)

#### Reconciliation of net cash flow to movements in net debt

	2002 £m	2001 £m	2000 £m
(Decrease)/increase in cash in the period	(320)	113	168
Management of liquid resources	459	–	–
Cash (inflow)/outflow from increase in debt	(1,295)	146	10
(Increase)/decrease in net debt resulting from cash flows	(1,156)	259	178
Other non-cash movements	333	–	–
Debt assumed on acquisitions	–	(33)	(159)
(Increase)/decrease in net debt in the year	(823)	226	19
Net funds/(debt) at beginning of year	206	(20)	(39)
<b>Net (debt)/funds at end of year</b>	<b>(617)</b>	<b>206</b>	<b>(20)</b>

Other non-cash movements relate principally to the inception of new finance leases and interest accrued thereon.

### 25. Acquisitions

In February 2001, Telenor exercised a put option to sell its remaining 49.5 per cent interest in O<sub>2</sub> Ireland to the Group and this transaction was completed in April 2001, following approval by the regulator.

The total consideration for this stake was £877 million including expenses resulting in additional goodwill of £884 million. The consideration includes £17 million payable to the former Managing Director for his 2 per cent stake in the non-voting shares of O<sub>2</sub> Ireland, of which £13 million is payable after the year end.

## notes to the financial statements

### 26. Financial commitments and contingent liabilities

#### Obligations under hire purchase contracts

Future gross hire purchase payments payable by Group as at 31 March 2002 are as follows: £m

#### Payable in the year ending 31 March:

2003	51
2004	54
2005	52
2006	50
2007	47
Thereafter	335

**Total future gross hire purchase payments** **589**

Hire purchase commitments are mainly in respect of leases of plant and equipment. Full details of these leases are provided in note 18.

#### Capital commitments

	<b>2002</b>	2001
	<b>£m</b>	£m
Contracts placed for capital expenditure not provided in the accounts	<b>704</b>	475

#### Operating lease commitments

At 31 March 2002 the Group was committed to making the following payments during the next year in respect of operating leases:

	Land and buildings £m	2002 Other £m	Land and buildings £m	2001 Other £m
<b>Leases which expire:</b>				
Within one year	10	23	3	2
Between one and five years	20	7	9	9
After five years	73	34	95	2
	<b>103</b>	<b>64</b>	107	13

Future minimum operating lease payments due by the Group as at 31 March 2002 are as follows: £m

#### Payable in the year ending 31 March:

2003	167
2004	145
2005	138
2006	124
2007	108
Thereafter	757

**Total future minimum operating lease payments** **1,439**

There are no contingent liabilities or guarantees other than those detailed in note 18 to the financial statements and those arising in the ordinary course of the Group's business and on these no material losses are anticipated. The Group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations.

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

## 27. Related party disclosures

In addition to the pension costs referred to in note 7, the Group had the following transactions with related parties during the year:

	2002 £m	2001 £m
Telecommunications services (net) <sup>1</sup>	172	(4)
Building rental <sup>1</sup>	(50)	(5)
Other <sup>1</sup>	(123)	(39)
<b>Total net transactions (analysed below)</b>	<b>(1)</b>	<b>(48)</b>

<sup>1</sup>Transactions are at arm's length rates.

	2002 £m	2001 £m
<b>Turnover</b>		
BT	607	517
The Link Stores Limited	47	116
<b>Purchases</b>		
BT	(560)	(536)
The Link Stores Limited	(95)	(145)
<b>Total net transactions</b>	<b>(1)</b>	<b>(48)</b>

The Group had the following balances outstanding with BT as at 31 March 2002:

	2002 £m	2001 £m
Trade debtors	92	–
Trade creditors	(115)	–

### Joint venture loans

During the year ended 31 March 2001, the Group provided loans to its joint venture, O<sub>2</sub> Germany, totalling £2,591 million. Following the acquisition of the remaining shareholding in O<sub>2</sub> Germany in February 2001, there were no loans owed to the Group by joint ventures as at 31 March 2001 or 31 March 2002.

## 28. Principal subsidiary undertakings and associates

The principal operating subsidiary undertakings are detailed below, all of which are included in the Group financial statements.

Name	Country of incorporation and operation	Activity	Portion of ordinary shares held %
O <sub>2</sub> Limited <sup>1</sup>	England and Wales	Intermediate holding company	100
O <sub>2</sub> (UK) Limited <sup>2</sup>	England and Wales	Mobile cellular telephone system provider and operator	100
DX Communications Limited	Scotland	Telecommunications equipment retailer	100
O <sub>2</sub> Third Generation Limited <sup>3</sup>	England and Wales	UMTS licence holder	100
O <sub>2</sub> (Online) Limited <sup>4</sup>	England and Wales	Mobile internet business	100
O <sub>2</sub> Communications (Ireland) Limited <sup>5</sup>	Ireland	Mobile cellular telephone system provider and operator	100
Manx Telecom Limited	Isle of Man	Telecommunication services supplier	100
O <sub>2</sub> (Netherlands) BV <sup>6</sup>	Netherlands	Mobile cellular telephone system provider and operator	100
O <sub>2</sub> (Germany) GmbH & Co. OHG <sup>7</sup>	Germany	Mobile cellular telephone system provider and operator	100
Airwave mmO <sub>2</sub> Limited	England and Wales	Digital radio service for public safety organisations	100

<sup>1</sup>Cellnet Group Limited changed its name to BT Wireless Limited on 30 March 2001, and then to O<sub>2</sub> Limited on 3 September 2001.

<sup>2</sup>BT Cellnet Limited changed its name to O<sub>2</sub> (UK) Limited on 19 April 2002.

<sup>3</sup>BT3G Limited changed its name to O<sub>2</sub> Third Generation Limited on 19 April 2002.

<sup>4</sup>Genie Internet Limited changed its name to O<sub>2</sub> (Online) Limited on 19 April 2002.

<sup>5</sup>Esat Digifone Limited changed its name to Digifone mmO<sub>2</sub> Limited on 12 September 2001, and then to O<sub>2</sub> Communications (Ireland) Limited on 23 April 2002.

<sup>6</sup>Telfort Mobiel BV changed its name to O<sub>2</sub> (Netherlands) BV on 19 April 2002.

<sup>7</sup>Viag Interkom GmbH & Co. changed its name to O<sub>2</sub> (Germany) GmbH & Co. OHG on 19 April 2002.

The shares in O<sub>2</sub> Limited are held directly by mmO<sub>2</sub> plc. The shares of the other operating companies are held by O<sub>2</sub> Limited or its wholly owned subsidiaries. The accounting reference date of all the subsidiary undertakings is 31 March. The Group also owns a 40% stake in an associate, The Link Stores Limited, which is a telecommunications equipment retailer.



## notes to the financial statements

### 29. Parent Company Balance Sheet of mmO<sub>2</sub> plc at 31 March 2002

	Note	2002 £m
<b>Fixed assets</b>		
Investments in subsidiary undertakings	13	<b>18,498</b>
Investment in own shares	13	<b>3</b>
		<b>18,501</b>
<b>Current assets</b>		
Debtors	14	<b>715</b>
Investments	15	<b>459</b>
		<b>1,174</b>
<b>Creditors:</b> amounts falling due within one year	16	<b>(202)</b>
<b>Net current assets</b>		<b>972</b>
<b>Total assets less current liabilities</b>		<b>19,473</b>
<b>Creditors:</b> amounts falling due after more than one year	17	<b>(982)</b>
<b>Net assets</b>		<b>18,491</b>
<b>Capital and reserves</b>		
Called up share capital	21	<b>9</b>
Other reserves	22	<b>18,488</b>
Profit and loss account	22	<b>(6)</b>
<b>Shareholders' funds</b>		<b>18,491</b>

These financial statements were approved by the Board of Directors on 28 May 2002 and were signed on its behalf by:

P ERSKINE  
CHIEF EXECUTIVE OFFICER

D FINCH  
CHIEF FINANCIAL OFFICER

## non-financial metrics

	2002	2001	2000		2002	2001	2000
<b>O<sub>2</sub> UK</b>							
<b>Customer Numbers (thousands)<sup>1</sup></b>				<b>Churn<sup>3</sup></b>			
Pre-pay	7,542	7,134	3,591	Pre-pay	32%	24%	12%
Post-pay	3,542	3,455	3,813	Post-pay	31%	44%	41%
Total	11,084	10,589	7,404	Blended	32%	32%	30%
<b>ARPU (£)<sup>2</sup></b>				<b>SAC per Connection (£)<sup>4</sup></b>			
Pre-pay	108	114	112	Pre-pay	53	63	66
Post-pay	498	485	455	Post-pay	180	184	169
Blended	231	269	332	Blended	90	87	105
<b>O<sub>2</sub> Germany</b>							
<b>Customer Numbers (thousands)<sup>1</sup></b>				<b>Churn<sup>3</sup></b>			
Pre-pay	1,912	1,560	269	Pre-pay	35%	n/a <sup>5</sup>	
Post-pay	1,979	1,607	954	Post-pay	21%	16%	8%
Total	3,891	3,167	1,223	Blended	28%	n/a <sup>5</sup>	
<b>ARPU (£)<sup>2, 6</sup></b>				<b>SAC per Connection (£)<sup>4, 6</sup></b>			
Pre-pay	71	n/a <sup>5</sup>	33	Pre-pay	44	87	
Post-pay	313	358	402	Post-pay	160	220	104
Blended	195	n/a <sup>5</sup>	388	Blended	95	142	104
<b>O<sub>2</sub> Netherlands</b>							
<b>Customer Numbers (thousands)<sup>1</sup></b>				<b>Churn<sup>3</sup></b>			
Pre-pay	1,022	617	390	Pre-pay	27%	n/a <sup>5</sup>	6%
Post-pay	233	176	94	Post-pay	27%	32%	40%
Total	1,255	793	484	Blended	27%	n/a <sup>5</sup>	16%
<b>ARPU (£)<sup>2</sup></b>				<b>SAC per Connection (£)<sup>4</sup></b>			
Pre-pay	84	80		Pre-pay	55	88	
Post-pay	492	469		Post-pay	198	138	
Blended	163	151	203	Blended	75	99	96
<b>O<sub>2</sub> Ireland</b>							
<b>Customer Numbers (thousands)<sup>1</sup></b>				<b>Churn<sup>3</sup></b>			
Pre-pay	824	641	366	Pre-pay	44%	n/a <sup>5</sup>	4%
Post-pay	356	332	262	Post-pay	23%	n/a <sup>5</sup>	20%
Total	1,180	973	628	Blended	38%	n/a <sup>5</sup>	12%
<b>ARPU (£)<sup>2</sup></b>				<b>SAC per Connection (£)<sup>4</sup></b>			
Pre-pay	197	n/a <sup>5</sup>	215	Pre-pay	44	69	55
Post-pay	622	637	645	Post-pay	202	185	183
Blended	329	n/a <sup>5</sup>	434	Blended	75	95	89
<b>Manx Telecom</b>							
<b>Customer Numbers (thousands)<sup>1</sup></b>				<b>Churn<sup>3</sup></b>			
Pre-pay	26	13	3	Pre-pay	11%	13%	
Post-pay	21	19	16	Post-pay	17%	18%	17%
Total	47	32	19	Blended	14%	16%	
<b>ARPU (£)<sup>2</sup></b>							
Pre-pay	120	115	165				
Post-pay	506	506	536				
Blended	317	388	526				
<b>O<sub>2</sub> Online</b>							
<b>Web Portal Registered Accounts (thousands)<sup>7</sup></b>				<b>WAP Page Impressions (million)<sup>7</sup></b>			
	4,869	3,925	544		1,846	n/a	n/a

### Notes on Operating Data

<sup>1</sup>Customer Numbers – are stated on the active base for years ending March 2001 and 2002 and registered for the year ended March 2000. Customers are treated as being active if they have used the network in the preceding three months.

<sup>2</sup>Average Revenue Per User (ARPU) – is calculated by dividing total service revenue from sales to customers for the preceding 12 months by the weighted average number of customers for the same period. ARPU has been calculated using the active base for years ending March 2001 and 2002 and registered for the year ended March 2000.

<sup>3</sup>Churn – is calculated by expressing the sum of disconnections for the preceding 12 months as a percentage of the weighted average number of customers for the same period. Churn has been calculated using the active base for years ending March 2001 and 2002 and registered for the year ended March 2000.

<sup>4</sup>Subscriber Acquisition Costs (SAC) per Connection – are calculated by dividing the total costs (total cost of handset (including handset costs, SIM costs and packaging) less handset revenue plus commissions paid to sales channels) for the preceding 12 months by the total number of connections over the same period.

<sup>5</sup>Comparable data not available; registered pre-pay customer base previously reported.

