

**Telefonica Europe plc**  
**Year ended 31 December 2017**

**Registered Number: 5310128**

**Telefonica Europe plc**  
**Financial Statements**  
**Year ended 31 December 2017**



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## **STRATEGIC REPORT**

Telefónica Europe plc (the "Company") is a member of the Telefonica group of companies (the Telefonica Group). The ultimate parent company is Telefónica S.A. headquartered in Spain and primarily listed on the Spanish stock exchange.

### **Business Model and Strategy**

The Company does not trade but acts as an intermediate holding company for the Telefonica Group operations in the UK including:

#### **Telefonica UK Limited**

Telefonica UK Limited (Telefonica UK) trading under the O2 brand is a leading UK mobile network operator whose primary business is providing mobile telecommunication and related services with over 32 million connections on the network. O2 pursues a customer led, mobile first strategy focused on delivering a differentiated customer experience and helping customers get the most out of mobile connectivity. This strategy requires that O2 focuses primarily on customer needs, using mobile technologies as the key enabler with the aim of making every day better through personal experiences that count.

O2 has a strong track record of delivering leading, customer focused propositions such as the O2 Refresh proposition (which offers separate airtime and device contracts so that customers can pay off the cost of their device at any time). To bring even more flexibility to customers, O2 has launched propositions such as: O2 Recycle (which allows customers to sell their old device in exchange for cash and has become one of the largest mobile recycling programmes by a mobile operator in Europe); an Annual Upgrade Program (which enables customers to get the newest device every year) and Like New (which offers customers a choice of quality-assured pre-owned handsets). More recently, O2 has launched Yo-Yo (which allows customers to change their tariff each month); Oops (which provides a free screen replacement on certain handsets) and Family plans (which provide discounts for additional family members using O2).

O2's customer focus also extends to looking after our planet with two world firsts: 1) Charger out of the Box, which means that with many phones we don't automatically give out a charger and 2) Eco rating, which enables customers to choose more sustainable phones.

#### **giffgaff Limited**

giffgaff operates as a 100% owned subsidiary of Telefonica UK Limited. giffgaff is an ancient Scottish word that means 'mutual giving' and, as such, giffgaff has 'members' rather than 'customers'.

giffgaff is a mobile virtual network operator which runs on the O2 Network, it seeks to attract a different profile of members to that which would be attracted to O2.

## STRATEGIC REPORT (CONTINUED)

### **giffgaff Limited (continued)**

giffgaff believes in listening to its members, involving them, being run by them and rewarding them with money. The idea is that "together with its members anything is possible". Members can help each other by answering one another's questions. They can recruit new members to the cause. They can come up with new ideas that improve the way giffgaff is run. In essence, giffgaff seeks to minimise costs by working in collaboration with its members and running a lean operation, without the need for its own retail shops or traditional call centres.

### **Weve Limited**

Weve operates as a 100% owned subsidiary of Telefonica UK Limited offering a full range of media and data powered services. It also delivers sophisticated brand communications through mobile messaging and display platforms for leading brands. Services are underpinned by some of the most intelligent data analytics available in the UK, providing clients with invaluable insight in campaign performance for both potential and existing customers.

Weve has verified first party data with O2 that provides and influences its business. Proprietary technology ensures that the data is anonymised, secure and ready for marketing.

Weve's vision is to deliver the most insightful, relevant, accurate and effective mobile advertising in the UK, which links offline (real world) behaviours with online (digital) activity. Weve's goal is to help advertisers better understand who their consumers are and how they behave and to connect with them in a uniquely engaging and effective way.

### **Tesco Mobile Ltd (Tesco)**

Tesco Mobile Ltd is a joint venture owned equally by the Tesco Plc Group and Telefonica, S.A. Group. Tesco operates as the provider of pre and post pay mobile communications and related services to consumers under the Tesco mobile brand, using the Tesco retail network for handset distribution and subscriber acquisition, and Telefonica's mobile communications network for airtime and related services.

The Group accounts for this entity using the equity method in the consolidated financial statements.

### **Cornerstone Telecommunications Infrastructure Ltd (CTIL)**

CTIL is engaged in maintaining and managing the non-radio (passive) assets supporting the mobile wireless network of Vodafone Limited (Vodafone) and Telefonica UK Limited (Telefonica). Telefonica and Vodafone are seeking to generate efficiencies in the deployment and operation of their networks in order to provide the best 2G, 3G and 4G network in the UK and reduce the environmental impact of their operations.

## **STRATEGIC REPORT (CONTINUED)**

### **Business Model and Strategy (continued)**

#### **Cornerstone Telecommunications Infrastructure Ltd (CTIL) (continued)**

In 2012, Telefonica and Vodafone pooled their respective networks into an evenly split joint venture, with the purpose of creating a joint single national grid of sites of passive assets. The 50% interest by Telefonica in CTIL is legally held by O2 Cedar Limited (10%) and O2 Networks Limited (40%). However Telefonica UK Limited as the main operating entity of the Group in UK, has the beneficial rights and obligations relating to Telefonica's interest in assets, liabilities, revenues and costs of this joint operation and consequently Telefonica's interest in the joint operation has been integrated into the separate financial statements of Telefonica UK Limited in accordance with IFRS11.

### **Our people**

The Company operates the same employee related policies and procedures as Telefonica UK, which is the main employing company in the UK.

Telefonica UK believes that people are a key part of our differentiation. Our aim is to create an environment that attracts a diverse and talented workforce with a focus on the customer and passion for our brand. This enables our people to perform at their best and helps us to deliver on our customer led, mobile first strategy.

We do this through three priorities:

- High Performing Culture – creating an environment and mind-set that encourages our people to perform at their best.
- Workforce Capability – ensuring we have the best people with the right skills for today, and a growth mind-set for tomorrow.
- Our People Experience – making it easier for our people, so they can spend their time at work on the things that matter.

### **Human rights and integrity**

We are committed to acting professionally, fairly and with integrity and do not tolerate any form of bribery or corruption. Our anti-bribery and corruption approach is summarised in our Business Principles which are essential for everyone working either for or on our behalf.

Based on the United Nations Guiding Principles on Business and Human Rights we have developed an express commitment to respecting the human rights of our stakeholders, including our people, members of the community, customers and business partners, as well as the millions of people who we influence every day through our products and services.

