Registered Number: 7884976

Telefonica Digital Limited

Annual Report and Financial Statements
Year ended 31 December 2016

Telefonica Digital Limited

Contents

Telefonica Digital Limited

Directors and advisers

Directors

Antonio Martí Ciruelos
Michael Alan Duncan

Secretary

O2 Secretaries Limited

Registered office

260 Bath Road
Slough
Berkshire SL1 4DX
United Kingdom

Auditor

Ernst & Young LLP
Apex Plaza
Forbury Road
Reading
RG1 1YE

Telefonica Digital Limited

Strategic report

The Company

Telefonica Digital Limited is a subsidiary within the Telefonica Group (hereafter, "Telefonica") and, along with Telefonica Digital España S.L.U. (a fellow subsidiary based in Spain) is responsible for managing the operations and developing digital products and services in a range of areas within the Chief Commercial Digital Office (CCDO) and Chief Data Office (CDO) areas of the Telefonica Group. In this report, references to "the Company" mean Telefonica Digital Limited.

The Company earns revenue through the licensing of digital products and services to other Telefonica operating businesses ("OBs") across the Telefonica Group. The Company is also looking to commercialise these digital products and services to partners outside of the Telefonica geographic footprint.

The Company oversees the following key areas:

- **Communications and Innovation**: *Drives innovation in Telefonica's core business of communications, building on its expertise in IP and video communications, and discovering and incubating the next generation of digital services. It covers early stage R&D as well as emerging new businesses*
- **Business Solutions** - *Sales support on the communications and ICT services to our corporate and business clients. Drives growth in emerging B2B digital products including Cloud Computing, Security and Financial Services*
- **Internet of Things (IOT)** - *Supports the global strategy to build and sell the best IoT connectivity and selected end to end solutions*
- **Consumer** - *Supports Telefonica´s Operating Businesses Consumer Units providing services on marketing, devices, channels, deals and alliances with other digital companies*
- **Security and Big Data** – *Focused in helping Telefonica Corporate Customers to analyze, interpret and extract the maximum value of transparent, responsible use of its corporate and customer data.*

Development and Performance

Telefonica Digital Limited has an agreement with certain OBs of the Telefonica Group (Telefonica UK, Telefonica Germany & Telefonica US) to operate through a licensing model (Liceo) to remunerate at market conditions the usage of digital products and services developed by the Company. This model replaced the cost sharing agreement that existed in the years 2012 and 2013 (CSA, Digital Products and Service Costs Agreement). Under this new licensing model, the Company receives a pay per use or a share of the revenues generated by the OBs through the sale of products or services developed by Telefonica Digital Limited. Liceo applies in the same way when income is generated by the OB on a platform developed by the Company. In the case of products or services that do not generate a direct and specific income to the OB, a payment for active user of the product or service applies.

During the year, the Company continued to deliver on its priorities, building powerful positions through partnerships and fostering digital products and services in several markets. The Company earns revenue through the licensing of digital products and services to other Telefonica OB's.

A review of the Company's performance for the year ended 31 December 2016 has been measured using certain key performance measures including:

Revenue – Total revenue for the year ended 31 December 2016 was £25.7 million (2015: £14 million). The Increase is mainly due to cost recharges to Telefonica Digital Espana and Telefonica SA under the cost sharing agreement between these companies.

Strategic report (continued)

Development and Performance (continued)

Operating losses – The Company has also continued to invest in developing new digital products and services and consequently the operating loss for the year ended 31 December 2016 was £75.1 million, an increase of £3.5 million compared with the period ended 31 December 2015 mostly driven by impairment of certain tangible and intangible assets included in the administrative expenses. This has been disclosed in notes 5 and 6.

Net assets - The net assets of the Company as at 31 December 2016 were £83.0 million (2015: £29 million). The increase is due to the cash injection via a share issue to the parent company during the year. The company performs a periodic asset portfolio evaluation to impair those assets not leading to revenue.

Investment

On 11th January 2016 and 05th August 2016 Telefonica Digital Limited invested a further $3.3m in Axonix Limited, a programmatic advertising company which is the first telco-run mobile ad exchange platform, maintaining a 78% share on equity.

On April 30th 2016, the Company also invested a further $119m in its fully-owned subsidiary Telefonica Digital Inc., a company incorporated in Delaware, USA. At year end, the value of the investment in the company was written down to the carrying value of its net assets.

Subsequent event

Since the year end, the Company invested a further $4.2m in Axonix in 3 different stages and received a cash injection from its parent of approximately £35m.