<sup>6</sup>O<sub>2</sub> Germany ARPU and SAC – for the years ending 31 March 2000 and 2001, ARPUs and SAC shown are December 1999 and 2000 respectively.

<sup>7</sup>O<sub>2</sub> Online Web Portal Registered Accounts – are accounts opened with the O<sub>2</sub> Online portal sites. WAP Page Impressions – a file or combination of files sent to a WAP unique visitor as a result of that visitor's request being received by the O<sub>2</sub> Online gateway.

## five year summary

### Selected profit and loss account information

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
<b>UK GAAP</b>					
<b>Group turnover</b>	<b>4,276</b>	3,200	2,618	1,814	1,442
Net operating expenses before exceptional items	<b>(4,982)</b>	(3,543)	(2,551)	(1,648)	(1,216)
Exceptional items	<b>(150)</b>	(2,821)	(47)	–	13
<b>EBITDA before exceptional items</b>	<b>433</b>	317	385	366	386
<b>Group operating (loss)/profit</b>	<b>(856)</b>	(3,164)	20	166	239
Group's share of operating profit/(loss) of joint ventures and associates	<b>8</b>	(286)	(270)	(133)	(36)
Net interest payable and similar charges	<b>(25)</b>	(9)	(8)	(1)	1
<b>(Loss)/profit on ordinary activities before taxation</b>	<b>(873)</b>	(3,459)	(258)	32	204
Tax on ordinary activities	<b>23</b>	(70)	9	(53)	(70)
<b>(Loss)/profit on ordinary activities after taxation</b>	<b>(850)</b>	(3,529)	(249)	(21)	134
Minority interests	<b>–</b>	(4)	(1)	(34)	(54)
<b>Retained (loss)/profit for the financial year</b>	<b>(850)</b>	(3,533)	(250)	(55)	80
Basic and diluted (loss)/earnings per share (pence)	<b>(9.8)</b>	(40.7)	(2.9)	(0.6)	0.9
<b>US GAAP</b>					
Retained loss for the financial year	<b>(1,463)</b>	(3,747)	(386)		
Basic and diluted net loss per share (pence)	<b>(16.9)</b>				

### Selected balance sheet information

	2002 £m	2001 £m	2000 £m	1999 £m	1998 £m
<b>Fixed assets</b>					
Intangible assets	<b>15,992</b>	15,624	4,566	157	3
Tangible assets	<b>4,094</b>	3,727	1,770	1,403	1,125
Investments	<b>37</b>	33	393	245	42
<b>Total fixed assets</b>	<b>20,123</b>	19,384	6,729	1,805	1,170
<b>Current assets</b>					
<b>Current assets</b>	<b>2,037</b>	1,785	1,113	621	383
<b>Creditors: amounts falling due within one year</b>	<b>(1,521)</b>	(1,504)	(2,636)	(814)	(439)
<b>Creditors: amounts falling due after more than one year</b>	<b>(1,403)</b>	(399)	(18)	(15)	(18)
<b>Provisions for liabilities and charges</b>	<b>(402)</b>	(206)	(147)	(157)	(134)
<b>Net assets</b>	<b>18,834</b>	19,060	5,041	1,440	962
Equity shareholders' funds	<b>18,834</b>	19,068	5,029	1,609	1,102
Equity minority interests	<b>–</b>	(8)	12	(169)	(140)
	<b>18,834</b>	19,060	5,041	1,440	962
<b>US GAAP</b>					
Equity shareholders' funds	<b>19,428</b>	2,722	2,106		

## supplementary information for United States investors

### Reconciliation with US GAAP

The Group's financial statements are prepared in accordance with accounting principles generally accepted in the United Kingdom (UK GAAP), which differ in certain respects from generally accepted accounting principles in the United States of America ("US GAAP").

#### Basis of preparation

The financial statements which are presented to comply with the Companies Act 1985 have been prepared using accounting policies which differ in certain respects to those used in the preparation of the financial information contained within the Listing Particulars of mmO<sub>2</sub> plc dated 18 September 2001 (the "Listing Particulars") and the Form 20-F/A Registration Statement dated 31 October 2001 (the "Form 20-F/A"). In the Listing Particulars and the Form 20-F/A, a portion of BT's short- and long-term loans and other borrowings were allocated to the Group. The basis of preparation adopted for these financial statements, under UK GAAP, shows the results and financial position of the Group with no push-down allocations of loans and other borrowings. Additional information regarding this treatment is provided in the Basis of preparation disclosed in Note 1 to the financial statements.

#### I. Differences between accounting principles generally accepted in the United Kingdom and the United States of America

The following are the main differences between UK GAAP and US GAAP, which are relevant to the Group's financial statements.

##### (a) Capitalisation of interest

Under UK GAAP, the Group does not capitalise interest in its financial statements. To comply with US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in fixed assets and depreciated over the lives of the related assets. This includes capitalisation of interest incurred on funding the UMTS licences for the period up to the launch of the related services. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. As at 31 March 2002 under US GAAP, gross capitalised interest of £1,214 million (2001: £621 million) was subject to depreciation generally over periods of five to 20 years.

##### (b) Intangible assets

###### Goodwill

Under UK GAAP, in respect of acquisitions completed prior to 1 April 1998, the Group wrote off goodwill arising from the purchase of subsidiary undertakings, associates and joint ventures on acquisition against shareholders' funds. The goodwill is reflected in the net income of the period of disposal, as part of the calculation of the gain or loss on divestment. Under US GAAP, such goodwill is held as an intangible asset in the balance sheet and amortised over its useful life and only the unamortised portion is included in the gain or loss recognised at the time of divestment. Under UK GAAP, goodwill arising on acquisitions completed on or after 1 April 1998 is generally accounted for in line with US GAAP. In addition, under UK GAAP, contingent purchase consideration is generally included as part of the purchase cost at the date of acquisition. Under US GAAP, this cost is not recognised until the contingency is resolved or the amount is determinable beyond reasonable doubt. Gross goodwill under US GAAP as at 31 March 2002 was £9,412 million (2001: £8,715 million) and was subject to amortisation over ten to 20 years. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred.

###### Mobile cellular telephone licences, software and other intangible assets

Certain intangible fixed assets recognised under US GAAP purchase accounting requirements are subsumed within goodwill under UK GAAP. Under US GAAP, these separately identified intangible assets are valued and amortised over their useful lives.

For US GAAP purposes, the Group's separately identified intangible assets relate to customer bases, internally developed software, licences and assembled workforce. Gross intangibles as at 31 March 2002 amounted to £10,212 million (2001: £10,198 million), subject to amortisation over two to 20 years.

Under UK GAAP, intangible and tangible fixed assets are tested for impairment when an event that might affect asset values has occurred. An impairment loss is recognised to the extent that the carrying amount cannot be recovered either by selling the asset or from the discounted future earnings from operating the asset.

Under US GAAP, in SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", if events indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, the entity should estimate the future cash flows expected to result from the use of the asset and its eventual disposal. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the entity shall recognise an impairment loss. An impairment loss recognised would be measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. Additionally, goodwill under US GAAP should be evaluated for impairment in accordance with the provisions set forth in APB 17 "Intangible Assets". Goodwill impairment is measured based upon utilising discounted cash flows or using quoted market prices, if available. In the process of the demerger of mmO<sub>2</sub> from BT, the Group has adopted a new tradename and brand. In carrying out the purchase price allocations on the acquisitions made by the Group, the tradename and brands of the acquired entities were valued at £186 million. At the time of management's decision, commitment and communication to change the brands of the Group this separately identified intangible asset had a value of £181 million. Under the provisions of SFAS No. 121, this intangible asset was written down to its fair value and the

## supplementary information for United States investors

remaining net book value will be amortised over the remaining life. This resulted in an additional amortisation charge in the year which was included in net operating expenses before exceptional items. The effect of this charge has been reflected in the mobile telecommunications/ other countries segment.

### **(c) Software impairment**

In the year ended 31 March 2001, O<sub>2</sub> Germany wrote off certain software related to the integration of the fixed and mobile business units that were abandoned as a result of the split of the mobile and fixed line businesses of O<sub>2</sub> Germany. Under US GAAP, the software abandonment is treated as a purchase price allocation adjustment for the portion acquired on 20 February 2001. The portion owned by the Group prior to the February acquisition is expensed at the acquisition date. Under UK GAAP, the entire amount of software is written off subsequent to the purchase after the Group has attained full control of the entity and commenced the reorganisation of O<sub>2</sub> Germany. The adjustment presented reverses the expense recorded under UK GAAP related to the purchase price adjustment. The corresponding effect on owners' net investment/shareholders' funds of the software write-off increases the recognised goodwill.

### **(d) Employee share plans**

Certain share options have been granted under the mmO<sub>2</sub> Save-As-You-Earn plans at a 20 per cent discount. Under UK GAAP, the share issues are recorded at their discounted price when the options are exercised. Under US GAAP, a plan is considered compensatory when the discount to market price is in excess of 15 per cent. Compensation cost is recognised for the difference between the exercise price of the share options granted and the quoted market price of the shares at the measurement date (the grant date in this case) and accrued over the vesting period of the options.

Additionally, certain shares have been awarded to a small group of executives on the basis that they will only vest if participants build up a pre-determined personal shareholding in the Group. Under US GAAP an expense is only recognised where it can be reasonably assured that the executive will build up the required personal shareholding and such an expense is recognised over the vesting period.

The Group's potentially dilutive share options are anti-dilutive and therefore, in accordance with US GAAP, are not included in the computation of weighted average shares used in computing the dilutive loss per share.

### **(e) Investments accounted for under the equity method**

#### **1) Additional US GAAP adjustments to equity method investments**

Under UK GAAP, certain joint ventures and associates have been accounted for using the equity method of accounting. For the purposes of this reconciliation, adjustments have been made to restate net loss and owners' net investment/shareholders' funds of these associates to US GAAP. The only material reconciling item is capitalised interest, which reduced US GAAP net loss by £nil for the year ended 31 March 2002 (2001: £66 million, 2000: £1 million). This adjustment is reflected in the capitalised interest reconciling line item.

#### **2) Change in the reporting period of a subsidiary**

Under UK GAAP, the additional reporting period, or lag time, resulting from a parent changing a subsidiary's year end is included in the income statement. Under US GAAP, the results from this period are treated as a direct adjustment to retained earnings. The amount included in the US GAAP reconciliation of net loss relates to the O<sub>2</sub> Germany equity loss pick-up for the three-month period 1 January 2000 through 31 March 2000 included in the UK GAAP profit and loss account for the year ended 31 March 2001.

### **(f) Other employee compensation expense**

Under UK GAAP certain amounts paid and payable to former owners of purchased companies who are also employees are included as part of the acquisition cost of these companies. Under US GAAP, where payment of those amounts is based on achievement of certain performance goals, they qualify as employee compensation expense and are recognised in the financial statements when the performance goals are met.

### **(g) Restructuring costs**

The Group has recognised a restructuring charge related to employee termination benefits and real estate closures. This plan called for the reduction of over 1,900 positions in the technical, retail and administrative departments of O<sub>2</sub> UK and O<sub>2</sub> Germany. As of 31 March 2002, approximately 650 employees have been terminated as a result of this plan. Under US GAAP, site closure costs can only be recognised for the period post cessation of operations at that site, whereas under UK GAAP the provision may be recognised at the time of managements' commitment, communication and reasonable estimate of the associated cost.

### **(h) Treasury stock**

In the year ended 31 March 2002, mmO<sub>2</sub> plc purchased 6 million shares on the stock market for £4 million. Under UK GAAP these shares have been classified as a current asset investment and a charge of £1 million has been recognised for stock compensation. Under US GAAP such shares are classified as treasury stock and are included as a deduction in shareholders' funds. This treasury stock has been accounted for under the cost method.

### (i) Derivative financial instruments

Under UK GAAP certain derivative financial instruments qualify for hedge accounting which do not qualify for hedge accounting under US GAAP. The financial instruments, under US GAAP, are carried at market value with valuation adjustments recorded in the profit and loss account.

### (j) Notional loans due to BT

As at 31 March 2000 and 2001, £3 billion and £16.8 billion of notional debt, including accrued interest, was allocated to the Group, representing the borrowings raised by BT to fund the Group's major mobile acquisitions, including UMTS licences. These loans had a deemed average annual interest rate of 6.9 per cent and 7.2 per cent respectively, which resulted in £90 million and £660 million of interest being notionally charged to the Group in the years ended 31 March 2000 and 2001 respectively. Notional interest of £756 million has been recognised under US GAAP for the period from 1 April 2002 to demerger. The effect of this interest charge on the deferred tax has been included in the Deferred tax effect of US GAAP adjustments below.