## **STRATEGIC REPORT (CONTINUED)**

### **Human rights and integrity**

We respect our people, defining and implementing exacting labour, environmental, health and safety standards, as well as fair, equitable, high-quality labour conditions:

- We are fully aware that, as a leading technology provider, our organisation can help to promote – or be used to impede – Human Rights.
- We extend the responsibility to respect human rights to our business relations. Requiring high performance levels from our supply chain – in labour, environmental and health and safety conditions – is for us a way of promoting and obtaining the best result to achieve changes and thus mitigate the risks related to abusive behaviour in business relations.
- With due consideration to Human Rights and through our products, services and knowledge of the challenges of the local communities, we respond to some of society's most relevant needs.

We undertake to explore all relevant opportunities for participation or alliance with external stakeholders to enable us to promote systemic changes and respect for human rights.

### **Telefonica UK Pension Plan**

Telefonica Europe plc is the Principal Employer of the Telefonica UK Pension Plan ("the Plan") which has been established to provide pension and life assurance benefits to employees of the Company and Participating Employers.

The Plan has Defined Benefit (DB) sections which are closed to future accrual. It also has Defined Contribution (DC) sections open to employees of the Principal Employer and Participating Employers. The Participating Employers are O2 Holdings Limited, Telefonica UK Limited, O2 Unify Limited and Telefonica Digital Limited.

The Plan operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, plan rules and UK legislation. The Plan's corporate trustee is Telefonica UK Pension Trustee Limited ("the Trustee"). The Trustee is the legal owner of the Plan's assets which are held separately from the assets of the Company and Participating Employers. The Board of the Trustee is responsible for operating the Plan in line with its formal rules and pensions law.

As Principal Employer, the Company liaises with the Board of the Trustee on the actuarial valuation of the DB sections of the Plan and other matters relating to the management of the Plan. The Principal Employer is committed to working with the Board of the Trustee to ensure that the Plan meets its regulatory requirements in line with the Pensions Regulator's guidelines, including ensuring that there is an ongoing recovery plan for any agreed deficit in the defined benefit sections of the Plan.

More information is provided in note 14 to the financial statements.

## **STRATEGIC REPORT (CONTINUED)**

### **Performance and Development**

The operating loss for the Company in the year to 31 December 2017 is £2m (31 December 2016: loss - £937m). This is primarily due to pension administration costs in the current year.

The Company has generated a profit before tax of £543m in 2017 in comparison to a loss before tax of £406m in the prior year which includes an impairment of £936m related to the investment in O2 Holdings Limited. Dividends of £550m (2016: £525m) were declared in 2017 and paid in cash in the year.

The net assets of the Company as at 31 December 2017 were £9,725m compared to £9,763m at 31 December 2016.

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

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

### **Principal risks and uncertainties**

The Directors have satisfied themselves that it is not essential for the Company to have a separate risk management system since the Company's risk and uncertainties are integral to the principal risk and uncertainties of its key subsidiaries as listed in note 17 and the Directors of the Company are the same as the Directors of the most significant subsidiary, Telefonica UK Limited.

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

This is supported by a Risk Management Policy and detailed process documentation which have been independently assessed by the British Standards Institute against the ISO31000:2009 Standard.

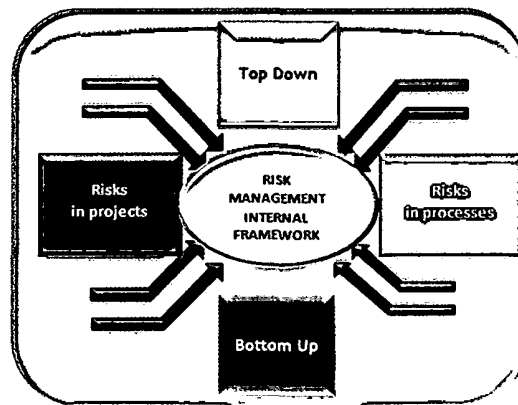


The framework is designed to identify, assess, manage, monitor and treat significant risks that could adversely affect the future success of the organisation through a well-established risk management framework supported by dedicated Risk Business Partners within the Central Risk Management team. The framework gives the Board of Telefonica UK a high awareness of key risks and the capacity to assign the most effective resources at the optimal moment to control and respond to the risks and opportunities identified.

## STRATEGIC REPORT (CONTINUED)

### Principal risks and uncertainties (continued)

The comprehensive model considers a risk assessment with four complementary perspectives: overall (top-down), local (bottom-up) and cross-sectional (projects and processes).



Topical risk workshops and forums are held regularly in order to discuss and evaluate key emerging and horizon risks to the Business such as climate change and the environment, data fraud and the withdrawal of the UK from the European Union ('Brexit').

In addition the Telefónica UK's Operating Committee, whose member include its statutory board formally approve the Risk register twice per year.

Risk Management monitoring activity includes monthly reporting of a KPI metric specific to Risk Management which remained Green for the whole of the 2017 year.

Continuous improvement activities are undertaken to ensure the Risk Management process remains effective and adding value to the business both at an Operational and Strategic level.

The most significant risks and uncertainties are those of Telefonica UK Limited, the principal trading subsidiary, and are as follows:

Risk Name	Risk Impact	Risk Treatment	Risk Evolution
Network Spectrum/ Capacity	We need to rapidly deploy the additional capacity gained at auction in order to keep up with growing customer demand for mobile data and meet customer expectations.	We have a 3-year plan which sets out our strategy and timeline for building the network to accommodate growing demand and make the most efficient use of our newly acquired spectrum, targeting the busiest areas of the radio network first.	Decreased