Risks and uncertainties

The Company's operations, including risks and uncertainties, are reviewed regularly. The principal risks and uncertainties facing the Company and its mitigation strategies are:

Risk	**Mitigation**
Business Risk	
Some of the Company's business areas are new and the markets are unproven and the Company may not earn a return on the products and services developed. The Company uses the Telefonica OB's in Europe and Latin America to launch and distribute its products.	The Company develops yearly business plans to evaluate the commercial feasibility of all its products and services. On a monthly basis the company executes a commercial performance analysis to check the evolution of products against plans.
Operational Risk	
Competitors may develop different products and services more quickly than the Company that are sold to customers. The Company may not be able to, or it may take longer than expected, to develop and launch new and innovative products or services and these products and services may not deliver appropriate customer engagement or usage when deployed. The products and services may not deliver a commercial return.	The Company executes periodical impairment tests to ensure recoverability of its assets.

These are also risks for the Telefonica Group. The Company has a regular system to review

Strategic report (continued)

operational performance including the management of these risks.

The Strategic Report was approved by the Board on May 31st 2017.
By Order of the Board

Robert Harwood
for and on behalf of O2 Secretaries Limited
Company Secretary

Directors' report

Legal Form

Telefonica Digital Limited is a private limited company registered in England and Wales under the number 7884976. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX and the trading address is 20 Air Street, London W1B 5AN.

The Company is a wholly owned subsidiary within the Telefonica Group of companies ("Telefonica") of which the ultimate parent is Telefonica S.A., a company incorporated in Spain.

Directors and secretary

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

Antonio Martí Ciruelos
Michael Alan Duncan

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

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.

Employees

The Company has a wide range of communication channels with employees including face-to-face meetings, team briefings, audio conferences and a comprehensive intranet. The aim of all these channels is to ensure employees fully understand the Company's objectives and its operational and financial performance as well as our latest products and services, whilst creating an inclusive employee culture.

The Company is committed to employment policies that follow best practice, based on equal opportunities for all, and recognises the diversity of its people. This approach includes the fair treatment of people with disabilities in relation to their recruitment, training and development. The Company has also invested in researching age, gender and disability diversity across the organisation, seeking to support all employees and their career development at every level of the organisation.

Dividend

The Company did not pay a dividend for the year ended 31 December 2016 (year ended 31 December 2015: nil).

Political donations

The Company made no political donations during the year ended 31 December 2016 (year ended 31 December 2015: nil).

Directors' report (continued)

Financial risk management objectives, policies and exposure

Details of the Company's approach to financial risk management are set out in note 1 to the financial statements.

Going concern

The financial position of the Company is described in the Strategic report. In addition, note 1 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk and liquidity risk. Consequently, the Directors believe that the Company is well placed to manage its business risk successfully.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Furthermore, Telefonica Group has the ability and willingness to provide continued support to the Company, and thus the Directors have adopted the going concern basis of accounting in preparing the annual financial statements

Statement as to disclosure to auditor

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

The Directors' Report was approved by the Board on May 31st 2017.

By Order of the Board

Robert Harwood
for and on behalf of O2 Secretaries Limited
Company Secretary

Telefonica Digital Limited

Statement of Director's Responsiblities

The Directors are responsible for preparing the Annual Report and the Company financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare 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 Company financial statements unless they are satisfied that they fairly present the financial position, financial performance and cash flows of the Company for that period. In preparing the Company financial statements the Directors are required to:

- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance;
- make an assessment of the company's ability to continue as a going concern;
- state that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements; and
- make judgements and estimates that are reasonable and prudent.

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 Company financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF TELEFONICA DIGITAL LIMITED

We have audited the financial statements of Telefonica Digital Limited for the year ended 31 December 2016 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statements of Changes in Equity, the Statement of Cash Flow and the related notes 1 to 23. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its losses 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.

Opinion on other matters prescribed by the Companies Act 2006

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

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF TELEFONICA DIGITAL LIMITED (Continued)

Matters on which we are required to report by exception

In light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have identified no material misstatements in the Strategic Report or Directors' Report.

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

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

Ernst & Young LLP

Marcus Butler (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading
Date: 31/05/17

Telefonica Digital Limited

Statement of comprehensive income
Year ended 31 December 2016

	Notes	2016 £'000	2015 £'000
Revenue	2	25,760	14,424
Cost of sales		(46,497)	(66,051)
Gross Loss		(20,737)	(51,627)
Administrative expenses		(27,854)	(19,954)
Non Recurring Expenses - Impairment charge	2	(26,516)	-
Operating Loss	2	(75,107)	(71,581)
Financial income	3	14	4,312
Financial expense	3	(65)	(4,167)
Loss before taxation		(75,158)	(71,436)
Taxation	4	9,124	14,077
Loss for the year attributable to equity shareholders		(66,034)	(57,359)

The accompanying notes on pages 13 to 36 are an integral part of these financial statements.

There were no other recognised income or expenses other than those shown above.