### (k) Deferred tax effect of US GAAP adjustments

As at 31 March 2002, the adjustment of £(102) million (2001: £138 million) reconciling owners' net investment/shareholders' funds under UK GAAP to the amount under US GAAP included the tax effect of US GAAP adjustments. This comprises an adjustment to increase non-current assets by £74 million (2001: £228 million increase) and increase long-term liabilities by £176 million (2001: £90 million increase).

## II. Net loss and owners' net investment reconciliation

The following statements summarise the material estimated adjustments, which reconcile net loss and owners' net investment/shareholders' funds from that reported under UK GAAP to that which would have been reported had US GAAP been applied.

Net loss	Note	2002 £m	Year ended 31 March	
			2001 £m	2000 £m
Net loss under UK GAAP <sup>1</sup>		<b>(850)</b>	(3,533)	(250)
Adjustment for:				
Capitalisation of interest, net of related depreciation	(a)	<b>579</b>	344	(1)
Goodwill amortisation	(b)	<b>23</b>	19	6
Mobile licences, software and other intangible assets	(b)	<b>(217)</b>	(98)	(69)
Software impairment	(c)	<b>–</b>	12	–
Employee share plans	(d)	<b>(1)</b>	(8)	(3)
Equity investments: adjustment for change in the reporting period	(e)	<b>–</b>	51	–
Other employee compensation expense	(f)	<b>(3)</b>	(8)	–
Restructuring costs	(g)	<b>21</b>	–	–
Fair value of derivatives	(i)	<b>(19)</b>	–	–
Notional loans due to BT	(j)	<b>(756)</b>	(660)	(90)
Deferred taxation on US GAAP differences	(k)	<b>(240)</b>	134	21
Net loss as adjusted for US GAAP		<b>(1,463)</b>	(3,747)	(386)
Net loss per share, as adjusted for US GAAP (pence)		<b>(16.9)</b>		

Shareholders' funds/owners' net investment	Note	2002 £m	At 31 March	
			2001 £m	2000 £m
Shareholders' funds/owners' net investment under UK GAAP <sup>2</sup>		<b>18,834</b>	19,068	
Adjustment for:				
Capitalisation of interest, net of related depreciation	(a)	<b>979</b>	400	
Goodwill amortisation	(b)	<b>116</b>	93	
Mobile licences, software and other intangible assets	(b)	<b>(384)</b>	(167)	
Employee share plans	(d)	<b>(3)</b>	(2)	
Other employee compensation expense	(f)	<b>(11)</b>	(8)	
Restructuring costs	(g)	<b>21</b>	–	
Treasury stock	(h)	<b>(3)</b>	–	
Fair value of derivatives	(i)	<b>(19)</b>	–	
Notional loans due to BT	(j)	<b>–</b>	(16,800)	
Deferred taxation on US GAAP difference	(k)	<b>(102)</b>	138	
Shareholders' funds/owners' net investment as adjusted for US GAAP		<b>19,428</b>	2,722	

## supplementary information for United States investors

The net loss and shareholders' funds/owners' net investment under UK GAAP have been prepared for statutory reporting purposes using accounting policies which differ in certain respects to those used in the Listing Particulars and Form 20-F/A. The impact of the different accounting policies is set out below:

	2002 £m	2001 £m	2000 £m
Net loss per 2001 Form 20-F/A basis	<b>(1,379)</b>	(4,009)	(340)
Notional loans due to BT	<b>756</b>	660	90
Deferred taxation on US GAAP differences	<b>(227)</b>	(184)	–
Net loss under UK GAAP for statutory reporting purposes	<b>(850)</b>	(3,533)	(250)

	2002 £m	2001 £m
Net shareholders' funds/owners' net investment per 2001 Form 20-F/A basis	<b>18,834</b>	2,452
Notional loans due to BT	–	16,800
Deferred taxation on US GAAP differences	–	(184)
Net shareholders' funds/owners' net investment under UK GAAP for statutory reporting purposes	<b>18,834</b>	19,068

The above adjustments have no impact on the net loss or shareholders' funds/owners' net investment as adjusted for US GAAP.

### III. Minority interests

Under UK GAAP, a provision against a deficit minority interest should be made where funding is likely to be required by the Group. However, where the losses are likely to be made good by subsequent profits, no provision is required. Under US GAAP, in the absence of an express obligation of the minority interest holders to fund the investee, it would not be appropriate to record an asset for a deficit minority interest. In addition, if a deficit minority interest exists at the date of a step acquisition and no express obligation of the minority interest to fund the investee exists, this would result in additional goodwill recognition.

Under US GAAP, minority interest and net assets attributable to minority interest would have been £nil in 2001 and 2000. As at 31 March 2002 no minority interests exist under either UK or US GAAP.

### IV. Accounting for stock options

Under UK GAAP, the cost of shares expected to be awarded under each plan is amortised evenly over the period from the original date of grant of the particular award, to the time of vesting. Under US GAAP, the Group adopted the disclosure-only option in SFAS No. 123, "Accounting for Stock-Based Compensation". Accordingly, the Group accounts for share options in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees", under which compensation expense is recognised to the extent that the fair market value of the shares optioned exceeds the option exercise price. Aggregate stock compensation of £2 million has been recognised under APB No. 25 in the year.

#### Share option and purchase schemes

The Group operates savings-related share option schemes for its employees and those of participating subsidiaries and further share option schemes (the mmO<sub>2</sub> Executive Share Option Plan and the mmO<sub>2</sub> Legacy Option Plan) for selected Group employees.

#### Sharesave Scheme

The major share option scheme in the UK, the mmO<sub>2</sub> Sharesave Scheme, is savings related. Share options are normally exercisable on completion of a three- or five-year Save-As-You-Earn contract. Under this scheme, the option exercise price is determined at the time of initial subscription to join the scheme and represents a 20 per cent discount to the market price at the date of grant. Similar savings related schemes exist for Group employees based outside the UK.

#### mmO<sub>2</sub> Executive Share Option Plan

The mmO<sub>2</sub> Executive Share Option Plan was approved by BT shareholders in October 2001. From demerger to 31 March 2002, options were granted for nil consideration to 1,157 employees. All such options have an exercise price equal to the market value at grant date. The majority of these options were granted on the terms that they normally only become exercisable on the third anniversary of grant, subject to certain performance criteria. If these criteria are not met on the third anniversary of grant, the performance goals will be retested on the fourth and fifth anniversaries. Options under this scheme generally have a life of ten years.

## mmO<sub>2</sub> Legacy Option Plan

In addition, the Group operates the mmO<sub>2</sub> Legacy Option Plan, in which existing options over BT shares granted under BT executive share option plans have been replaced with options over mmO<sub>2</sub> plc shares for those participants now employed by the Group. Existing BT options were released in exchange for the grant of replacement options under the mmO<sub>2</sub> Legacy Option Plan. The replacement options were granted on the same terms, and were exercisable between the same dates, as the options for which they were exchanged. The terms of this exchange ensured that the total amount payable on exercise, and any gain or loss arising had the options been exercised at the time of the exchange, was the same before and after the exchange.

Options are normally exercisable up until the tenth anniversary of the date of the original grant. The exercise price of these options equalled the market value as at original grant date.

Options outstanding in relation to group employees under these share option schemes as at 31 March 2002 together with their exercise prices and vesting periods, were as follows:

Range of exercise prices <sup>1</sup>	Options outstanding over ordinary shares			Options exercisable over ordinary shares	
	Number outstanding (m)	Weighted-average remaining contractual life (years)	Weighted-average exercise price (£)	Number exercisable (m)	Weighted-average exercise price (£)
£0.64-0.72	11.7	10	0.68	–	–
£0.73	30.6	4	0.73	–	–
£0.74-0.83	3.6	9	0.83	–	–
£0.87	49.4	10	0.87	0.3	0.87
£0.94-2.55	4.2	8	1.64	–	–
	<b>99.5</b>	<b>8</b>	<b>0.84</b>	<b>0.3</b>	<b>0.87</b>

<sup>1</sup>Share options over American Depositary Shares have exercise prices termed in US Dollars. For purposes of disclosure, these options' exercise prices have been translated into Sterling at the year end exchange rate. As each American Depositary Share represents ten Ordinary Shares, the number of options and exercise prices have been adjusted by this ratio to reflect the options on a like for like basis.

As at 31 March 2000 and 2001, 0.2 million share options were exercisable.

Options granted, exercised and lapsed in respect of group employees under these share option schemes during the years ended 31 March 2002, 2001 and 2000 were as follows:

Range of exercise prices <sup>1</sup>	Options over ordinary shares			Options over American depositary shares		
	Number of ordinary shares <sup>1</sup>		Weighted-average exercise price (£)	Number of American depositary shares <sup>2</sup>		Weighted-average exercise price (£)
	Savings-related share options (m)	Other share options (m)		Savings-related share options (m)	Other share options (m)	
Balance at 1 April 1999	58.6	1.7	0.86	–	–	–
Granted	7.8	0.4	2.09	–	–	–
Exercised	(9.1)	(0.4)	0.81	–	–	–
Lapsed	(2.1)	–	0.89	–	–	–
Balance at 31 March 2000	55.2	1.7	1.05	–	–	–
Granted	10.3	2.5	1.82	–	–	–
Exercised	(11.1)	(0.4)	0.77	–	–	–
Lapsed	(4.1)	(0.4)	1.50	–	–	–
Balance at 31 March 2001	50.3	3.4	1.37	–	–	–
Lapsed on demerger	(50.3)	(3.4)	1.37	–	–	–
Balance on demerger	–	–	–	–	–	–
Granted	30.9	64.9	0.82	–	5.6	1.17
Exercised	–	–	–	–	–	–
Lapsed	(0.3)	(1.6)	0.84	–	–	–
<b>Balance at 31 March 2002</b>	<b>30.6</b>	<b>63.3</b>	<b>0.82</b>	<b>–</b>	<b>5.6</b>	<b>1.17</b>

<sup>1</sup>All options granted, exercised, lapsed and outstanding for periods prior to demerger have been adjusted to reflect the exchange ratio of 4.1266 shares of mmO<sub>2</sub> per share of BT.

<sup>2</sup>Share options over American Depositary Shares have exercise prices termed in US Dollars. For purposes of disclosure, these options' exercise prices have been translated into Sterling at the year end exchange rate. As each American Depositary Share represents ten Ordinary Shares, the number of options and exercise prices have been adjusted by this ratio to reflect the options on a like for like basis.



## supplementary information for United States investors

### mmO<sub>2</sub> Restricted Share Plan

Restricted share awards have been granted to a small group of senior executives. Most of these awards were granted on terms that they will normally only vest on the third anniversary of grant if the participant builds up a pre-determined personal shareholding in the Group, and remains in employment with the Group. Shares required to satisfy these awards are held in trust during the restricted period. In accordance with APB No. 25, an expense has been recognised to the extent that executives have commenced building their personal shareholding. The weighted average grant date fair value of the 9.4 million shares granted under this plan in the year to 31 March 2002 was £0.80.

For disclosure purposes, the fair value of all stock options granted is estimated using the Black-Scholes option-pricing model. The following weighted average assumptions were used for stock options granted by the Group:

	2002	Year ended 31 March	
	%	2001	2000
		%	%
Annual dividends	nil	2	2
Expected volatility	55	40	40
Risk free interest rate	5	7	6

The expected life applied in the model anticipated the life of options extending one month later than the first exercise date.

Had compensation expense been determined on the basis of fair value pursuant to SFAS No. 123, net loss and net loss per share would have been as follows:

	2002	Year ended 31 March	
		2001	2000
(in £ millions, except per share data which is stated in pence)			
<b>Net loss</b>			
As reported	1,463	3,747	386
Pro forma	1,463	3,750	388
<b>Net loss per share</b>			
As reported	16.9		
Pro forma	16.9		

The weighted average fair value of share options granted in the year ended 31 March 2002 was £0.16 for options exercisable one year after the date of grant, £0.22 for options exercisable two years after the date of grant, £0.35 (2001: £0.80, 2000: £1.00) for options exercisable three years after the date of grant and £0.46 (2001: £1.03, 2000: £1.27) for options exercisable five years after the date of grant.

### BT Honoured Share Plans

A number of key employees of mmO<sub>2</sub> were participants prior to demerger in BT share plans. It was agreed by the BT plc remuneration committee and endorsed by the mmO<sub>2</sub> Board that share awards under certain BT executive share plans held by mmO<sub>2</sub> employees would continue to subsist following demerger. The awards have been adjusted so that they relate solely to mmO<sub>2</sub> plc shares, and any performance measure has been translated into a measure of mmO<sub>2</sub> performance from demerger to the end of the performance period. Therefore, where relevant, the vesting of these share awards is dependent on the performance of BT prior to demerger and mmO<sub>2</sub> thereafter.