## STRATEGIC REPORT (CONTINUED)

### Principal risks and uncertainties (continued)

Risk Name	Risk Impact	Risk Treatment	Risk Evolution
Breach of Data Security	Due to the way in which data is electronically stored and transmitted, there is a risk that a breach of security could occur and lead to the accidental or unlawful destruction, loss, alteration, unauthorised disclosure of, or access to that data. This could result in fines, loss of reputation, loss of customer and employee trust, increased churn and loss of revenue.	We have carried out a review to identify the principal areas where data breaches could occur and mitigating controls are in place where relevant.	Stable
Fraud Management	Fraudulent activity by customers, suppliers, and sales channels may lead to the business suffering financial loss due to being unable to recover revenue from products and services already provided. Examples could include identity fraud, card payment fraud and the fraudulent takeover of genuine customer accounts.	We remain ever-vigilant to the constantly changing threat environment and numerous defences are in place to defend our products and services, including dynamic and technological security solutions.	Stable
Child Protection	We provide mobile and online services and due to the ever-increasing penetration of WiFi and Smartphone use amongst young people there is a risk of corporate reputation and brand damage or regulatory intervention flowing from a failure to protect children from inappropriate content, contact or conduct.	We have a robust network of 'SHIELD' controls in place to protect young people. We also work with the NSPCC to raise awareness of online safety and share advice with parents and children.	Stable
Data Privacy	We have an obligation to manage our customer's data sensitively and within the relevant permissions, making it very clear and transparent to customers how their private data is being used and shared.  In the event that the business shared customer data without permission or where that permission had not been clearly understood, the business would be at risk of fines, loss of reputation, loss of customer and employee trust, increased churn and loss of revenue.	We have a programme in place to address this risk.	Increased

**STRATEGIC REPORT (CONTINUED)**

**Principal risks and uncertainties (continued)**

<b>Risk name</b>	<b>Risk Impact</b>	<b>Risk Treatment</b>	<b>Risk Evolution</b>
Annual Licence Fees	In 2015, Ofcom reset the Annual Licence Fees (ALFs) for the 900 & 1800 MHz bands from approximately £65m to £200m per annum for all operators. O2's fees were increased from £15.6m to £49.8m pa. Following an appeal by BT/EE, supported by the other operators, the Court of Appeal quashed the decision that imposed the revised fees. Following judgment, the fees have reverted to the pre-existing levels. The operators are pursuing restitution claim for the amount overpaid between 2015 and 2017. In O2's case, that amounts to £52.8m.	Ofcom is resisting the operators' claims. Therefore further litigation is anticipated. Separately Ofcom is consulting on new Annual Licence Fees; it is proposed that O2's ALF's will remain at about £50m pa.	Stable
IFRS Accounting Regulations	We must comply with new Revenue Recognition accounting standard IFRS15 from 1 Jan 2018. This is a significant change in accounting treatment for certain contracts.	We are aligning practices to new rules	Stable
Loss of FCA Authorisation to sell FCA Regulated products	O2 and giffgaff require FCA authorisation to sell certain products which are regulated products. A loss of authorisation would mean we could no longer sell these products.	We have Compliance teams embedded in the business to help design all processes and practices in an FCA compliant manner.	Increased
Legacy Systems architecture	Legacy architecture becomes more unreliable potentially leading to a systems failure which could cause a significant service interruption.	We are engaging on an IT Transformation programme to invest in multiple architectures due to their age	Increased
Cyber Security	We provide our consumer facing services through the internet via its online estate. Consequently, we must ensure that the estate is maintained to an acceptable and secure level so that customers are protected when using its services.	We are engaged in reviewing the front facing domains and have identified a number of items as needing redress to ensure provision of the best possible security against the physical estate. Mitigation elements are being introduced across systems gradually and the risk value will be reviewed at each significant step.	Increased

## **STRATEGIC REPORT (CONTINUED)**

### **The General Data Protection Regulation**

The General Data Protection Regulations (GDPR), which apply from 25 May 2018, aim to harmonise data protection rules across all EU member states. The UK Government has confirmed that the decision to leave the EU will not impact the GDPR implementation in the UK.

We have reviewed our systems and processes and our focus is to align the GDPR implementation programme with our data principles and be customer led.

Our people are required to complete a computer based training to ensure that we are all aware of our responsibilities and the Information Governance Forum (a cross-functional group) will continue to carry out Privacy Impact Assessments to ensure continued compliance. We will continue to raise the awareness of GDPR to ensure that 'privacy' is embedded in our culture.

### **Significant post year end event**

#### **Spectrum**

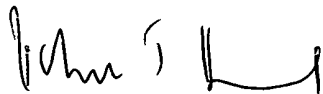
Telefonica UK Limited, a subsidiary of Telefonica Europe plc, has secured 80 MHz of spectrum in the recent Ofcom auction, at a cost of £523.6m. This includes 40MHz of immediately useable (2.3GHz) spectrum, which was all of the spectrum available in this band, as well as 40MHz of 3.4 GHz spectrum, earmarked for 5G. Securing all of the available 2.3 GHz spectrum provides Telefonica UK with the capability to increase network capacity, significantly and the intention is to deploy it, rapidly, for the benefit of customers.

Telefonica UK is expecting to utilise the 40 MHz 'slice' of 5G-ready 3.4 GHz spectrum as soon as 2020. Ahead of that, Telefonica UK is planning to launch a 5G test bed at The O2, putting next generation technology into customers' hands up to two years before it is officially rolled out.

The 5G world affords the ability to better support technology ranging from tele-health, connected transport, smart cities and more. Telefonica UK is proud to be leading the charge into that world, and to be putting its customers at the forefront of it.

The Strategic Report was approved by the Board on **25** June 2018.

By Order of the Board



**Robert Harwood**  
Company Secretary

**DIRECTORS' REPORT**

The Directors of the Company present their report and the audited financial statements for the year ended 31 December 2017.

**Directors and Secretary**

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

Patricia Cobian  
Mark Evans

The Secretary who held office during the year was Robert Harwood.

**Directors' liability insurance and indemnities**

Telefónica S.A., the Company's parent company, maintains Directors' and Officers' Liability Insurance in respect of legal action that might be brought against Directors of companies within the Telefónica Group and the Directors of the Company are covered by this Insurance. The insurance was in force throughout the last financial year and is currently in force.

**Dividends**

During the year ended 31 December 2017 the Directors paid an interim dividend of £550m (31 December 2016: £525m).

**Political donations**

No political donations were made or political expenditures incurred in accordance with the Companies Act 2006, in respect of political parties during the financial year ended 31 December 2017.