Telefonica Digital Limited

Statement of financial position
As at 31 December 2016

	Notes	2016 £'000	2015 £'000
Non-current assets			
Property, plant and equipment	5	6,813	7,644
Intangible assets	6	2,653	7,807
Long-term financial assets	7	65,006	4,377
		74,472	**19,828**
Current assets			
Trade and other receivables	8	40,079	30,684
Other Financial Assets	9	15,776	-
Cash and cash equivalents	10	455	17,534
		56,310	**48,218**
Current liabilities			
Trade and other payables	11	(40,013)	(37,588)
Net current Assets		**16,297**	**10,630**
Total assets less current liabilities		**90,769**	**30,458**
Non-current liabilities			
Provisions	12	(1,458)	(1,423)
Other Liabilities	19	(6,309)	-
Net Assets		**83,002**	**29,035**
Equity			
Ordinary share capital	14	34,803	22,803
Share premium		353,223	245,223
Retained earnings		(305,024)	(238,991)
Total equity		**83,002**	**29,035**

The accompanying notes on pages 13 to 36 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors on May 31st 2017 and were signed on its behalf by:

Antonio Marti Ciruelos
Director

Telefonica Digital Limited

Statement of changes in equity
Year ended 31 December 2016

	Ordinary share capital £'000	Share premium £'000	Retained earnings £'000	Total equity £'000
At 31 December 2014	**22,803**	**245,223**	**(181,632)**	**86,394**
Total comprehensive loss for the period	-	-	(57,359)	(57,359)
At 31 December 2015	**22,803**	**245,223**	**(238,991)**	**29,035**
Issues of sharing during the year	**12,000**	**108,000**		**120,000**
Total comprehensive loss for the period			(66,034)	(66,034)
At 31 December 2016	**34,803**	**353,223**	**(305,025)**	**83,002**

A description of the Ordinary share capital is provided in note 14.

Statement of cash flows
Year ended 31 December 2016

	Notes	2016 £'000	2015 £'000
Loss before taxation		**(75,158)**	**(71,436)**
Depreciation and amortisation charges	5, 6	8,816	14,750
Loss on disposal of intangible assets	6	6,284	2,255
Impairment Charge	7	26,516	-
Decrease in trade and other receivables	8	(15,823)	20,183
Decrease in trade and other payables	11	2,201	(28,547)
Increase in provisions & other liabilties	12, 19	6,344	34
Decrease in deferred income		-	(981)
Net Finance charges		51	(145)
Net cash flow used in operating activities		**(40,769)**	**(63,887)**
Taxation		-	19,148
Investment in subsidiaries	7	(87,144)	(506)
Purchase of property, plant and equipment		(1,876)	-
Generation of intangible assets	6	(7,239)	(6,727)
Net cash flow used in investing activities		**(96,259)**	**(7,233)**
Issue of shares		120,000	-
Decrease in loans payable		-	30
Decrease in loans receivable		-	25,722
Interest received		14	4,312
Interest paid		(65)	(4,167)
Net cash flow generated from financing activities		**119,950**	**25,897**
Net decrease in cash and cash equivalents		(17,079)	(26,075)
Cash and cash equivalents brought forward		17,534	43,609
Cash and cash equivalents carried forward	10	**455**	**17,534**

The accompanying notes on pages 13 to 36 are an integral part of these financial statements.

1. Accounting policies

Basis of preparation

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

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

Presentation of financial information

Operating items in the statement of comprehensive income are derived from the primary operations of the Company as a digital communications company. Items recognised below operating profit represent activities that are not directly attributable to the Company's primary operations.

Property, plant and equipment

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

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

Leasehold buildings	10 years
Furniture and other items	3 to 5 years

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

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income when the asset is derecognised.

1. Accounting policies (continued)

Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is reflected in profit and loss in the period in which the expenditure is incurred.

The useful lives of intangible assets have been assessed as finite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement as the expense category that is consistent with the function of the intangible assets.

Amortisation is provided on intangible assets from the date they are brought into use over their estimated useful lives on a straight-line basis. The lives assigned to intangible assets are from 2 to 3 years.

No amortisation is provided on assets in the course of construction.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

Capitalised product development costs

Product development costs are capitalised and measured at the cost incurred to develop and bring into use the specific products. Costs that are directly associated with the production of identifiable unique products controlled by the Company, which are expected to generate economic benefits over a period of more than one year, are recognised as intangible assets. Such product development costs recognised as intangible assets are amortised over their expected future benefit lives on a straight-line basis.

Development expenditure is written off as incurred unless the Company can demonstrate the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale,
- its intention to complete and its ability to use or sell the asset,
- the asset will generate future economic benefits,
- the availability of resources to complete the asset and
- the ability to measure reliably the expenditure during the development.

Where these recognition criteria are met, development expenditure is capitalised as an intangible asset and amortised over its useful economic life.