In accordance with the rules of these plans the awards were converted into awards over mmO<sub>2</sub> plc shares on the basis of an adjustment factor of 4.1266.

### Incentive Share Plan and Retention Share Plan

The Incentive Share Plan (ISP) and the Retention Share Plan (RSP) were introduced for employees of the BT Group, including current mmO<sub>2</sub> employees, in July 2000. Under the plans, shares are acquired by an employee share ownership trust and are conditionally awarded to participants dependent upon specific corporate performance criteria.

### Executive Share Plan and Deferred Bonus Plan

The Executive Share Plan (ESP) and Deferred Bonus Plan (DBP) were introduced for employees of the BT Group, including current mmO<sub>2</sub> employees, in 1994 and 1998 respectively. Under the plans, shares are acquired by an employee share ownership trust and are conditionally awarded to participants. Under the ESP, participants are only entitled to these shares in full at the end of a five-year period if, at the end of the period, the Group has met specific performance goals. Under the DBP there are no associated performance goals.

Under the Separation Agreement between the Group and BT, it has been endorsed and agreed that all share awards required under the ISP, RSP, ESP and DBP will be honoured by BT and will be satisfied by issuance of existing mmO<sub>2</sub> shares held by a BT trust which has already been funded by BT. Thus, the Group is not responsible for any of the options or shares under these schemes and will bear no compensation expense in association with them.

## V. Group cash flow statements

Under UK GAAP, the Group cash flow statements are presented in accordance with UK Financial Reporting Standard No. 1 (FRS 1). The statements prepared under FRS 1 present substantially the same information as that required under SFAS No. 95 "Statement of Cash Flows".

Under SFAS No. 95, cash and cash equivalents include cash and short-term investments with original maturities of three months or less. Under FRS 1, cash comprises cash in hand and at bank and overnight deposits, net of bank overdrafts.

Under FRS 1, cash flows are presented for operating activities, returns on investments and servicing of finance, taxation, capital expenditure and financial investments, acquisitions and disposals, dividends paid to the Company's shareholders, management of liquid resources and financing. SFAS No. 95 requires a classification of cash flows as resulting from operating, investing and financing activities.

Cash flows under FRS 1 in respect of interest received, interest paid and taxation would be included within operating activities under SFAS No. 95. Cash flows from purchases, sales and maturities of trading securities, while not separately identified under UK GAAP, would be included within operating activities under US GAAP.

The following statements summarise the combined cash flow statements as if they had been presented in accordance with US GAAP, and include the adjustments that reconcile cash and cash equivalents under US GAAP to cash at bank and in hand reported under UK GAAP.

	2002 £m	Year ended 31 March	
		2001 £m	2000 £m
Net cash provided by operating activities	444	328	333
Net cash used in investing activities	(2,095)	(17,808)	(4,027)
Net cash provided by financing activities	1,790	17,593	3,862
Net increase in cash and cash equivalents	139	113	168
Cash and cash equivalents under US GAAP at the beginning of the year	340	227	59
Cash and cash equivalents under US GAAP at the end of the year	479	340	227
Short-term investments	(459)	–	–
Bank overdrafts	–	49	18
Cash at bank and in hand under UK GAAP at the end of the year	20	389	245

## VI. Pensions

The BT Pension Scheme is a defined benefit pension scheme. The Group was a participating employer in this scheme which is now closed to members. The O<sub>2</sub> Netherlands scheme is also defined benefit in nature. For US GAAP purposes in respect of these schemes multi-employer accounting has been applied as there is more than one participating employer. Accordingly the annual expense in respect of these schemes is equal to the annual employer contribution, as is the case under UK GAAP.

At the start of the year, an unfunded defined benefit scheme was operated at O<sub>2</sub> Germany. During the year a new defined contribution scheme was set up to replace the existing unfunded arrangement. The total cost incurred during the year in respect of these schemes was £2 million.

An unfunded pension scheme operates in the UK. The cost of providing pension benefits may be calculated by the use of any actuarial method which is appropriate and also whose assumptions reflect the long-term nature of the assets and liabilities involved. Under US GAAP, the cost of providing these benefits is calculated in accordance with SFAS No. 87 which requires the use of the projected unit credit method and a discount rate (reflecting the rate of interest at which the pension liabilities could effectively be settled), which reflects current market rates.

## supplementary information for United States investors

### VII. Deferred taxation

The elements of deferred taxation to be considered for US GAAP purposes are as follows:

	As at 31 March	
	2002 £m	2001 £m
Bad debt provision	8	5
Other general provision	7	10
<b>Deferred current tax assets</b>	<b>15</b>	<b>15</b>
Tax losses carried forward	893	542
Intangible assets	–	3
Other	8	1
<b>Deferred non-current tax asset</b>	<b>901</b>	<b>546</b>
Allowance	(631)	(339)
<b>Total deferred non-current tax asset after allowance</b>	<b>270</b>	<b>207</b>
Capitalised interest	(385)	(94)
Intangible assets	(16)	(30)
Accelerated capital allowance	(359)	(226)
<b>Total deferred tax liabilities</b>	<b>(760)</b>	<b>(350)</b>
<b>Net deferred non-current liabilities (net of deferred tax assets)</b>	<b>(475)</b>	<b>(128)</b>

The table below represents the deferred tax for loss carry forwards, the expiration dates and the valuation allowance for US GAAP purposes as at 31 March 2002:

	O <sub>2</sub> UK £m	O <sub>2</sub> Germany £m	O <sub>2</sub> Netherlands £m	O <sub>2</sub> Ireland £m	Total £m
Total (no expiration)	52	793	47	1	893
Allowance	–	(594)	(37)	–	(631)
<b>Deferred tax assets for loss carry forwards</b>	<b>52</b>	<b>199</b>	<b>10</b>	<b>1</b>	<b>262</b>

### VIII. Additional US GAAP disclosures

#### (a) Investments

Under UK GAAP, the Group accounts for joint venture investments using the gross equity method of accounting. The profit and loss account includes the Group's share of the operating profit and loss, interest income or expense and attributable taxation of those companies. The balance sheet shows the Group's share of the gross assets and liabilities of those companies and attributed goodwill. Under US GAAP, these investments would be accounted for using the net equity method. The profit and loss account would include on one line an item with the Group's share of the loss before tax of £nil (2001: £374 million, 2000: £283 million). The balance sheet would show on one line an item with the Group's share of the net assets of those companies.

(b) Under UK GAAP exceptional costs totalling £150 million have been recognised (2001: £2,821 million; 2000: £47 million). Under US GAAP these would not be considered exceptional items and would be classified within net operating expenses.

#### (c) Use of estimates in preparation of financial statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United Kingdom and the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities to the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

#### (d) New US accounting standards

In June 2001, the Financial Accounting Standards Board (FASB or the "Board") issued Statement of Financial Accounting Standards No. 141 (SFAS 141), Business Combinations, and No. 142 (SFAS 142), Goodwill and Other Intangible Assets, collectively referred to as the "Standards". SFAS 141 supersedes Accounting Principles Board Opinion (APB) No. 16, Business Combination. The provisions of SFAS 141 (1) require that the purchase method of accounting be used for all business combinations initiated after 30 June 2001; (2) provide specific criteria for the initial recognition and measurement of intangible assets apart from goodwill; and (3) require that unamortised negative goodwill be written off immediately as an extraordinary gain instead of being deferred and amortised. SFAS 141 also requires that upon adoption of SFAS 142 the Group reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria. SFAS 142 supersedes APB 17, Intangible Assets, and is effective for fiscal years beginning after 15 December 2001. SFAS 142 primarily

addresses the accounting for goodwill and intangible assets subsequent to their initial recognition. The provisions of SFAS 142 (1) prohibit the amortisation of goodwill and indefinite-lived intangible assets; (2) require that goodwill and indefinite-lived intangible assets be tested annually for impairment (and in interim periods if certain events occur indicating that the carrying value of goodwill and/or indefinite-lived intangible assets may be impaired); (3) require that reporting units be identified for the purpose of assessing potential future impairments of goodwill; and (4) remove the 40-year limitation on the amortisation period of intangible assets that have finite lives.

The provisions of the Standards also apply to equity-method investments made both before and after 30 June 2001. SFAS 141 requires that the unamortised deferred credit related to an excess over cost arising from an investment that was accounted for using the equity method (equity-method negative goodwill), and that was acquired before 1 July 2001, must be written-off immediately and recognised as the cumulative effect of a change in accounting principle. Equity-method negative goodwill arising from equity investments made after 30 June 2001 must be written-off immediately and recorded as an extraordinary gain, instead of being deferred and amortised. SFAS 142 prohibits amortisation of the excess of cost over the underlying equity in the net assets of an equity-method investee that is recognised as goodwill.

The Group will adopt the provisions of SFAS 142 in the first half of the financial year ending 31 March 2003. The Group is in the process of preparing for its adoption of SFAS 142 and is making the determinations as to what its reporting units are and what amounts of goodwill, intangible assets, other assets, and liabilities should be allocated to those reporting units. In connection with the adoption of SFAS 142, the Group expects to reclassify approximately £125 million of its intangible assets and the related deferred tax liabilities to goodwill. The Group expects that it will no longer record approximately £300 million of amortisation relating to its existing goodwill and indefinite-lived intangibles, as adjusted for the reclassifications just mentioned. The Group will also evaluate the useful lives assigned to its intangible assets.

SFAS 142 requires that goodwill be tested annually for impairment using a two-step process. The first step is to identify a potential impairment and, in transition, this step must be measured as of the beginning of the fiscal year. However, an entity has six months from the date of adoption to complete the first step. The Group expects to complete that first step of the goodwill impairment test during the first half of the financial year ending 31 March 2003. The second step of the goodwill impairment test measures the amount of the impairment loss (measured as of the beginning of the year of adoption), if any, and must be completed by the end of the Group's financial year. Intangible assets deemed to have an indefinite life will be tested for impairment using a one-step process which compares the fair value to the carrying amount of the assets as of the beginning of the fiscal year, and pursuant to the requirements of SFAS 142 will be completed during the first half of the financial year ending 31 March 2003. Any impairment loss resulting from the transitional impairment tests will be reflected as the cumulative effect of a change in accounting principle in the first half of the financial year ending 31 March 2003. The Group has not yet determined what effect these impairment tests will have on the Group's earnings and financial position.

In July 2001, the FASB issued SFAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets". SFAS No. 143 is effective for companies with fiscal years beginning after 30 June 2002; early adoption is permitted. The standard provides the accounting requirements for retirement obligations associated with tangible long-lived assets. The standard requires that the obligation associated with the retirement of the tangible long-lived assets be capitalised into the asset cost at the time of initial recognition. The liability is then discounted to its fair value at the time of recognition using the guidance provided by the standard. The Group already applies this accounting principle under UK GAAP and does not expect a significant impact for US GAAP purposes.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which supersedes SFAS No. 121. SFAS No. 144 retains the fundamental provisions in SFAS No. 121 for recognising and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with SFAS No. 121. Unlike SFAS No. 121, an impairment assessment under SFAS No. 144 will never result in a write-down of goodwill. Rather, goodwill will be evaluated for impairment under SFAS No. 142, as discussed above. The Group is required to adopt SFAS No. 144 on 1 April 2003. Management does not expect the adoption of SFAS No. 144 for long-lived assets held for use to have a material impact on the Group's consolidated financial statements because the impairment assessment under SFAS No. 144 is largely unchanged from SFAS No. 121.

#### **(e) New UK accounting standards**

In November 2000, the Accounting Standards Board issued FRS 17, "Retirement Benefits". Accounting for pensions in accordance with FRS 17 is mandatory for accounting periods ending on or after 22 June 2003, however progressive footnote disclosures are required for June 2001 and June 2002 year-ends. The changes introduced by FRS 17 principally affect the way defined benefit pension schemes are accounted for and the Group is currently evaluating the effect it will have on its results and financial position. At each year-end the pension scheme assets should be measured at market value while pension scheme liabilities should be measured at a present value using a specified actuarial valuation method and discounted at a corporate bond rate. The resulting pension scheme surplus or deficit must be shown on the Group's balance sheet, and could be volatile because of the dependence on market conditions at the balance sheet date.

## Taxation

The following discussion is a summary of the material UK tax and US federal income tax considerations under present law relevant to the purchase, ownership and disposition of our shares or American Depositary Shares (ADSs). It applies only if you are a US holder, you hold our shares or ADSs as capital assets and you use the US dollar as your functional currency. It does not address the tax treatment of US holders

## supplementary information for United States investors

subject to special rules, such as banks, dealers, traders in securities that elect to mark to market, insurance companies, tax-exempt entities, holders of 10% or more of our voting shares, persons holding our shares or ADSs as part of a hedge, straddle, conversion or constructive sale transaction and persons that are resident or ordinarily resident in the United Kingdom.