**Employees**

The Company is committed to employment policies that follow good practice, based on equal opportunities for all, and recognise diversity, including fair treatment of people with disabilities in relation to their recruitment, training and development. The Company supports the health and wellbeing of its employees and, specifically, is committed to making improvements to the issue of mental health in the workplace as well as providing a range of occupational health and employee support services to employees.

**DIRECTORS' REPORT (continued)****Employees**

These policies include guidance for line managers and employees about recruitment processes and additional arrangements which can be made as required due to any disability, such as:

- Making reasonable adjustments and practical considerations relating to disabilities.
- Increasing the accessibility of our services making them more inclusive for disabled people.
- Drawing attention to the importance of diversity and ensuring that discrimination does not occur.
- Drawing attention to the importance of focussing on what people can do rather than what they cannot and challenging stereotypes about people with disabilities.
- Making e-learning available to all Company employees to highlight the legal and behavioural aspects of Diversity & Inclusion.

**Financial risk management objectives, policies and exposure**

Details of the Group's approach to financial risk management objectives and policies are set out in the financial statements in note 17 "Financial instruments".

**Important events since the end of the financial year**

The Strategic report on pages 4 to 12 details the important events affecting the Company and its subsidiaries which have occurred since the financial year end.

**Capital structure and rights attached to shares**

The details of the Company's capital structure including the rights attached to shares are detailed in note 15 of the financial statements.

**Going concern**

The Company's business activity is to act as an intermediate holding company within the Telefonica Group. The financial position of the Company is described in the Strategic Report. In addition, note 3 and 17 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk, liquidity risk and interest rate risk. The Directors believe that the Company is well placed to manage its business risk successfully despite the current uncertain economic outlook.

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

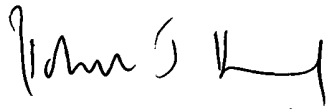
**DIRECTORS' REPORT (continued)**

**Statement as to disclosure to auditors**

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

The Directors' report was approved by the Board on **25** June 2018.

By Order of the Board

A handwritten signature in black ink, appearing to read 'Robert Harwood', written over a horizontal line.

**Robert Harwood**  
Company Secretary

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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

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

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

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

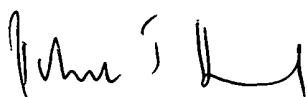
The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

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

The Statement of Directors' responsibilities was approved by the Board on **25** June 2018.

By Order of the Board



**Robert Harwood**  
Company Secretary

# ***Independent auditors' report to the members of Telefonica Europe plc***

## **Report on the audit of the financial statements**

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### **Opinion**

In our opinion, Telefonica Europe plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Financial Statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2017; the statement of comprehensive income, the cash flow statement and the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

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### **Basis for opinion**

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

### **Independence**

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

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### **Conclusions relating to going concern**

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

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

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

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### **Reporting on other information**

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

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

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

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



# ***Independent auditors' report to the members of Telefonica Europe plc***

## **Report on the audit of the financial statements (continued)**

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### ***Strategic Report and Directors' Report***

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

### **Responsibilities for the financial statements and the audit**

#### ***Responsibilities of the directors for the financial statements***

As explained more fully in the Statement of the Directors' responsibilities set out on page 16, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

#### ***Auditors' responsibilities for the audit of the financial statements***

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

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

#### ***Use of this report***

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

# ***Independent auditors' report to the members of Telefonica Europe plc***

## **Report on the audit of the financial statements (continued)**

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### **Other required reporting**

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#### **Companies Act 2006 exception reporting**

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

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

We have no exceptions to report arising from this responsibility.



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

June 2018

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**Statement of comprehensive income**  
**For the year ended 31 December 2017**

	<b>Note</b>	<b>2017 £m</b>	<b>2016 £m</b>
<b>Revenue</b>		-	-
Other expenses		(2)	(1)
		<b>(2)</b>	<b>(1)</b>
Impairment of investment in subsidiaries	9	-	(936)
<b>Operating loss</b>	<b>4</b>	<b>(2)</b>	<b>(937)</b>
Financial income	6	-	6
Financial costs	6	(5)	-
Dividend income	6	550	525
<b>Profit/(loss) before taxation</b>		<b>543</b>	<b>(406)</b>
<b>Taxation</b>	<b>7</b>	-	-
<b>Profit/(loss) for the year from continuing operations</b>		<b>543</b>	<b>(406)</b>
<b>Profit/(loss) for the year attributable to equity holders</b>		<b>543</b>	<b>(406)</b>
<b>Other comprehensive loss:</b>			
<u>Items that will not be reclassified subsequently to profit and loss</u>			
Actuarial loss on pensions		(5)	(252)
Income tax relating to other comprehensive loss		(26)	45
<b>Other comprehensive loss for the year, net of tax</b>		<b>(31)</b>	<b>(207)</b>
<b>Total comprehensive income/(loss) for the year attributable to equity holders</b>		<b>512</b>	<b>(613)</b>

The accompanying notes on page 24 to 41 are an integral part of these financial statements.

**Statement of financial position  
As at 31 December 2017**

	<b>Note</b>	<b>2017 £m</b>	<b>2016 £m</b>
<b>Non-current assets</b>			
Investments	9	9,599	9,599
Deferred tax asset	10	-	26
		<u>9,599</u>	<u>9,625</u>
<b>Current assets</b>			
Trade and other receivables	11	302	294
Cash and cash equivalents	12	4	4
		<u>306</u>	<u>298</u>
<b>Current liabilities</b>			
Trade and other payables	13	(27)	(17)
		<u>(27)</u>	<u>(17)</u>
<b>Net current assets</b>		<u>279</u>	<u>281</u>
<b>Total assets less current liabilities</b>		<u>9,878</u>	<u>9,906</u>
<b>Non-current liabilities</b>			
Retirement benefit liability	14	(153)	(143)
		<u>(153)</u>	<u>(143)</u>
<b>Net assets</b>		<u>9,725</u>	<u>9,763</u>
<b>Equity</b>			
Share capital	15	9	9
Share premium	15	440	440
Retained earnings		9,276	9,314
<b>Total equity attributable to equity holders</b>		<u>9,725</u>	<u>9,763</u>

The accompanying notes on pages 24 to 41 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors and authorised for issue on 26 June 2018. They were signed on its behalf by:



Patricia Cobian  
Director

**Statement of changes in equity**  
**For the year ended 31 December 2017**

	Share capital (note 15) £m	Share premium (note 15) £m	Retained earnings £m	Total equity £m
<b>Balance as at 1 January 2016</b>	<b>9</b>	<b>440</b>	<b>10,452</b>	<b>10,901</b>
Loss for the year	-	-	(406)	(406)
Other comprehensive loss	-	-	(207)	(207)
Total comprehensive loss for the year	-	-	(613)	(613)
Dividends paid (note 8)	-	-	(525)	(525)
<b>Balance as at 31 December 2016</b>	<b>9</b>	<b>440</b>	<b>9,314</b>	<b>9,763</b>
Profit for the year	-	-	543	542
Other comprehensive loss	-	-	(31)	(30)
Total comprehensive income for the year	-	-	512	512
Dividends paid (note 8)	-	-	(550)	(550)
<b>Balance as at 31 December 2017</b>	<b>9</b>	<b>440</b>	<b>9,276</b>	<b>9,725</b>

The accompanying notes on page 24 to 41 are an integral part of these financial statements.

**Statement of cash flows**  
**For the year ended 31 December 2017**

	<b>Note</b>	<b>2017 £m</b>	<b>2016 £m</b>
Profit/(loss) before taxation from continuing operations		543	(406)
<b>Profit/(loss) before taxation</b>		<b>543</b>	<b>(406)</b>
<i>Adjustment for:</i>			
Impairment of investment in subsidiaries	9	-	936
Other non-cash movements		-	(1)
Financial income	6	(545)	(531)
<b>Operating cash flows before movements in working capital</b>		<b>(2)</b>	<b>(2)</b>
(Increase) in trade and other receivables	11	(8)	(12)
Increase in trade and other payables	13	10	10
<b>Cash generated by operations</b>		<b>-</b>	<b>(4)</b>
Income taxes paid		-	-
<b>Net cash inflow/(outflow) from operating activities</b>		<b>-</b>	<b>(4)</b>
Dividend received	6	550	525
Interest received		-	4
<b>Net cash inflow from investing activities</b>		<b>550</b>	<b>529</b>
Dividends paid	8	(550)	(525)
<b>Net cash outflow from financing activities</b>		<b>(550)</b>	<b>(525)</b>
<b>Net increase in cash and cash equivalents</b>		<b>-</b>	<b>-</b>
Cash and cash equivalents at beginning of year		4	4
<b>Cash and cash equivalents at end of year</b>	12	<b>4</b>	<b>4</b>

The accompanying notes on page 24 to 41 are an integral part of these financial statements.

**Notes to the financial statements  
For the year ended 31 December 2017****1. General information**

Telefonica Europe plc (the "Company") is a public limited company registered in England and Wales under the number 5310128. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX. The principal activity of the Company is to act as an intermediate holding company within the Telefonica S.A. Group.

**2. Significant accounting policies****2.1 Basis of preparation**

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

The principal accounting policies of the Company applied in the preparation of these financial statements are set out below. The IFRS accounting policies have been applied consistently to all periods presented.

**2.2 Consolidated financial statements**

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

**2.3 Going concern**

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

**2.4 Functional currency**

These financial statements are presented in pounds sterling, which is also the functional currency, because that is the currency of the primary economic environment in which the Company operates.

**2.5 Investments**

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

**2.6 Other expenses**

Other expenses principally consists of pension scheme expenses.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017****2. Significant accounting policies (continued)****2.7 Pension obligations**

A defined benefit plan is a pension plan that sets the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The Company operates the Telefonica UK Pension Plan ("Plan"), a scheme sponsored by Telefonica Europe plc that provides benefits for the majority of UK employees in the Telefonica Europe plc group. During the period presented, the Plan had both defined benefit and defined contribution schemes. On 28 February 2013 the defined benefit scheme of the Plan closed to further benefit accrual. Member benefits of the defined benefit scheme of the Plan will continue to be increased in deferment by reference to the Consumer Prices Index (see note 14) but will not retain the link to any future increases in salary. Upon closure, members of the defined benefit scheme of the Plan were given the option to become members of the defined contribution scheme of the Plan. The defined contribution scheme of the Plan remain open to new entrants and further accrual. The assets of the Plan are held independently of the Company's finances.

The Company is the sponsoring employer of the Plan and its defined benefit scheme. The asset or liability recognised in the statement of financial position in respect of defined benefit pension plan is the present value of the defined benefit obligation at the statement of financial position date less the fair value of the plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

**2.8 Financial income and expense**

Financial income principally consists of interest income on Company deposits and gains arising from foreign exchange rate hedging instruments. Financial expense principally consists of interest expense on Company borrowings and losses arising from foreign exchange rate hedging instruments. The Company utilises foreign exchange rate hedging instruments to hedge foreign exchange rate exposure principally in respect of Euro and US dollar payments.

**2.9 Taxation**

Taxation expense for the period comprises current tax recognised in the reporting period. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case tax is also recognised in other comprehensive income or directly in equity respectively. Current taxation assets and liabilities are not discounted.

Current tax is the amount of income tax payable in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the period end. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

**2.10 Cash and cash equivalents**

Cash and cash equivalents are carried in the statement of financial position at cost. Cash and cash equivalents relates entirely to cash at bank only.



**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**2. Significant accounting policies (continued)**

**2.11 Trade and other receivables**

Trade and other receivables relate to intercompany transactions. A provision for doubtful debts is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Provisions are made based on an analysis of balances by age, previous losses experienced, disputes and ability to pay.