1. Accounting policies (continued)

Long term financial assets

Investments are stated at cost less provision form impairment. An impairment loss is recognized 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.

Revenue

Liceo is the licensing model under which Telefonica Digital Limited receives a pay per use or a share of the revenues generated by the OBs in the sale of products or services developed by Telefonica Digital Limited. Liceo applies in the same way when income is generated by the OB on a platform developed by Telefonica Digital Limited. In the case of products or services that do not generate a direct and specific income to the OB, a payment per active user of the product or service applies.

Revenue excludes value added tax and other sales taxes. It relates mainly to services provided to other entities in the Telefonica Group in relation to the principal activities of the Company.

Revenue is recognised when the service is rendered with deferred revenue recognised on the statement of financial position to the extent of the services paid but not yet rendered.

Foreign currencies

Transactions denominated in foreign currencies are translated into sterling at the average year to date rates, which do not materially defer from the rates as of the dates of the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at the rates ruling at the statement of financial position date.

Non-monetary assets and liabilities denominated in foreign currencies are translated at the foreign currency exchange rate ruling at the dates the non-monetary assets and liabilities are recognised.

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. A defined contribution plan is a pension plan under which the Company pays fixed contributions on behalf of employees and under which there is no legal or constructive obligation to pay further contributions for employees' service in the current and prior periods. The Company participates in the Telefonica Pension Plan ("Telefonica PP"), a scheme sponsored by Telefonica Europe plc, a fellow subsidiary of Telefonica SA, which provides benefits for the majority of UK employees in the Telefonica SA Group.

During the reporting year, the Telefonica PP had both defined benefit and defined contribution sections. On 28 February 2013, the defined benefit sections of the Telefonica PP closed to further benefit accrual. Members' of the defined benefit sections of the Telefonica PP will continue to be increased in deferment by reference to the Consumer Prices Index but will not retain the link to any future increases in salary. Upon closure, members of the defined benefit sections of the Telefonica PP were given the option to become members of the defined contribution section of the Telefonica PP. The defined contribution sections of the Telefonica PP remain open to new entrants and further accrual. The assets of the Telefonica PP are held independently of the Company's finances.

In its capacity as a participating employer of the defined contribution section of the Telefonica PP, Telefonica Digital Limited pays contributions into the plan on behalf of employees of the Company. Telefonica Digital Limited has no further payment obligations once the contributions have been paid. The contributions are recharged to the Company and are recognised as employee benefit expense when they are due.

1. Accounting policies (continued)

Share based payments

The Company recognises an expense for share awards and share options, which are both equity and cash settled, based on the fair value of the share awards or share options granted as compensation for the services rendered by employees. The fair value is calculated at the grant date using an adjusted statistical model and excludes the impact of non-market conditions. Instead, the expense is adjusted for the effect of non-market conditions at each reporting date through the number of share awards or share options expected to be exercisable. The effect of market and non-vesting conditions is included in the fair value at the date of grant and is recognised as an expense irrespective of whether the market or non-vesting condition is satisfied. Any proceeds received are credited to share capital and share premium when the share option or award is exercised.

Taxation

The charge for current tax is based on the results for the period as adjusted for items which are non-assessable or disallowed.

Deferred income tax is provided in full, using the statement of financial position liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax and current tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Income tax relating to items recognised directly in equity is recognised in equity.

Cash and cash equivalents

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

Trade and other receivables

Trade and other receivables are carried at original invoice amount less provision for doubtful debts. A provision for doubtful debts is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the carrying amount and the present value of estimated future cash flows. Changes in the provision against receivables are recognised in the statement of comprehensive income.

1. Accounting policies (continued)

Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance expense.

Borrowings

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

Capital management

The Company's capital comprises share capital, share premium and retained earnings.

The Company's objectives when managing capital are to safeguard the Company's ability to continue to operate as a going concern, to maintain optimal capital structure commensurate with risk and return and to reduce the cost of capital.

Prior year adjustments

During the year, the company migrated its financial system to a new ERP, granting a greater visibility into the financial information. As a result, it was identified that fixed assets had been misclassified between asset classes. The error in the prior year figures was corrected, resulting in an decrease in leasehold and buildings and a corresponding increase in furniture and other with no net impact on the fixed asset total in the balance sheet

Financial risk factors and management

The Company's operations expose it to a variety of financial risks including currency risk, credit risk and liquidity risk. The principal financial risks of the Company and how the Company manages these risks are discussed below.

Liquidity risk

Management of the Company's liquidity risk is achieved mostly through being a part of the larger Telefonica Group, which operates group wide policies in this area. The Company holds financial assets primarily in short-term deposits with a central Telefonica Group company that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

Foreign currency risk

The Company is exposed to transactional foreign exchange risks arising from various currency movements, primarily with respect to the Euro and US dollar that can affect its results and financial position. Significant exposures are managed using foreign exchange controls and the Telefonica Group managing positions on a group wide basis.