This summary does not consider your particular circumstances. It is not a substitute for tax advice. We urge you to consult your own tax advisers about the particular tax consequences to you in light of your particular circumstances of ownership of our shares or ADSs.

As used in this discussion, "US holder" means a beneficial owner of our shares or ADSs that is (i) a US citizen or resident, (ii) a corporation, partnership or other business entity organised under US law, (iii) a trust subject to the control of a US person and the primary supervision of a US court or (iv) an estate the income of which is subject to US federal income tax regardless of its source.

### UK taxation

#### Dividends

No tax is required to be withheld at source from dividends paid on our shares or ADSs. See "– US Federal Income Taxation – Dividends."

#### Dispositions

Except as discussed below, you will not be liable for tax on capital gains realised on your disposal of our shares or ADSs unless you are resident or ordinarily resident in the United Kingdom, or you carry on a trade, profession or vocation in the United Kingdom through a branch or agency in the UK for years in which your disposal occurs and our shares or ADSs are or have been used, held or acquired for the purposes of such trade (or profession or vocation), branch or agency.

If you are an individual who has been resident or ordinarily resident in the United Kingdom during the five years before you disposed of our shares or ADSs, you are likely to be liable for tax on capital gains if you return to the United Kingdom, subject to any available exemption or relief.

#### UK Inheritance Tax

Our ordinary shares will be assets situated, and our ADSs are likely to be assets situated, in the United Kingdom for the purposes of the UK inheritance tax. Subject to the discussion of the UK-US estate tax treaty in the next paragraph, UK inheritance tax may apply if you hold our shares or ADSs, and you gift them or die even if you are neither domiciled nor deemed to be domiciled in the United Kingdom. If you transfer our shares or ADSs at less than full market value, you may be treated as making a gift. Special rules apply to gifts if the donor retains some benefit, to close companies, and to trustees of settlements.

If your domicile is in the United States for purposes of the UK-US estate tax treaty and you are not a UK national, you will not be subject to UK inheritance tax if you die or gift our shares or ADSs unless our shares or ADSs are part of the business property of a UK permanent establishment or pertain to a UK fixed base of an individual used for the performance of independent personal services.

The UK-US estate tax treaty provides a credit mechanism if our shares or ADSs are subject to both UK inheritance tax and to the US federal estate or gift tax.

#### UK stamp duty and stamp duty reserve tax

UK stamp duty and stamp duty reserve tax, or SDRT, are generally payable upon the issue and deposit of our shares with the depository or its nominee in exchange for our ADSs evidenced by ADRs. The current rate of stamp duty and SDRT imposed on these issues and transfers is 1.5% applied, in each case, to the value of the consideration or, in some circumstances, to the value of our shares. The stamp duty or SDRT is payable by the depository. In accordance with the terms of the deposit agreement holders of our ADRs must reimburse the depository for the stamp duty or SDRT.

No such SDRT or stamp duty will however arise from the issuance and deposit of our shares pursuant to the scheme of arrangement.

No UK stamp duty will be payable on the transfer of our ADRs if the instrument of transfer is not executed in the United Kingdom and remains outside the United Kingdom. Transfer of our ADRs will not give rise to a liability for SDRT.

A transfer of our shares by the depository to an ADR holder where there is no change in beneficial ownership will result in UK stamp duty at the rate of £5 per transfer.

Transfers of our shares to persons other than the depository or its nominee will give rise to UK stamp duty or SDRT at the time of transfer or agreement to transfer, normally at the rate of 0.5% (rounded up, in the case of stamp duty, to the nearest £5) of the amount payable for our shares. The purchaser usually pays SDRT or UK stamp duty. If our shares are later transferred to the depository, additional UK stamp duty or SDRT will normally be payable as described above.

### US Federal Income Taxation

If the obligations contemplated by the deposit agreement are performed in accordance with their terms, holders of our ADSs generally will be treated for US federal income tax purposes as the owners of our shares represented by those ADSs.

## Dividends

Dividends will be included in your gross income as ordinary income from foreign sources. The dividends will not be eligible for the dividends-received deduction available to corporations. Dividends paid in pounds sterling will be inclusive in income in a US dollar amount based on the exchange rate in effect on the date received by the depository (in the case of our ADSs) or the holder (in the case of our shares) whether or not the payment is converted into US dollars at that time. Any gain or loss you recognise on a subsequent conversion of pounds sterling for a different amount generally will be US source ordinary income or loss. Distributions to a US holder of additional shares or ADSs or rights to acquire additional shares or ADSs that are made as part of a pro rata distribution to all shareholders of mmO2 generally should not be subject to US federal income tax.

If you hold our shares or ADSs and you are eligible for benefits under the current UK-US income tax treaty, you may be entitled to a foreign tax credit for UK withholding tax. The amount of the foreign tax credit equals the tax credit payment that you are entitled to receive from the UK Inland Revenue. At current rates, a dividend of £90 entitles an eligible US holder to a payment of £10 offset by a UK withholding tax of £10. Because the tax credit payment and the withholding tax offset each other, the UK Inland Revenue neither makes the payment nor collects the tax. The offsetting payments nevertheless have US tax significance. If you elect the benefits of the UK-US income tax treaty, you must include the tax credit payment in your income and you can claim a foreign tax credit for the UK withholding tax (subject to otherwise applicable limitations on foreign tax credit claims). To make the election, you must file a completed US Internal Revenue Service Form 8833 with your US federal income tax return for the relevant year. A US partnership is entitled to benefits under the UK-US income tax treaty only with respect to income allocated to partners who are so entitled.

The United Kingdom and the United States recently signed a new income tax treaty that does not provide for UK tax credit payments to US shareholders, except during the 12 months after it comes into effect. It is not clear when that will be.

## Dispositions

You will recognise capital gain or loss on the sale or other disposition of our shares or ADSs in an amount equal to the difference between your basis in the shares or ADSs and the amount realised from the sale or other disposition. Any gain or loss generally will be treated as arising from US sources.

A US holder that receives pounds sterling on the sale or other disposition of our shares will realise an amount equal to the US dollar value of the pounds sterling on the date of sale (or, in the case of cash basis or electing accrual basis taxpayers, the settlement date). A US holder will have a tax basis in the pounds sterling received equal to the US dollar amount realised. Any gain or loss realised on a subsequent conversion of the pounds sterling for a different amount generally will be US source ordinary income or loss.

## Information reporting and backup withholding

Dividends from our shares or ADSs and proceeds from the sale of our shares or ADSs may be reported to the Internal Revenue Service (IRS), unless the holder (i) is a corporation, (ii) provides a properly executed IRS Form W-8BEN or (iii) otherwise establishes a basis for exemption. Backup withholding tax may apply to amounts subject to reporting if the holder fails to provide an accurate taxpayer identification number or otherwise establish a basis for exemption. The amount of any backup withholding tax will be allowed as a credit against the holder's US federal income tax liability.

## Material contracts

The following contracts, not being contracts entered into in the ordinary course of business, have been entered into by a member of our Group and either:

- >> have been entered into within the two years immediately preceding the date of this document and are material: or
  - >> contain any provision under which any member of our Group has any obligation or entitlement which is material at the date of this document:
- (a) the Demerger Agreement, the Separation Agreement and the Tax Agreement, detailed discussion of which are set out in "Supplementary information for United States investors."
  - (b) the Wireless Trading Agreement, a detailed discussion of which is set out in "Supplementary information for United States investors."
  - (c) the Sponsors' Agreement dated 18 September 2001 between mmO<sub>2</sub>, BT, Merrill Lynch International, Morgan Stanley & Co. International Limited and Salomon Brothers International Limited, pursuant to which Merrill Lynch International, Morgan Stanley & Co. International Limited and Salomon Brothers International Limited agreed to act as joint sponsors for mmO<sub>2</sub> in connection with its admission. Under this agreement, mmO<sub>2</sub> has given certain customary representations, warranties and undertakings to the joint sponsors including as to the accuracy of the information contained in the UK Listing Particulars, as to other matters relating to the mmO<sub>2</sub> Group and its businesses and in connection with its admission BT has given certain limited warranties in connection with the implementation of the reorganisation, the scheme of arrangement and the demerger transaction and certain other matters.

## supplementary information for United States investors

- (d) a syndicated credit facilities agreement (which became available for drawdown on the date of our demerger), dated 14 September 2001 (the "Facility Agreement"), between mmO<sub>2</sub> and O<sub>2</sub> as borrowers, certain financial institutions who have participated in the credit facility (the "Banks").

The Facility Agreement provides for the Banks to make available to mmO<sub>2</sub> and O<sub>2</sub> a five year committed £1,750 million multicurrency revolving credit facility ("Tranche A") and a 364 day committed £1,750 million multicurrency revolving facility ("Tranche B").

Cash advances under Tranche A, general corporate purposes of the mmO<sub>2</sub> Group, and Tranche B is to bridge proposed capital market issuances by mmO<sub>2</sub>. £1,000 million of Tranche B was refinanced through €1,000 million and £375 million Eurobond issues launched in January 2002 and which have a five-year and ten-year term, respectively.

The facility is guaranteed by mmO<sub>2</sub> in respect of drawings of each additional borrower, and by such subsidiaries of mmO<sub>2</sub> as are nominated by mmO<sub>2</sub> and accede to the Facility Agreement as guarantors.

- (e) A €5,000,000,000 Euro Medium Term Note Programme (the "Programme"), was established for the issue of Euro Medium Term Notes (the "Notes"). Notes issued will be constituted by a trust deed dated 18 December 2001 entered into between the Issuer and Bankers Trustee Company Limited. Under the Programme, the Issuer may issue Notes denominated in any currency under the terms and conditions as set out in an offering circular dated 18 December 2001 (the "Offering Circular") up to €5,000,000,000 (or its equivalent in other currencies) outstanding at any time.

### Related party transactions

#### Details of the Reorganisation

Numerous transactions were required to effect the reorganisation of the mmO<sub>2</sub> Group. The broad effect of the reorganisation is described below.

In Germany, in order to separate the mobile business from the fixed line business, pursuant to a transfer agreement dated 28 February 2001, O<sub>2</sub> Germany, transferred its fixed line business to a German partnership, BT Ignite GmbH & Co. OHG, referred to as BT Ignite, which is wholly owned by BT. In the Netherlands, BT held its combined mobile and fixed business indirectly through a wholly owned subsidiary, Telfort Holdings NV and its wholly owned subsidiary Telfort BV. Telfort Holdings NV's mobile telecommunications licences were transferred to Telfort BV pursuant to a transfer agreement dated 21 February 2001, effective as of 1 April 2001. Subsequently, the mobile business, including the licences, was transferred from Telfort BV to a newly incorporated subsidiary of Telfort BV, O<sub>2</sub> Netherlands. This transfer took place pursuant to a notarial deed of demerger dated 31 March 2001. From 1 April 2001, Telfort Holdings NV was renamed BT Ignite Nederland Holding NV and Telfort BV was renamed BT Ignite Nederland BV.

In the United Kingdom, BT transferred its BT Messaging, BT Mobile and BT Paging businesses and its BT Shops business to the mmO<sub>2</sub> Group by means of two asset transfer agreements each dated 31 May 2001. The agreement transferring the BT Messaging, BT Mobile and BT Paging businesses treats that transfer as having economic effect from the close of business on 31 March 2000. Pursuant to an agreement dated 18 September 2001, BT agreed to transfer the Airwave business to a subsidiary of O<sub>2</sub> prior to the demerger. The transfer was effected on 15 November 2001.

Pursuant to a share transfer agreement dated 14 August 2001, BT transferred its shares in O<sub>2</sub> Online to O<sub>2</sub> UK. BT and O<sub>2</sub> UK also transferred certain O<sub>2</sub> Online assets to O<sub>2</sub> Online, pursuant to an agency letter and a transfer agreement dated 28 June 2001 and 14 August 2001 respectively. Pursuant to further share transfer agreements dated between 9 August 2001 and 14 August 2001, BT transferred its interests in subsidiaries operating O<sub>2</sub> Online's overseas activities in Spain, Italy, France and certain Asian countries to a subsidiary of O<sub>2</sub>.

BT's mobile business in Ireland was held in a distinct subsidiary of BT and therefore did not require separation from non-mobile businesses.

The subgroup of companies forming the business of O<sub>2</sub> UK was already held by O<sub>2</sub>.