**2.12 Trade and other payables**

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

**2.13 Dividend income and distribution**

Dividend distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

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

**2.14 New standards and IFRS IC interpretations not applied**

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

<b>IAS/IFRS standards</b>	<b>Effective for accounting periods beginning on or after</b>
IFRS 9 <i>Financial Instruments</i>	1 January 2018
IFRS 15 <i>Revenues from Contracts with Customers</i>	1 January 2018
Clarifications to IFRS 15 (Apr 2016) <i>Clarifications to IFRS 15 Revenue from Contracts with Customers</i>	1 January 2018
Amendments to IFRS 4 (Sept 2016) <i>Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts</i>	1 January 2018
Amendments to IFRS 2 (Jun 16) <i>Classification and Measurement of Share-based Payment Transactions</i>	1 January 2018
IFRS 16 <i>Leases</i>	1 January 2019

Based on the analysis made to date, the Company estimates that the adoption of these standards, amendments and improvements will not have a significant impact on the financial statements.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017****2. Significant accounting policies (continued)****2.15 Adoption of new and revised standards**

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

**3. Critical accounting estimates and judgements**

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

**3.1 Impairment of investments**

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

**3.2 Pension benefits**

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

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

Further details about the assumptions are given in note 14.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**4. Operating loss**

Company operating loss from continuing activities is stated after charging:

	<b>2017</b>	2016
	<b>£m</b>	£m
Other expenses – Pension scheme administration expenses (note 14)	2	1
Impairment of investment in subsidiaries (note 9)	-	936
	<u>          </u>	<u>          </u>

Other income relates to contributions from subsidiary companies in respect of the Telefonica UK Pensions Plan ("Plan"). Further information on the Plan is provided in note 14.

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

	<b>2017</b>	2016
	<b>£'000</b>	£'000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	21	27
	<u>          </u>	<u>          </u>

**5. Directors and employees**

No directors or employees are remunerated through the Company. Directors' remuneration, including benefits, are met by Telefonica UK Ltd, since the Directors' services are provided to that company.

**6. Investment income and finance cost**

	<b>2017</b>	2016
	<b>£m</b>	£m
Interest income for financial assets measured at amortised cost	-	4
Other financial income	-	2
Dividends received	550	525
	<u>          </u>	<u>          </u>
<b>Investment income</b>	<b>550</b>	<b>531</b>
Other financial costs	(5)	-
	<u>          </u>	<u>          </u>
<b>Finance costs</b>	<b>(5)</b>	<b>-</b>
	<u>          </u>	<u>          </u>
<b>Net investment income</b>	<b>545</b>	<b>531</b>
	<u>          </u>	<u>          </u>

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**7. Taxation**

The analysis of the charge for the year is as follows:

	<b>2017</b>	2016
	<b>£m</b>	£m
Current tax	-	-
<b>Total tax</b>	<b>-</b>	<b>-</b>

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

	<b>2017</b>	2016
	<b>£m</b>	£m
Profit/(loss) before tax from continuing operations	543	(406)
<b>Profit/(loss) before taxation</b>	<b>543</b>	<b>(406)</b>
<b>Profit/(loss) on ordinary activities multiplied by the rate of UK corporation tax of 19.25% (2016: 20%)</b>	105	(81)
Expenses not deductible for tax purposes	-	186
Income not taxable for tax purposes <sup>(a)</sup>	(106)	(105)
Deferred tax not recognised	1	-
<b>Taxation – (credit)/charge for the year</b>	<b>-</b>	<b>-</b>

<sup>(a)</sup> Income not taxable relates to dividends received

The Finance Act 2013 reduced the main rate of corporation tax to 21% with effect from 1 April 2014, with a further reduction to 20%, with effect from 1 April 2015. Finance (No.2) Act 2015 reduced the main rate of corporate tax to 19%, with effect from 1 April 2017.

The analysis of income tax charged/ (credited) to other comprehensive income during the year is as follows:

	<b>2017</b>	2016
	<b>£m</b>	£m
Deferred tax	26	(45)
<b>Total taxation charge/ (credited) in other comprehensive income</b>	<b>26</b>	<b>(45)</b>

Amounts charged/ (credited) to other comprehensive income relate to the defined benefit pension scheme.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**8. Dividends paid**

	<b>2017</b>	2016
	<b>£m</b>	£m
Dividend – 6.2p (2016:5.9p) per share	<b>550</b>	525

Dividends of £550m (2016: £525m) were declared in 2017 and paid in cash in the year.

**9. Investments in subsidiary undertakings**

	<b>2017</b>	2016
	<b>£m</b>	£m
<b>Shares in subsidiary undertakings:</b>		
Beginning of the financial year	<b>9,599</b>	10,535
Impairment during the financial year	-	(936)
<b>Balance as at the end of the financial year</b>	<b>9,599</b>	9,599

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

In the year ended 31 December 2017 the Company has recognised no impairment loss in relation to its investments in subsidiary undertakings (2016: £936m). The impairment in the prior year was related to the investment in O2 Holdings Limited.

The recoverable amount, being the value in use of the investment in O2 Holdings Limited is £9,339m. The remaining net book value of £260m is related to investment in mmO2 Limited.

The recoverable amount of the investments in subsidiary undertakings has been determined based on a value in use calculation using cash flow projections from financial budgets covering a five-year period. The impairment loss was determined by performing a value in use assessment of its principal trading subsidiaries, applying a pre-tax discount rate of 7.5% (2016: 8.0%) and a perpetuity growth rate of 1% (2016: 1%) to its trading forecasts.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017****9. Investments in subsidiary undertakings (continued)***Value in use*

Value in use is calculated based on the approved business plan and taking into account certain variables such as operating profit before depreciation and amortisation (OIBDA) margin, capital expenditure

*OIBDA margin and long-term CAPEX*

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

*Discount rate*

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

*Perpetuity growth rate*

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

*Terminal value*

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

*Sensitivity to changes in assumptions*

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

- Discount rate (-1.0p.p. / +1.0p.p.);
- Perpetuity growth rates (+0.5p.p. / -0.5p.p.);
- OIBDA margin (+0.25p.p. / -0.25p.p.); and
- Ratio of CAPEX / revenues (+0.25p.p. / -0.25p.p.).

As a consequence of the sensitivity analysis performed as of December 2017, there is no significant risk associated to changes in financial and operating variables considered individually and in aggregate.

Details of the Company's subsidiaries are provided in note 16.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**10. Deferred taxation**

The movement in deferred tax assets/(liabilities) during the year, is as follows:

	<b>Assets £m</b>	<b>Liabilities £m</b>
At 1 January 2016	-	(19)
Charge to other comprehensive income	45	-
Transfer between assets and liabilities	(19)	19
	<hr/>	<hr/>
At 31 December 2016	26	-
Charge/(credit) to other comprehensive income	(26)	-
	<hr/>	<hr/>
At 31 December 2017	<u>-</u>	<u>-</u>

Deferred tax assets totalling £26m have not been recognised as pension contributions are made by other group companies.