Notes to the financial statements

1. Accounting policies (continued)

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

The accounting policies applied in the preparation of the financial statements for the year ended December 31, 2016 are consistent with those used in the preparation of the Company's annual financial statements for the year ended December 31, 2015, except for the adoption, on January 1, 2015, of new amendments to standards published by the International Accounting Standards Board (IASB) and adopted by the European Union for application in Europe, noted below:

- Defined Benefit Plans: Employee Contributions – Amendments to IAS 19:
  These amendments clarify the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In addition, the amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered. The application of these amendments had no impact on the Company's financial position or results.
- Improvements to IFRS 2010-2012
- Improvements to IFRS 2011-2013

The annual improvements projects provide a vehicle for making non-urgent but necessary amendments to IFRSs, with the aim of removing inconsistencies and clarifying wording. These improvements do not have a significant impact on the results or financial position of the Company.

New standards and amendments to standards issued but not effected as of December 31, 2016.

At the date of preparation of the consolidated financial statements, the following IFRSs and amendments had been published, but their application was not mandatory:

Standards and amendments		**Mandatory application: annual periods beginning on or after**
Improvements to IFRS 2012-2014		January 1, 2016
IFRS 14	*Regulatory Deferral Accounts*	January 1, 2016
Amendments to IFRS 11	*Accounting for Acquisitions of Interests in Joint Operations*	January 1, 2016
Amendments to IAS 16 and IAS 38	*Clarification of Acceptable Methods of Depreciation and Amortization*	January 1, 2016
Amendments to IAS 16 and IAS 41	*Agriculture: Bearer Plants*	January 1, 2016
Amendments to IAS 1	*Disclosure Initiative*	January 1, 2016
Amendments to IFRS 10, IFRS 12 and IAS 28	*Investment Entities: Applying the Consolidation Exception*	January 1, 2016
Amendments to IAS 7	*Disclosure Initiative*	January 1, 2017
Amendments to IAS 12	*Recognition of Deferred Tax Assets for Unrealised Losses*	January 1, 2017
IFRS 9	*Financial instruments*	January 1, 2018
Amendments to IFRS 7	Disclosures - Transition to IFRS 9	January 1, 2018
IFRS 15	*Revenues from Contracts with Customers*	January 1, 2018
IFRS 16	*Leases*	January 1, 2019
Amendments to IFRS 10 and IAS 28	*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*	Deferred Indefinitely

Notes to the financial statements

1. Accounting policies (continued)

Based on the analyses made to date, the Company estimates that the adoption of most of these standards, amendments and improvements will not have a significant impact on the financial statements in the initial period of application. The Company is currently assessing the impact of the application of IFRS 15. In addition to this, IFRS 16 requires a company to report on the statement of financial position lease assets and lease liabilities for all leases (other than short-term leases and leases of low-value assets). Based on the number of lease arrangements in the Company, changes introduced by IFRS 16 are expected to have a significant impact in the Company's financial statements.

Critical accounting estimates and judgements

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

Property, plant and equipment and product development

Accounting for property, plant and equipment and product development involves the use of estimates and judgements for determining the useful lives over which these are to be depreciated or amortised and the existence and amount of any impairment.

Property, plant and equipment and product development are depreciated or amortised on a straight-line basis over their estimated useful lives and taking into account their expected residual values. When the Company estimates useful lives, various factors are considered including expected technological obsolescence and the expected usage of the asset.

The Directors regularly review these asset lives and change them as necessary to reflect the estimated current remaining lives in light of technological changes, future economic utilisation and physical condition of the assets concerned. A significant change in asset lives can have a significant change on depreciation and amortisation charges for the period.

It is not practicable to quantify the impact of changes in property, plant and equipment and product development asset lives on an overall basis as asset lives are individually determined and there are a significant number of asset lives in use. The impact of any change would vary significantly depending on the individual changes in assets and the classes of assets impacted.

Deferred tax assets and liabilities

The Company evaluates the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the course of the period for which the deferred tax assets remain deductible. This analysis is based on the estimated reversal of deferred taxes as well as estimates of taxable earnings, which are sourced from internal projections and are updated to reflect the latest trends. The appropriate classification of tax assets and liabilities depends on a number of factors, including estimates as to the timing and materialisation of deferred tax assets and the forecast tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. This obligation may be legal or constructive deriving from regulations,

Notes to the financial statements

1. Accounting policies (continued)

contracts, normal practices or public commitments that lead third parties to reasonably expect that the Company will assume certain responsibilities. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, considering all available information.

No provision is recognised if the amount of liability cannot be estimated reliably. In this case, the relevant information is disclosed in the notes to the financial statements.