Before contributing its various mobile and related interests to O<sub>2</sub> and its subsidiaries, BT reorganised its shareholdings in O<sub>2</sub> resulting in BT holding directly all of the issued shares in O<sub>2</sub>.

BT then transferred its subsidiaries owning mobile businesses in the United Kingdom, Germany, the Netherlands and Ireland and its subsidiary owning combined fixed and mobile businesses in the Isle of Man to O<sub>2</sub> or its subsidiaries, pursuant to a series of transfer agreements. Following all of these transfers, O<sub>2</sub> held BT's mobile businesses in the United Kingdom, Germany, the Netherlands, Ireland and the Isle of Man and the O<sub>2</sub> Online directly or indirectly, in a distinct sub-group, the mmO<sub>2</sub> Group.

#### Details of the Scheme of Arrangement

Under a UK court sanctioned scheme of arrangement which we refer to as the scheme of arrangement, a new holding company, mmO<sub>2</sub>, became the ultimate holding company of both the BT Group and our Group pursuant to a scheme of arrangement under Section 425 of the Companies Act.

Under the scheme of arrangement:

- >> the BT shares were cancelled and the holders of BT shares at the scheme of arrangement record time were allotted one mmO<sub>2</sub> ordinary share, credited as fully paid, for each BT share then held; and
- >> following the cancellation of the BT shares, the issued share capital of BT was restored to its former amount by applying the reserve arising in the books of BT as a result of the cancellation of the BT shares in paying up in full new ordinary shares of an equivalent nominal amount. These were issued to mmO<sub>2</sub> and/or its nominees.

As a result, mmO<sub>2</sub> became the holding company of BT Group plc and the mmO<sub>2</sub> Group and all of its shares were owned by the former BT Shareholders. It remained the holding company of the BT Group only until completion of the demerger transaction, which took place a short time after the scheme of arrangement became effective.

### Details of the Demerger Transaction

Under the demerger transaction, as a result of the arrangements described in more detail below, BT Group plc issued BT Group plc ordinary shares to mmO<sub>2</sub> shareholders at the demerger record time on the basis of one BT Group plc ordinary share for each mmO<sub>2</sub> ordinary share held at the demerger record time. Former BT shareholders received one BT Group plc ordinary share and one mmO<sub>2</sub> ordinary share for each BT share held at the scheme record time.

### Relationship with BT

In the year ended 31 March 2001, we received £517 million of turnover from and paid £536 million to the BT Group predominantly related to charges for telecommunications services provided to each other. Going forward, we do not expect these amounts to differ materially other than as a result of variations in utilisation of each others services.

mmO<sub>2</sub>, other members of the mmO<sub>2</sub> Group, BT and BT Group plc have entered into several agreements for the purpose of giving effect to the demerger transaction and defining the continuing relationship between the BT Group and the mmO<sub>2</sub> Group. These agreements have been concluded as a result of arm's-length negotiations and are summarised below.

### Demerger Agreement

On 18 September 2001, mmO<sub>2</sub>, BT Group plc and BT entered into an agreement, the Demerger Agreement, which set out the obligations of the parties in implementing the steps to achieve the demerger transaction.

Under this agreement mmO<sub>2</sub> agreed to transfer BT Group Investments to BT Group plc, and in exchange for such transfer, BT Group plc agreed to allot and issue BT Group plc ordinary shares to mmO<sub>2</sub> shareholders in satisfaction of the dividend required to effect the last step of the demerger transaction such that each mmO<sub>2</sub> shareholder at the demerger record time was entitled to receive one BT Group plc ordinary share for each mmO<sub>2</sub> ordinary share then held. No party to this agreement has given any representation, warranty or indemnity to the others and no party has any right to rescind this agreement.

### Separation Agreement

On 18 September 2001, mmO<sub>2</sub>, BT Group plc, O<sub>2</sub> and BT entered into a Separation Agreement, which was amended and restated on 31 October 2001. Under the Separation Agreement, prior to the demerger transaction becoming effective, BT agreed to convert into equity part of the intercompany debt owed by the mmO<sub>2</sub> Group to the BT Group such that the net indebtedness (excluding trading balances) owed by the mmO<sub>2</sub> Group (including to the BT Group) outstanding at the effective date of the demerger transaction was approximately £500 million.

Following the demerger transaction mmO<sub>2</sub> and BT Group plc also agreed to allocate certain assets and liabilities and rights and obligations between their respective groups. mmO<sub>2</sub> was to be responsible for insuring the ongoing activities of its business following the demerger transaction.

The allocation of assets and liabilities in the Separation Agreement supplemented the asset and share transfer agreements entered into between members of our Group and the BT Group to effect the reorganisation.

In addition, under the Separation Agreement, mmO<sub>2</sub> and BT Group plc agreed, subject to certain limited exceptions, to indemnify each other against certain actual and contingent liabilities to the extent arising directly or indirectly out of our respective businesses. The purpose of these indemnities is to ensure effective implementation of the principles on which it has been agreed that assets and liabilities should be allocated between us and the BT Group. Furthermore, mmO<sub>2</sub> and BT Group plc have agreed to indemnify one another against certain liabilities arising from certain incomplete, false or misleading information provided by either of mmO<sub>2</sub> or BT Group plc, or their respective groups, for inclusion in public documents. Such indemnities apply indefinitely and are not subject to any financial limit.

The Separation Agreement contains no representations or warranties by any party.

mmO<sub>2</sub> agreed that it will use all reasonable endeavours to obtain a full and effective release of each relevant member of the BT Group from



## supplementary information for United States investors

any guarantees, undertakings, and indemnities which such BT Group member may have given in respect of our Group, including certain undertakings in respect of O<sub>2</sub> Germany's UMTS licence obligations.

Each of mmO<sub>2</sub> and BT Group plc agreed to make certain information available to the other in so far as it is reasonably necessary for the other's commercial affairs and, in particular, for the purpose of preparing financial statements or complying with regulatory requirements.

The Separation Agreement also sets out the parties' agreement for the separation of the pensions arrangements of the BT Group and the mmO<sub>2</sub> Group. These arrangements are described in more detail below.

### Pensions Arrangements

The Separation Agreement described above sets out in a schedule the terms on which mmO<sub>2</sub> and BT have agreed to deal with the pensions arrangements affected by the demerger transaction for the BT Group and the mmO<sub>2</sub> Group.

During the participation period, mmO<sub>2</sub> will contribute in respect of employees who are members of the BT Pension Scheme at the rate of 11.6 per cent of such employees' pensionable salaries and employees will continue to contribute 6 per cent of pensionable salary.

The pensions schedule to the Separation Agreement also provides for the making of a transfer payment, subject to certain conditions, following the end of the participation period in respect of those members of the BT pension scheme who consent to the transfer of their past service benefits from the BT pension scheme to a new pension arrangement to be established by mmO<sub>2</sub>. mmO<sub>2</sub> intends that these arrangements will provide benefits which are broadly equivalent in actuarial value to those accruing under the BT pension scheme. The pensions schedule also provides that the transfer payment will be calculated on a past service reserve basis (that is, based on accrued rights with an allowance for projected future salary increases) in accordance with actuarial methods and assumptions set out in the pensions schedule. Under the pensions schedule, BT will use its best endeavours to procure the payment of the transfer payment by the trustees of the BT pension scheme. If the transfer amount is not paid in full by the trustees, BT is obliged to make up the shortfall up to a maximum of £30 million. Under the terms of the pensions schedule, mmO<sub>2</sub> will be indemnified by BT against any liability it has to the BT pension scheme following the demerger transaction (other than liability to continue to make contributions during the duration of the participation period as set out in the pensions schedule) and in relation to any potential past service liability for the non-recognition of employees' part-time services and non-compliance with any obligations to replicate civil service benefits.

### Tax Agreement

On 18 September 2001, mmO<sub>2</sub> and BT Group plc entered into a Tax Agreement. The Tax Agreement contains provisions relating to, among other things, the allocation of tax liabilities between the mmO<sub>2</sub> Group and the BT Group, the manner in which the groups will prepare and agree tax computations and returns, the basis on which certain claims and elections can be made (including the surrender of tax reliefs from one group to the other and the ability of the BT Group to "roll over" capital gains into assets owned by the mmO<sub>2</sub> Group), the conduct of negotiations and disputes with the tax authorities, the exchange of information relating to their tax affairs and certain other administrative matters.

The two general principles underlying the Tax Agreement are that:

- >> each group company shall be responsible for its own tax liabilities arising after the demerger transaction; and
- >> the two groups shall co-operate to try to minimise the aggregate tax liabilities of members of the groups for accounting periods beginning before the demerger transaction was effected.

There are certain limited exceptions to these general principles.

mmO<sub>2</sub> and BT Group plc have agreed that they shall respectively be responsible for the preparation of the tax computations and returns for the members of their respective groups for all periods after the demerger transaction, and deal with all negotiations, correspondence and agreements with the tax authorities with respect to those computations and returns subject to certain limited exceptions. mmO<sub>2</sub> has agreed to procure the surrender of losses to members of the BT Group and to permit certain capital gains realised by members of the BT Group to be rolled over for UK tax purposes into certain assets of the mmO<sub>2</sub> Group.

The parties have agreed that each group shall be responsible for conducting any negotiations or disputes with the tax authorities relating to the tax liabilities of that group, subject to certain limited exceptions.

### Framework Agreement

O<sub>2</sub> entered into a framework agreement, the Framework Agreement, on 31 May 2001 with BT which prescribes that following the demerger transaction, each will deal with each other and will procure that their respective subsidiaries deal with each other on an arm's length basis in the United Kingdom, on commercial terms and that each will treat the other and its subsidiaries as independent trading entities. The Framework Agreement also prescribes certain terms and conditions which apply across the various UK trading and shared services agreements between O<sub>2</sub>, its subsidiaries and BT and its subsidiaries, described below, subject to certain exceptions. For the purposes of the Framework Agreement, and the trading and shared services agreements described below, the United Kingdom includes the Isle of Man.

In the event that there is a conflict between the provisions of a trading or shared services agreement in the United Kingdom and the Framework Agreement, the trading or shared services agreement will take precedence.

The Framework Agreement with BT is effective from the date of signature and is for an initial period of 12 months, terminable by O<sub>2</sub> or by BT on three months' written notice taking effect after the initial 12-month period. Expiry of a framework agreement will not affect the continuance of any trading agreement entered into pursuant to it.

No monetary consideration is payable under this agreement. Neither party to it gives any representation, warranty or indemnity.

The terms and conditions of the Framework Agreement do not apply to agreements between O<sub>2</sub> and BT or their respective subsidiaries for network services and telecommunications services, which are and will continue to be provided, where relevant, on standard arm's length terms and conditions that are applicable to other recipients of such services, or to arrangements for the use of BT properties by us, which are addressed separately and for which the provisions of the Framework Agreement are not appropriate.

We have not entered into framework agreements in relation to our business in Germany, the Netherlands and Ireland. Nevertheless, our trading arrangements with the BT Group in these countries are and will continue to be on arm's length terms.

The key trading and shared services agreements that we have agreed with the BT Group may be summarised as follows.

### Trading Agreements

**IT Master Services Agreement.** O<sub>2</sub> entered into an agreement with BT on 18 September 2001, under which BT has agreed to continue to provide O<sub>2</sub>, and the other members of the mmO<sub>2</sub> Group in the United Kingdom, with IT services of a project or a continuous nature. Our UK mmO<sub>2</sub> Group companies will continue to receive these services from different divisions within the BT Group. The IT Master Agreement is designed to harmonise the legal structure for the provision by the different divisions within the BT Group of IT services to such mmO<sub>2</sub> Group companies. In general, a member of the mmO<sub>2</sub> Group or BT may terminate services of a continuous nature on industry standard notice periods. However, BT has, in respect of certain key services, agreed to use all reasonable endeavours to ensure that the UK mmO<sub>2</sub> Group companies continue to receive from the BT Group, on an arm's length basis, the IT services that were provided to such companies before the demerger transaction, for at least a transitional period.

**Telecommunications Services.** In the United Kingdom, Germany, the Netherlands and Ireland there are a series of agreements between us and members of the BT Group governing the provision of telecommunications services between us such as voice, data and telephony services. These agreements vary in term but, in general, in the United Kingdom such services are supplied on standard published terms and conditions. Elsewhere, agreements are based on terms and conditions generally applicable to such services offered by the relevant party.

**Network Agreements.** In the United Kingdom, Germany, the Netherlands and Ireland there are a series of network agreements between us and members of the BT Group governing the provision of operator to operator services including, for example, the provision of private circuits, frame relay services, leased lines, call termination and interconnection services. These agreements vary in term but, in general, in the United Kingdom interconnection is on BT's standard published terms for interconnection. Elsewhere, agreements are based on terms and conditions generally applicable to such services offered by the relevant party.