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

**11. Trade and other receivables**

	<b>2017 £m</b>	<b>2016 £m</b>
Amounts owed by group and related undertakings	<u>302</u>	<u>294</u>

Amounts owed by subsidiaries represent receivables due from Telefonica UK Limited, O2 Europe Limited, O2 Holdings Limited, and Cellular Radio Limited.

All intercompany balances are interest free and repayable on demand.

**12. Cash and cash equivalents**

	<b>2017 £m</b>	<b>2016 £m</b>
Cash at bank	<u>4</u>	<u>4</u>

Cash and cash equivalents represents balances held with Telfisa Global BV, a related party.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**13. Trade and other payables**

	<b>2017</b>	2016
	<b>£m</b>	£m
Amounts owed to group and related undertakings	<b>27</b>	17

Amounts owed to Company undertakings represent amounts owed to Telefonica UK Limited and mmO2 Limited. All amounts are interest free and repayable on demand.

**14. Pensions**

Telefonica Europe plc, which is the ultimate UK parent company of Telefonica UK Limited, acts as the Principal Employer of the Telefónica UK Pension Plan ("the Plan"), this comprises the following:

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

The Plan provides the pension benefits for the majority of Telefónica's UK employees. The retirement benefit obligation of the Plan is therefore recognised on the statement of financial position of Telefónica Europe plc.

The net defined benefit cost of the defined benefit scheme, as assessed in accordance with the advice of a qualified, independent actuary, measuring actuarial liabilities using the projected unit method and taking assets at market value, is recognised by the principal employer, Telefónica Europe plc.

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

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



**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**14. Pensions (continued)**

**Actuarial valuation**

A full valuation of the defined benefit scheme of the Plan was undertaken as at 30 September 2014 by a suitably qualified independent actuary. The valuation used the projected unit method. The full valuation was completed in line with the current investment strategy of the Plan which is predominantly a corporate bond basis initiated following the 2008 valuation. A full valuation of the defined benefit scheme of the Plan is currently being undertaken as at 30 September 2017 by a suitably qualified independent actuary. The Plan's assets are currently invested in a diversified range of credit assets and long-dated inflation linked gilts, which are aligned to the Plan's liability characteristics.

No payment was made to the defined benefit scheme by the company or other group companies in the year ended 31 December 2017 (2016: £nil).

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

	<b>Year ended 31 December 2017</b>		<b>Year ended 31 December 2016</b>	
	<b>Funded</b>	<b>Unfunded</b>	<b>Funded</b>	<b>Unfunded</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Fair value of assets	1,465	-	1,422	-
Present value of defined benefit obligations	(1,618)	(4)	(1,565)	(4)
<b>Net obligation recognised in statement of financial position</b>	<b>(153)</b>	<b>(4)</b>	<b>(143)</b>	<b>(4)</b>

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

	<b>Year ended 31 December 2017</b>		<b>Year ended 31 December 2016</b>	
	<b>Funded</b>	<b>Unfunded</b>	<b>Funded</b>	<b>Unfunded</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>At start of the year</b>	<b>1,565</b>	<b>4</b>	<b>1,180</b>	<b>3</b>
Interest expense	40	-	44	-
Actuarial losses on demographic assumptions	1	-	-	-
Actuarial losses on financial assumptions	42	-	382	1
Actuarial losses /(gains) on expectation adjustments	10	-	(20)	-
Benefits paid	(40)	-	(21)	-
<b>At the end of the year</b>	<b>1,618</b>	<b>4</b>	<b>1,565</b>	<b>4</b>

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**14. Pensions (continued)**

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

	<b>Year ended 31 December 2017</b>		<b>Year ended 31 December 2016</b>	
	<b>Funded £m</b>	<b>Unfunded £m</b>	<b>Funded £m</b>	<b>Unfunded £m</b>
<b>At start of the year</b>	<b>1,422</b>	<b>-</b>	<b>1,286</b>	<b>-</b>
Interest income	36	-	48	-
Return on plan assets in excess of interest income	48	-	110	-
Scheme expenses paid	(1)	-	(1)	-
Benefits paid	(40)	-	(21)	-
<b>At the end of the year</b>	<b>1,465</b>	<b>-</b>	<b>1,422</b>	<b>-</b>

The Trustee has recently reviewed the Plan's investment strategy and further changes are expected to be made during 2018. As at 31 December 2017, the Plan's assets are currently invested in a diversified range of credit assets and long-dated inflation linked gilts, which are aligned to the Plan's liability characteristics. This strategy is achieved through a mixture of direct investments in the target asset classes and derivatives. This includes the Liability Driven Investment strategy which aims to reduce the Plan's exposure to interest rate and inflation risk.

The fair value of the Plan's asset in each category were as follows:

	<b>31 Dec 2017 £m</b>	<b>31 Dec 2016 £m</b>
Equities	-	306
Credit instruments	1,465	1,116
<b>Total</b>	<b>1,465</b>	<b>1,422</b>

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

	<b>31 Dec 2017</b>	<b>31 Dec 2016</b>
<b>Equities</b>		
Equity instrument funds	0%	100%
<b>Credit instruments</b>		
AAA rated	7%	12%
AA rated	63%	18%
A rated	11%	24%
BBB and lower	36%	46%
Not rated	13%	0%
Other	-31%	-

The figures above are as at the balance sheet date. Market values of Plan's assets, which are not intended to be realised in the short-term, may be subject to significant changes before they are realised.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**14. Pensions (continued)**

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

	<b>Year ended 31 December 2017</b>	<b>Year ended 31 December 2016</b>
Life expectancy (male currently aged 40/60) in years	88.4/87.1	88.7/87.2
Life expectancy (female currently aged 40/60) in years	90.5/89.2	91/89.5
Nominal rate of increase of pensions in payment: (RPI max 5%)	3.15%	3.15%
Discount rate (%)	2.45%	2.60%
Inflation assumption (%)		
- CPI	2.30%	2.35%
- RPI	3.30%	3.35%

The initial results of the actuarial valuation of the Plan as at 30 September 2014 have been updated to 31 December 2017 by third party qualified actuary in accordance with the requirements of IAS 19. The defined benefit liabilities have been measured using the projected unit credit method. Plan assets are stated at fair value.