Given the uncertainties inherent in the estimates used to determine the amount of provision, actual outflows of resources may differ from the amounts recognised originally on the basis of the estimates.

Development costs

Development costs are capitalised in accordance with the accounting policy. Initial capitalisation of costs is based on management's judgement that technological and economic feasibility is confirmed, usually when a product development project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised, management makes assumptions regarding the expected future cash generation of the project, discount rates to be applied and the expected period of benefits. At 31 December 2016, the carrying amount of capitalised development costs was £2.7 million (2015: £7.8 million).

Going concern

The financial position of the Company is described in the Strategic report. In addition, this note 1 to the financial statements includes the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk and liquidity risk. Consequently, the Directors believe that the Company is well placed to manage its business risk successfully.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Furthermore, Telefonica Group has the ability and willingness to provide continued support to the Company, and thus the Directors have adopted the going concern basis of accounting in preparing the annual financial statements

2. Revenue and Operating Loss

Revenues are composed of the following items:

	2016	2015
	£'000	£'000
Liceo revenues	7,526	5,512
Non-Liceo revenues	18,234	8,912
Total revenues	**25,760**	**14,424**

Since January 1, 2014, Telefonica Digital Limited has an agreement with certain OBs of the Telefonica Group to operate through a licensing model (Liceo) to remunerate at market conditions the usage of digital products and services developed by Telefonica Digital Limited. Under this licensing model, the Company receives a pay per use or a share of the revenues generated by the OBs through the sale of products or services developed by the Company. Liceo applies in the same way when income is generated by the OB on a platform developed by the Company. In the case of products or services that do not generate a direct and specific income to the OB, a payment for active user of the product or service applies.

Other non-Liceo revenues are mostly generated by recharges to Telefonica S.A. for costs of global activities executed in Telefonica Digital Limited not related to Liceo licensing model.

2. Revenue and Operating Loss (continued)

The following items have been included in arriving at operating loss:

	2016 £'000	2015 £'000
Depreciation of property, plant and equipment (note 5)	(1,896)	(1,697)
Amortisation of development costs (note 6)	(6,920)	(13,053)
Disposal of property, plant and equipment (note 5)	(2,685)	-
Impairment of development costs (note 6)	(4,808)	-
Non recurring expenses – Impairment charge (Note 7)	(26,516)	-
Staff costs (note 18)	(28,938)	(25,155)
Auditor's remuneration (note 16)	(53)	(78)

3. Net financial expense

	2016 £'000	2015 £'000
Financial income		
Interest income from other group companies	14	332
Other financial income	-	3,980
Total financial income	**14**	**4,312**
Financial expense		
Interest payable to other group companies	-	(30)
Other financial costs	(65)	(4,137)
Total financial expense	**(65)**	**(4,167)**
Net financial (gain)/loss	**(51)**	**145**

4. Taxation

Analysis of Credit in the period

	2016	2015
	£'000	£'000
Current tax	9,115	15,704
Current tax – adjustments in respect of prior periods	9	1,304
Deferred tax	-	(1,773)
Deferred tax - adjustments in respect of prior periods	-	(1,205)
Effect in Change in tax rate	-	47
Taxation	**9,124**	**14,077**

	2016	2015
	£'000	£'000
Loss before taxation	**(75,158)**	**(71,436)**
Loss before taxation multiplied by rate of		
Corporation tax in the UK of 20% (2015: 20.25%)	**15,031**	**14,466**
Effects of:		
Expenses not deductible for tax purposes	(5,699)	(147)
Adjustments in respect of prior periods	10	99
Effect of change in tax rate	(22)	64
Deferred tax not recognized	(196)	(405)
Total taxation	**9,124**	**14,077**

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.

5. Property, plant and equipment

	Leasehold and buildings £'000	Furniture and other items £'000	Total £'000
Cost			
At 1 January 2015 - Restated	9,646	4,080	13,726
Additions	-	-	-
Disposals	-	-	-
Transfers	-	-	-
At 31 December 2015 - Restated	**9,646**	**4,080**	**13,726**
Additions	1,840	36	1,876
Disposals	(1,707)	(978)	(2,685)
At 31 December 2016	**9,779**	**3,138**	**12,918**
Depreciation			
At 1 January 2015 - Restated	(2,108)	(2,277)	(4,385)
Charge for the year - Restated	(911)	(786)	(1,697)
Disposals	-	-	-
At 31 December 2015 - Restated	**(3,019)**	**(3,063)**	**(6,082)**
Charge for the year	(1,063)	(832)	(1,896)
Disposals	732	1,142	1,874
At 31 December 2016	**(3,351)**	**(2,753)**	**(6,105)**
Net book value			
At 31 December 2015 - Restated	6,627	1,017	7,644
At 31 December 2016	**6,428**	**385**	**6,813**

During the year, the company migrated its financial system to a new ERP, granting a greater visibility into the financial information. As a result, it was identified that fixed assets had been misclassified between asset classes. The error in the prior year figures was corrected, resulting in an decrease in NBV in leasehold and buildings of £800 thousand and a corresponding increase in NBV in furniture and other of £800 thousand with no net impact on the fixed asset total in the balance sheet

Furthermore, The Company went through reorganising the current premises which resulted in retiring some costs related to the original set up costs.