**Field Operation Services and Maintenance Agreements.** In the United Kingdom, certain members of our Group entered into several agreements with BT that provide that BT will maintain cell site equipment and the core network switching infrastructure relating to various networks in the United Kingdom, including O<sub>2</sub> UK's principal network and paging network. These agreements vary in term. The most significant of these agreements, relating to O<sub>2</sub> UK's principal network, has a term of five years, terminable on between three and 12 months' notice, depending on the circumstances.

**Point to Multi-Point (PMP) Frequency Usage Agreement and Side Letters.** In Germany, our subsidiary O<sub>2</sub> Germany holds licences for the use of local loop frequencies. For regulatory reasons, the licences for use of such frequencies which are used by the BT Ignite fixed-line business rather than by O<sub>2</sub> Germany's mobile business, cannot be transferred to BT Ignite. For this reason, O<sub>2</sub> Germany has granted to BT Ignite an irrevocable and exclusive right to exploit such frequencies as if BT Ignite, to the extent permitted by law, were the licensee. The agreement provides for a penalty to be paid by O<sub>2</sub> Germany to BT Ignite if, other than as a result of acts or omissions by BT Ignite or as a result of lawful governmental, regulatory or legal restrictions or requirements, any of these frequencies or licences are revoked and BT Ignite is prevented from carrying on its services.

The agreement will terminate automatically in the event that all of the frequencies and frequency licences are lawfully transferred and/or assigned to BT Ignite. O<sub>2</sub> Germany has agreed with the BT Ignite to seek consent from the relevant German regulatory authority to the transfer of these frequencies and licences from O<sub>2</sub> Germany to BT Ignite. In addition, O<sub>2</sub> Germany has agreed to provide BT Ignite with consultancy services relating to the management of existing PMP sites and, at BT Ignite's request, any future PMP sites. BT Ignite may terminate the PMP Frequency Usage Agreement in whole, or with respect to a particular frequency, by giving O<sub>2</sub> Germany four weeks' notice of termination.

## supplementary information for United States investors

**Airwave Sub-contract.** The Airwave business provides radio network services to certain public safety organisations in the United Kingdom. In February 2000, BT was awarded a contract by the UK government to provide mobile radio services to a number of police authorities. On 15 November 2001 BT transferred the Airwave business, including this contract, to a subsidiary of O<sub>2</sub>. In addition to the contract with the UK government, BT has also entered into separate contracts with a number of police authorities detailing the services to be provided to those authorities. We entered into a sub-contract with BT on 15 November 2001 under which a subsidiary of O<sub>2</sub> will perform BT's obligations under any such contracts that do not transfer to us with the Airwave business due to delay in obtaining necessary police authority consents. We believe that we did not require the consent of affected police authorities to enter into such sub-contracting arrangements. The sub-contract transfers substantially all the costs and rewards of the contracts to us. We have agreed that we will indemnify BT for its liabilities under such contracts arising out of our performance as sub-contractor. The sub-contract will cease to apply to each services contract once it is transferred to us with the consent of the relevant authority, and will expire once all services contracts are transferred to us.

**Technical Services.** O<sub>2</sub> has entered into a framework agreement with BT (trading as BT Exact Technologies) under which O<sub>2</sub> may request BT Exact Technologies to provide mmO<sub>2</sub> Group companies with research, development and/or consultancy services in accordance with individual work packages agreed from time to time between O<sub>2</sub> and BT. The agreement has a term of three years, although work packages may be negotiated for a longer period and would continue to be governed by the agreement. The agreement is on arm's length terms. Charges are agreed as and when the commercial terms of individual work packages are agreed. Either party may terminate the agreement or a work package if the other party commits a material breach of the agreement or upon the other party being affected by insolvency related events.

**Wireless Trading Agreement.** O2 UK and BT entered into this agreement on 14 September 2001. It provides that BT will continue to promote exclusively our mobile telecommunications products and services to the business market in the United Kingdom. This agreement is for an initial term of three years and may be terminated by either party if the other does not meet certain performance targets. Either party may also terminate the agreement upon, amongst other things, material or persistent breach or insolvency proceedings. Either party may also terminate the agreement upon 12 months' notice following a change of control of the other party. O2 UK will pay BT a percentage of the revenue it receives for sales to business customers introduced by BT. BT may also buy mobile network capacity from O2 UK at wholesale prices in order to provide communications solutions to its own business customers. BT has undertaken to ensure that a specified minimum level of revenue will be generated for O2 UK by sales through BT to business customers contracting directly with O2 UK through BT as an agent rather than through wholesale sales by O2 UK to BT. Subject to limited exceptions BT has agreed not to solicit business customers who have contracts with O2 UK at the time the agreement was entered into.

Furthermore, for a period of three years, in the United Kingdom, BT will not, subject to certain specified exceptions, create its own mobile telecommunications network or virtual mobile telecommunications network or incur significant costs in the provision or sale of major wireless billing systems or major wireless network products for the purpose of providing wireless services to business customers. BT is permitted, however, amongst other things, to continue to provide network building services, outsourcing services, network capacity services to wholesale customers, research and development services, systems integration and management of infrastructure services.

BT is permitted to sell competing mobile services to consumers and to both business customers and consumers through certain marketing channels targeted at consumers, including BT's internet domains. In specified circumstances, BT may sell competing mobile services to business customers which have requested a service other than O<sub>2</sub> UK's, provided BT has offered O<sub>2</sub> UK the opportunity to offer a service to such customer.

Each party indemnifies the other for liability arising from breach of this agreement and any tortious act or omission. Other than in respect of liability arising from infringement of intellectual property rights, death or personal injury due to negligence or failure to pay charges properly due under this agreement, the liability of each party is limited in any annual period to £5 million.

### Shared Services Agreements

**Administrative Services.** In the United Kingdom, Germany and the Netherlands we entered into a number of agreements with the BT Group under which such BT Group members will provide us with many of the administrative non-network services that we received as part of the existing BT Group before the demerger transaction. The services covered by these agreements include, for example, services in respect of property management, payroll, customer billing and human resources. Administrative services required by O<sub>2</sub> Online in jurisdictions other than the United Kingdom, Germany and the Netherlands are provided by the BT Group under the UK administrative services agreement.

In addition, in the United Kingdom, Germany and the Netherlands members of the mmO<sub>2</sub> Group provide certain administrative services to the BT Group.

We anticipate that most services provided under these agreements will be provided by the BT Group to members of the mmO<sub>2</sub> Group and vice versa on a transitional basis only. However, some services are expected to be provided for a longer period until terminated in accordance with the relevant provisions of the administrative services agreement. For example, in Germany BT Ignite will provide risk management services in respect of our web-based Geographic Information Systems for an indefinite period, subject to termination on one month's notice.

**Site Sharing and Occupancy Licences.** In the United Kingdom, Ireland and Germany there are agreements between members of the mmO<sub>2</sub> Group and members of the BT Group that permit us access to and use of office premises, technical equipment premises and, in the United Kingdom and Ireland cell site premises, which are currently owned or leased by the BT Group, but occupied by us and our group companies. In the United Kingdom, around 9% of the cell sites which form part of O<sub>2</sub> UK's principal network are on premises owned or leased by BT. In addition, in Ireland, the site sharing agreement between us and the BT Group provides for the BT Group to access and use technical equipment sites currently leased by us.

The rent payable in respect of each of the properties covered by these agreements varies depending on the premises occupied. However, in each case the level of rent is market rate. The term of each of these agreements varies according to use.

**Trade Marks, Domain Names and Branding.** O<sub>2</sub> and O<sub>2</sub> UK entered into a Trade Mark and Domain Name Licence Agreement ("TM Licence") with BT on 18 September 2001. Under the TM Agreement, our UK businesses and O<sub>2</sub> Netherlands's business in the Netherlands have been granted the right until 31 March 2003 to continue to use the letters "BT" (including the stylised "BT" corporate logo), the BT full piper logo, the BT half piper logo and certain "BT" prefixed domain names ("BT Brands") to the extent that we used such BT Brands immediately before the demerger transaction, except in respect of fixed line telephony goods and services and all other hardware and telecommunications equipment and certain internet related services. BT is only entitled to terminate the TM Licence in limited circumstances, such as a breach of the licence by an mmO<sub>2</sub> Group member, or where O<sub>2</sub> or O<sub>2</sub> UK is affected by insolvency related proceedings. In any event, we are obliged to phase out all use (including use in domain names) of the BT Brands by 31 March 2003.

BT, O<sub>2</sub> and O<sub>2</sub> UK have provided various undertakings to each other in relation to the way in which they use and maintain the BT Brands. On termination of the TM Licence, O<sub>2</sub> and O<sub>2</sub> UK are required to transfer to BT any domain names still in the possession of the mmO<sub>2</sub> Group that include the prefix "BT". So as to avoid confusion in the marketplace on termination of the TM Licence BT, O<sub>2</sub> and O<sub>2</sub> UK will seek to agree, on a case-by-case basis, a reasonable period of time (not exceeding two years) during which BT may not re-use those "BT" prefixed domain names that were transferred back.

The TM Licence is royalty-free during its term provided that we comply with its terms. BT has a limited right to charge O<sub>2</sub> royalties in the event that O<sub>2</sub> UK does not meet certain quality standards.

Throughout the TM Licence term BT has agreed not to use, or licence the use of, in the United Kingdom any of the BT Brands in respect of mobile handsets, SIM cards or the provision of mobile airtime to consumers except that BT may use such brands in these areas alongside other mobile network operators (as part of a co-branding exercise) or as part of a bundled offering to consumers.

**Intellectual Property Licence.** O<sub>2</sub> and O<sub>2</sub> UK have a non-exclusive royalty-free licence from BT permitting them and the other mmO<sub>2</sub> Group members to continue to use any and all patents, copyrights, unregistered design rights, database rights and know how, which BT owns and which the mmO<sub>2</sub> Group uses, in connection with its world-wide businesses as they are carried on immediately prior to the demerger transaction to the extent that such rights were used in those businesses immediately before the demerger transaction. BT is only entitled to terminate the licence following an insolvency related event affecting O<sub>2</sub>.

## additional information for shareholders

### Cautionary statement regarding forward-looking statements

This annual report and financial statements contains certain forward-looking statements. We may also make written or oral forward-looking statements in:

- >> our periodic reports to the US Securities and Exchange Commission, also known as the SEC, on Forms 20-F and 6-K;
- >> our half-yearly reports;
- >> our press releases and other written materials; and
- >> oral statements made by our officers, Directors or employees to third parties.

We have based these forward-looking statements on our current plans, expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about us. Forward-looking statements speak only as of the date they are made.

Statements that are not historical facts, including statements about our beliefs and expectations are forward-looking statements. Words like "believe", "anticipate", "expect", "intend", "seek", "will", "plan", "could", "may", "might", "project", "goal", "target" and similar expressions often identify forward-looking statements but are not the only ways we identify these statements.

These statements may be found in "Risk Factors", "Business Review", "Operating and Financial Review and Prospects", "Supplementary information for United States investors", and in this registration statement generally. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in the above-mentioned sections.

If any one or more of the foregoing assumptions are ultimately incorrect, our actual results may differ from our expectations based on these assumptions. Also, the sector and markets in which we operate may not grow over the next several years as expected, or at all. The failure of these markets to grow as expected may have a material adverse effect on our business, operating results and financial condition and the market price of our ordinary shares and American Depositary Shares.

The information on our website, any website mentioned in this registration statement or any web site directly or indirectly linked to our or any other website mentioned in this registration statement is not incorporated by reference into this registration statement and you should not rely on it.

### Listings

The ordinary shares of the Company were listed on the London Stock Exchange on 19 November 2001. The ordinary shares were also listed on the New York Stock Exchange (in the form of American Depositary Shares (ADSs)) from the same date. ADSs evidenced by American Depositary Receipts (ADRs), each representing ten ordinary shares, have been issued by JPMorgan Chase Bank as Depositary for the ADRs.

### Share and ADR prices

	Pence per ordinary share		US\$ per ADR	
	High pence	Low pence	High \$	Low \$
December 2001	91.50	79.00	12.92	11.07
January 2002	91.50	76.25	13.06	10.85
February 2002	77.50	60.00	11.05	8.75
March 2002	72.00	63.25	10.15	8.86
April 2002	68.00	43.50	9.83	6.30

The prices are the highest and lowest closing middle market prices for mmO<sub>2</sub> plc ordinary shares, as derived from the Daily Official List of the London Stock Exchange, and the highest and lowest sales prices of mmO<sub>2</sub> plc ADRs, as reported on the New York Stock Exchange composite tape, for the months indicated.