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

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

	<b>Year ended 31 December 2017 Funded</b>	<b>Year ended 31 December 2016 Funded</b>
<b>Analysis of the amount recognised in other comprehensive income</b>	<b>£m</b>	<b>£m</b>
Return on plan assets in excess of interest income/ (expense)	(48)	(109)
Actuarial (gains)/ losses on demographic assumptions	1	-
Actuarial losses on financial assumptions	41	381
Actuarial (gains)/ losses on experience adjustments	11	(20)
<b>Actuarial loss recognised</b>	<b>5</b>	<b>252</b>

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**14. Pensions (continued)**

At 31 December 2017, the weighted average duration of the defined benefit obligation of the funded plan was 23 years (2016: 23 years).

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

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

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

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

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

Charge by assumptions:	Liabilities increase by (£m):
Decrease discount rate by 0.25%	107
Increase inflation rate by 0.25%	92
Increase life expectancy by 1 year	48

**15. Share capital and reserves**

	2017 Number of shares	£m	2016 Number of shares	£m
<b>Share capital</b>				
<b>Authorised</b>				
Ordinary shares of 0.1 pence each	20,000,000,000	20	20,000,000,000	20
<b>Called up, allotted and fully paid</b>				
Ordinary shares of 0.1 pence each	8,880,812,164	9	8,880,812,164	9

The Company has one class of authorised and issued share capital, comprising ordinary shares of 0.1 pence each. Subject to the Company's articles of association, and applicable law, the Company's ordinary shares have attached to them full voting, dividend and capital distribution (including on winding up) rights; they do not confer any right of redemption.

**Share premium**

The share premium account represents the premium on shares issued. The reserve is non-distributable.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**16. Subsidiary undertakings and joint arrangements**

A complete list of the Company's subsidiary undertakings at 31 December 2017 is detailed below.

<b>Name</b>	<b>Country of incorporation and operation</b>	<b>Principal activity</b>	<b>Portion of ordinary shares held</b>
<b>O2 Holdings Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Intermediate holding company	100
<b>mmO2 Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Active non trading company	100
<b>Telefonica UK Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Mobile cellular telephone system provider and operator	100
<b>Tesco Mobile Limited</b> Shire Park, Welwyn Garden City, AL7 1GA	England and Wales	Mobile cellular telephone distributor JV with Tesco plc	50
<b>Weve Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Mobile marketing and commerce services	100
<b>Cornerstone Telecommunications Infrastructure Limited</b> The Exchange Building 1330, Arlington Business Park Theale, Berkshire, RG7 4SA	England and Wales	Mobile infrastructure network JV with Vodafone Limited	50
<b>Cellular Radio Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Active non trading	100
<b>giffgaff Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Mobile communications services	100
<b>O2 Networks Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Active non trading	100

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**16. Subsidiary undertakings and joint arrangements (continued)**

<b>Telefonica Europe People Services Limited</b> Hanover Court Erne Street Lower Dublin 2	Republic of Ireland	HR Services	100
<b>DX Communications Limited</b> The Ca'D'Ore, 45 Gordon Street, Glasgow, United Kingdom, G1 3PE	Scotland	Dormant	100
<b>The Mobile Phone Store Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Dormant	100
<b>O2 Cedar Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Active non trading	100
<b>O2 Communications Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Intermediate holding company	100
<b>Telefonica UK Pension Trustee Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Corporate trustee of the Telefonica UK Pension Plan	100
<b>O2 Unify Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Information Communication Technology Solution	100
<b>O2 Secretaries Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Dormant	100
<b>O2 Redwood Limited</b> 260 Bath Road Slough Berkshire SL1 4DX	England and Wales	Dormant	100
<b>Digital Mobile Spectrum Limited</b> 83 Baker Street London W1U 6AG	England and Wales	Services in relation to the Spectrum auction obligation	25

The shares held in O2 Holdings Limited and mmO2 Limited are held directly by the Company and all other investments are held indirectly.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**17. Financial instruments**

**Financial risk factors and management**

The Company's principal financial liabilities comprise intercompany trade and other payables. The purpose of these financial liabilities is to raise finance for the Company's operations. The Company has various financial assets such as intercompany receivables and cash.

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

**Credit risk**

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

The Company's principal credit risks are attributable to its other financial assets which mostly comprise inter-company receivables and cash and cash equivalents. The Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

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

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

**Liquidity risk**

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

Management of the Company's liquidity risk is reduced through being a part of the larger Telefónica Group. The Company holds financial assets primarily in short-term deposits with Telefónica Group companies that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

**18. Parent company and controlling party**

The Company is a subsidiary undertaking of Telefonica S.A, which is the ultimate parent company and controlling party, incorporated in Spain.

The largest group in which the results of the Company are consolidated is that headed by Telefonica S.A. The consolidated financial statements of Telefonica S.A are available to the public and may be obtained from Gran Via 28, Madrid, Spain.

**Notes to the financial statements (continued)**  
**For the year ended 31 December 2017**

**19. Subsequent event**

**Spectrum**

Telefonica UK Limited, a subsidiary of Telefonica Europe Plc, has secured 80 MHz of spectrum in the recent Ofcom auction, at a cost of £523.6m. This includes 40MHz of immediately useable (2.3GHz) spectrum, which was all of the spectrum available in this band, as well as 40MHz of 3.4 GHz spectrum, earmarked for 5G. Securing all of the available 2.3 GHz spectrum provides Telefonica UK with the capability to increase network capacity, significantly and the intention is to deploy it, rapidly, for the benefit of customers.

Telefonica UK is expecting to utilise the 40 MHz 'slice' of 5G-ready 3.4 GHz spectrum as soon as 2020. Ahead of that, Telefonica UK is planning to launch a 5G test bed at The O2, putting next generation technology into customers' hands up to two years before it's officially rolled out.

The 5G world affords the ability to better support technology ranging from tele-health, connected transport, smart cities and more. Telefonica UK is proud to be leading the charge into that world, and to be putting its customers at the forefront of it.