Notes to the financial statements

6. Intangible assets

Cost	Total £'000
At 1 January 2015	**58,574**
Additions	6,727
Disposals	(4,100)
At 31 December 2015	**61,201**
Additions	7,239
Disposals	(9,400)
Transfers	-
At 31 December 2016	**59,040**
Amortisation	
At 1 January 2015	**(42,186)**
Charge for the year	(13,053)
Impairment	-
Disposals	1,845
At 31 December 2015	**(53,394)**
Charge for the year	(6,920)
Impairment	(4,808)
Disposals	8,736
At 31 December 2016	**(56,386)**
Net book value	
At 31 December 2015	**7,807**
At 31 December 2016	**2,653**

In 2016, The Company made a review of the useful life of intangible assets considering the nature of the business, the current and future market environment as well as the experience gained in the last year. It is a very dynamic market with a high level of innovation required by the continuous technological development. Because of this study the useful life of some intangible digital products has been modified, being reduced to 18 months, with an impact of £4,808 thousand in impairment charges. As a result, some of these assets were fully amortised. The impact of this change in estimate has been applied prospectively.

7. Long-term financial assets

	2016 £'000	2015 £'000
Investment in subsidiaries	65,006	4,377
Total long-term financial assets	**65,006**	**4,377**

During the year, The Company invested a further cash of $3.3m in Axonix Limited maintaining a 78% share holding. Furthermore, The Company also invested a further $119m (£85m) in its fully owned subsidiary Telefonica Digital Inc. At year end, however, the value of the investment in the company was written down to the carrying value of its net assets.

A list of principal subsidiary undertakings at 31 December 2016 is given below:

Name	Registered office address	Activity	Portion of shares held
Axonix Limited	260 Bath Road, Slough, SL1 4DX, UK	Mobile Advertising	78%
Telefonica Digital Inc	501 2nd Street Suite 310 San Francisco CA 94107	Intermediate Holding company	100%
Telefonica Digital Limited [1]	Hatidar 17 Raanana Israel	IP communications platform operator	100%
Tok Box Inc [1]	501 2nd Street Suite 310 San Francisco CA 94107	IP communications platform operator	100%
Tok Box Australia Pty Limited [1]	100 Harris Street, Level 4 Pyrmont Sydney, NSW 2009	IP communications platform operator	100%

(1) Subsidiary is indirectly owned.

8. Trade and other receivables

	2016 £'000	2015 £'000
Amounts owed by other group companies	37,903	27,398
Prepayments	1,860	1,485
Other debtors	316	1,801
Total trade and other receivables	**40,079**	**30,684**

Balances with other group companies include £15m from O2 UK in relation of 2016 tax losses of TDUK, £13m and £3m for non-Liceo revenue from Telefonica SA and Telefonica Espana respectively, £6m for cost recharges from Telefonica International Wholesale Limited and £1.5m from O2 UK for Liceo related revenue. All amounts owed by other group companies are unsecured, interest free and repayable on demand.

9. Other financial assets

	2016 £'000	2015 £'000
Other Financial Asset	15,776	-
Other financial asset	**15,776**	**-**

This relates to the 2015 tax losses that The Company surrendered to the O2UK. This was converted to a short terms loan payable with interest rate of Libor plus a margin of 0.55% per year repayable within a year

10. Cash and cash equivalents

	2016 £'000	2015 £'000
Short term deposits	455	17,534
Cash and cash equivalents included in cash flow statement	**455**	**17,534**

The Company used its cash reserves during the year and ended in an overdrawn position. However, the overdraft was with Telfisa Global (another Telefonica company) and the balance is included in the Amounts owed to other group companies (Note 11) in the balance sheet.

11. Trade and other payables

	2016 £'000	2015 £'000
Trade payables	4,808	3,470
Amounts owed to other group companies	24,676	25,191
Accrued expenses	10,529	8,927
Deferred income	-	-
Total trade and other payables	**40,013**	**37,588**

Amounts owed to group companies include £15m overdraft with Telfisa Global, £2m with Telefonica Digital Israel, £1.2m with O2 UK and £2m with Telefonica Europe. All amounts owed to other group companies are unsecured, interest free and repayable on demand.

12. Provisions

Site restoration provision	2016 £'000	2015 £'000
Non-current	**1,458**	**1,423**

	2016 £'000	2015 £'000
At 1 January	1,423	1,389
Credit for the year	-	-
Utilised in the year	-	-
Unwinding of discounts	35	34
At 31 December	**1,458**	**1,423**

The site restoration provision payment dates are uncertain.