### Analysis of shareholdings

Size of Shareholding at 31 March 2002	Number of shareholders	Percentage of total	Ordinary shares of 0.1p each	
			Number of shares held	Percentage of total
1 – 500	906,145	53.48	236,298,994	2.72
501 – 999	407,546	24.05	285,024,222	3.29
1,000 – 9,999	373,871	22.07	754,725,618	8.70
10,000 – 99,999	5,160	0.31	103,612,418	1.20
100,000 – 999,999	1,033	0.06	383,034,167	4.42
1,000,000 – 4,999,999	410	0.02	922,767,035	10.64
5,000,000 and above	227	0.01	5,984,586,962	69.03
<b>Total</b>	<b>1,694,392</b>	<b>100.00</b>	<b>8,670,049,416</b>	<b>100.00</b>

At 31 March 2002, the number of holders of record of mmO<sub>2</sub> plc ordinary shares in the USA was 3,331 with holdings of 2,171,161 ordinary shares, and the number of registered holders of ADRs was 2,045 with holdings of 15,274,320 ADRs, representing 152,743,200 ordinary shares. Because certain of these ordinary shares and ADRs were held by brokers or other nominees, the number of holders of record or registered holders in the USA is not representative of the number of beneficial holders or of the residence of beneficial holders.

At 28 May 2002 no person or company is known to hold more than five per cent of the Company's ordinary shares. The Company is not directly or indirectly owned or controlled by any other company or any government.

### Financial calendar/results announcements

Annual General Meeting 23 July 2002

#### Proposed dates:

Q1 Trading Statement July 2002  
 Interim Results November 2002  
 Q3 Trading Statement February 2003  
 Preliminary Announcement May 2003  
 Publication of the Annual Report and Financial Statements and Form 20-F June 2003

### ShareGift

The Orr Mackintosh Foundation (ShareGift) operates a charity share donation scheme for shareholders with small parcels of shares whose value makes it uneconomic to sell them. Details of the scheme are available on the ShareGift internet site [www.sharegift.org](http://www.sharegift.org).

### Exchange Controls and other limitations affecting security holders

There are currently no exchange controls or other limitations in the UK affecting security holders.

### Exchange rates

The table below sets forth, for the periods indicated, information concerning the highest and lowest noon buying rates in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York expressed in US dollars per pound sterling:

Month	£1.00 = US dollars		
	High	Low	Period End
November 2001	1.4650	1.4095	1.4255
December 2001	1.4588	1.4164	1.4543
January 2002	1.4482	1.4074	1.4120
February 2002	1.4322	1.4117	1.4129
March 2002	1.4287	1.4146	1.4250
April 2002	1.4592	1.4310	1.4565

The table below sets forth the average of the noon buying rates in New York City for cable transfers in pounds sterling on the last full day of each full month during each of the last five years ended 31 March 2002, as certified for customs purposes by the Federal Reserve Bank of New York expressed in US dollars per pounds sterling:

Year Ended 31 March	£1.00 = US dollars
1998	1.6463
1999	1.6526
2000	1.6085
2001	1.4737
2002	1.4320
1 April 2002 through 30 April 2002	1.4565

### Cassettes for visually impaired shareholders

The Company's Annual Review is available on audio cassette. Copies can be obtained, free of charge, from the Registrar, Lloyds TSB Registrars, by calling Freefone 0808 100 4102.

### Summary of the Memorandum and Articles of Association

The following change to the Articles of Association of the Company was made on 20 December 2001 pursuant to a conditional special resolution passed on 11 September 2001:

- >> on 20 December 2001, the one issued redeemable preference share of £50,000 was redeemed, following which, pursuant to a conditional special resolution passed on 11 September 2001, the authorised redeemable preference share capital was sub-divided into and redesignated as 50,000,000 ordinary shares with a face value of 0.1p each.

### Annual Report and Financial Statements

Further copies of our Annual Report and Financial Statements can be obtained by contacting our Registrar, Lloyds TSB Registrars, on Freefone 0808 100 4102.

### Capital Gains Tax

The confirmed official opening prices for mmO<sub>2</sub> ordinary shares and BT Group plc ordinary shares for Capital Gains Tax (CGT) purposes, were 82.75 pence and 285.75 pence respectively. This means that, of the total value of 368.5 pence, 22.456 per cent is attributable to mmO<sub>2</sub> and 77.544 per cent to BT Group plc.

Accordingly, for CGT calculations, the base cost of your mmO<sub>2</sub> ordinary shares is calculated by multiplying the acquisition cost of your BT shareholding by 22.456 per cent and the base cost of your BT Group plc ordinary shares is calculated by multiplying the acquisition cost of your BT shareholding by 77.544 per cent.

### Annual General Meeting

The first Annual General Meeting will be held at the Hilton Birmingham Metropole Hotel, National Exhibition Centre, Birmingham B40 1PP, on Tuesday 23 July 2002 at 10.30 a.m.

### Shareholder information

To view up-to-date information about your shareholding visit the Lloyds TSB Registrars shareview website at [www.shareview.co.uk](http://www.shareview.co.uk).

The portfolio service provides access to more information on your investments including balance movements and indicative share prices. To register with Lloyds TSB Registrars as a user of the portfolio service and for more information visit the website at [www.shareview.co.uk](http://www.shareview.co.uk).

## contacts

### Shareholder enquiries

Lloyds TSB Registrars maintain the Company's share register and provide a shareholder helpline service (details opposite). Shareholders should contact the Registrar if they have any enquiries about their shareholding.

### The Registrar

Lloyds TSB Registrars (2501)  
The Causeway  
Worthing  
West Sussex BN99 6DA

mmO<sub>2</sub> plc shareholder helpline  
Tel: Freefone 0808 100 4102  
Fax: 01903 833371  
From outside the UK:  
Tel: +44 121 415 7102  
Fax: +44 1903 833371

### ADR Depositary

JP Morgan Chase Bank  
ADR Service Center  
PO Box 43013  
Providence, RI 02940-3013  
USA

Toll-free from within the USA:  
Tel: 1 800 428 4237  
From outside the USA:  
Tel: +1 781 575 4328

### General enquiries

mmO<sub>2</sub> plc  
5 Longwalk Road  
Stockley Park East  
Uxbridge  
Middlesex UB11 1TT  
www.mmo2.com

Address from July 2002  
mmO<sub>2</sub> plc  
Wellington Street  
Slough SL1 1YP

### Registered offices

#### O<sub>2</sub> (UK) Limited

260 Bath Road  
Slough SL1 4DX  
www.o2.co.uk

#### O<sub>2</sub> (Germany) GmbH & Co. OHG

Georg-Brauchle-Ring 23-25  
80992 Munich  
Germany  
www.o2online.de

#### O<sub>2</sub> (Netherlands) B.V.

De Entree 222  
1101 EE Amsterdam ZO  
The Netherlands  
www.o2.nl

#### O<sub>2</sub> Communications (Ireland) Limited

Digifone House  
76 Lower Baggot Street  
Dublin 2  
Ireland  
www.o2.ie

#### O<sub>2</sub> (Online) Limited\*

5 Longwalk Road  
Stockley Park East  
Uxbridge  
Middlesex UB11 1TT

#### Manx Telecom Limited

Isle of Man Business Park  
Cooil Road, Braddan  
Isle of Man IM99 1HX  
www.manx-telecom.com

#### Airwave mmO<sub>2</sub> Limited\*

5 Longwalk Road  
Stockley Park East  
Uxbridge  
Middlesex UB11 1TT  
www.airwaveservice.co.uk

#### mmO<sub>2</sub> (North America) Inc.

Corporation Trust Center  
1209 Orange Street  
Wilmington  
Delaware DE 19801  
USA  
www.mmo2.com

\*In July 2002, the registered offices of these companies will change to the new address of mmO<sub>2</sub> plc in Slough.

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Designed and typeset by Pauffley, London  
Printed in England by St Ives Burrups Limited

## glossary of terms

Terms Used	US Equivalent or Brief Description
Articles of Association . . . . .	Bylaws
Associates . . . . .	Equity investments
Balance sheet . . . . .	Statement of financial position
Called-up share capital . . . . .	Ordinary shares, issued and fully paid
Capital allowances . . . . .	Tax depreciation allowances
Creditors . . . . .	Payables
Debtors . . . . .	Receivables
Finance lease . . . . .	Capital lease
Financial year . . . . .	Fiscal year
Freehold . . . . .	Ownership with absolute rights
Interest payable . . . . .	Interest expense
Interest receivable . . . . .	Interest income
Joint venture . . . . .	Equity investment
Nominal value . . . . .	Par value
Ordinary shares . . . . .	Common stock
Overdraft . . . . .	A line of credit, contractually repayable on demand unless a fixed-term has been agreed, established through a customer's current account
Preference shares . . . . .	Preferred stock
Profit & loss account . . . . .	Income statement
Profit & loss account reserve . . . . .	Retained earnings
Provisions . . . . .	Reserves
Share capital . . . . .	Ordinary shares or common stock issued and fully paid
Shareholders' funds . . . . .	Stockholders' equity
Stock . . . . .	Inventories
Tangible fixed assets . . . . .	Property, plant and equipment
Turnover . . . . .	Revenue



## definitions

The following definitions apply throughout this document unless the context requires otherwise:

- “Airwave” . . . . . Airwave mmO<sub>2</sub> Limited, a company incorporated in England and Wales with a registered number 3985643
- “analogue” . . . . . The first generation of mobile telecommunications technology in which radio signals are modulated proportionally by the strength and frequency of audio sounds.
- “BT” . . . . . British Telecommunications public limited company, a company incorporated in England and Wales with registered number 1800000.
- “BT Group” . . . . . BT Group plc and its subsidiary undertakings from time to time.
- “BT Group plc” . . . . . BT Group plc, a company incorporated in England and Wales with registered number 4190816.
- “GPRS” . . . . . General Packet Radio Service. A technology, sometimes referred to as 2.5G, that allows customers to remain connected to the network between calls for the receipt and transmission of data.
- “GSM” . . . . . The Global System for Mobile communications. Originally defined as a pan-European standard for digital cellular telephone networks to support roaming, it is now one of the world’s main digital mobile standards.
- “Manx Telecom” . . . . . Manx Telecom Limited, a company incorporated in the Isle of Man with registered number 28059.
- “mmO<sub>2</sub>” or the “Company” . . . . . mmO<sub>2</sub> plc, a company incorporated in England and Wales with registered number 4190833.
- “mmO<sub>2</sub> Group” or “Group” . . . . . mmO<sub>2</sub> plc and its subsidiary undertakings from time to time.
- “mmO<sub>2</sub> Ordinary Shares” or  
“ordinary shares” . . . . . Ordinary shares of 0.1 pence each in the capital of mmO<sub>2</sub>.
- “O<sub>2</sub>” . . . . . O<sub>2</sub> Limited, formerly BT Wireless Limited, formerly Cellnet Group Limited, a company incorporated in England and Wales with registered number 2604354 together, where the context requires, with its subsidiary and associated undertakings.
- “O<sub>2</sub> Germany” . . . . . O<sub>2</sub> (Germany) GmbH & Co.OHG formerly VIAG Interkom GmbH & Co. OHG, a company incorporated in Germany.
- “O<sub>2</sub> Ireland” . . . . . O<sub>2</sub> Communications (Ireland) Limited formerly Digifone mmO<sub>2</sub> Limited, formerly Esat Digifone Limited, a company incorporated in Ireland, together where the context requires with its subsidiary and associated undertakings.
- “O<sub>2</sub> Netherlands” . . . . . O<sub>2</sub> (Netherlands) B.V. formerly Telfort Mobiel BV, a company incorporated in the Netherlands.
- “O<sub>2</sub> Online” . . . . . O<sub>2</sub> (Online) Limited formerly Genie Internet Limited, a company incorporated in England and Wales with registered number 01906156 together, where the context requires, with its subsidiary and associated undertakings.
- “O<sub>2</sub> UK” . . . . . O<sub>2</sub> (UK) Limited formerly BT Cellnet Limited, a company incorporated in England and Wales with registered number 1743099 together, where the context requires, with its subsidiary and associated undertakings.
- “SMS” . . . . . a service sometimes known as text messaging, which enables mobile telephone users to send and receive written messages on their handsets.
- “TETRA” . . . . . Terrestrial Trunked Radio. Radio technology used in networks that require a high level of security and availability.
- “UMTS” . . . . . Universal Mobile Telecommunications System. An international standard of third generation, or 3G, mobile telecommunications.
- “WAP” . . . . . Wireless Application Protocol. A global, open standard for accessing online services through mobile devices.
- “we” or “us” . . . . . mmO<sub>2</sub> and/or, if the context so requires, one or more members of the mmO<sub>2</sub> Group.

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