13. Deferred taxation

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 18% (2015: 18%). The movement on the deferred tax account is as shown below:

	£'000
At 1 January 2015	3,024
Current year charge to statement of comprehensive income	(1,368)
Current year credit to statement of changes in equity	-
Prior year Charge to statement of comprehensive income	(1,205)
Effect of change in tax rate	(47)
Deferred tax assets not recognised	(405)
At 31 December 2015	-
At 1 January 2016	-
At 31 December 2016	-

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

The recognition of deferred tax assets is based upon whether it is more likely than not that sufficient and suitable taxable profits will be available in future against which the reversal of temporary differences can be deducted. Recognition therefore involves judgement regarding the future financial performance of the company and the UK tax group in which this company participates. As a result, deferred tax assets totalling £621,000 have not been recognised.

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

Unrecognised deferred tax assets	**Accelerated tax depreciation £'000**	**Employee share based payments £'000**	**Other £'000**	**Total £'000**
At 31 December 2015	213	174	27	414
At 31 December 2016	448	146	27	621

Net deferred tax Asset	**£'000**
At 31 December 2016	
At 31 December 2015	-

14. Ordinary share capital

	Number of Shares	31 December 2016 £'000	Number of shares	31 December 2015 £'000
Share capital				
Called up, allotted and fully paid				
Ordinary shares of £1 each				
At beginning of year	22,802,599	22,803	22,802,599	22,803
Issued during year	12,000,000	12,000	-	-
Total shares at end of year	**34,802,599**	**34,803**	**22,802,599**	**22,803**

15. Related party disclosures

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

	2016 £'000	2015 £'000
Revenue		
Other group undertakings	25,274	14,424
Purchases		
Other group undertakings	(19,466)	(18,613)
Total net transactions	**5,808**	**(4,189)**

All related party transactions relate to regular trading activities of the Company on an arm's length basis. Other related party balances are detailed in notes 3, 8 and 11. Related party transactions with Directors and key management are detailed in note 17.

16. Auditor's remuneration

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

	2016 £'000	2015 £'000
Audit services:		
UK statutory audit fees	53	78
Total audit and audit-related fees	**53**	**78**

The fees are owed to Ernst & Young LLP.

17. Key management and Directors' compensation

The compensation of key management for the period ended 31 December was as follows:

	2016 £'000	2015 £'000
Salaries and short-term employee benefits	2,686	3,113
Long term employee benefits	2	608
Post-employment benefits	5	4
Termination benefits	-	-
Share based payments	-	-
Total key management compensation	**2,693**	**3,725**

The key management of the Company are the same as the Directors of the Company.

Notes to the financial statements

17. Key management and Directors' compensation (continued)

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

	2016 £'000	2015 £'000
Aggregate emoluments in respect of qualifying services	2,686	3,113
Aggregate amount of company contributions paid to a pension scheme	5	4
Amounts received under long term incentive plans	-	608
Compensation for lost of office	-	-
Exercised share options	-	-
Total Directors emoluments	**2,691**	**3,725**

No Directors exercised share options during the current and prior period and one Director received Telefonica S.A. shares in respect of qualifying service under long-term incentive plans (2015: no Directors).

In respect of the highest paid Director:

	2016 £'000	2015 £'000
Aggregate emoluments in respect of qualifying services	1,440	1,524
Aggregate amount of company contributions to a pension scheme	5	4
Amounts receivable under long term incentive plans	-	83
Total highest paid Director emoluments	**1,445**	**1,611**

The highest paid Director did not receive shares under the Telefonica Performance and Investment Plan and did not exercise share options during the current or prior period. The accrued benefit of the highest paid Director in the defined benefit scheme is £209 thousand per year (at 28 February 2013, when accrual of defined benefit ceased).

18. Employees

	2016 No.	2015 No.
Average number of full time employee equivalents *(including executive Directors)*:		
Chief Commercial Digital Office	164	159
Head Quarters	41	42
Total employees	**205**	**201**

The benefits expense incurred in respect of these employees were:

	2016 £'000	2015 £'000
Wages and salaries	19,993	18,035
Social security costs	2,592	1,689
Pension costs (note 20)	-	1,815
Share based payments (note 21)	626	(581)
Redundancies	5,727	4,197
Total employees	**28,938**	**25,155**

18. Employees (continued)

The Company's employees and Directors participated in several employee incentive share schemes operated by Telefonica S.A. (see note 21 for further details).

19. Leases

The Company holds a 15-year operating lease on its Air Street offices from 2012 with a break clause after 10 years. The total future value of minimum lease payments due is as follows:

	2016 £'000	2015 £'000
No Later than one year	4,054	4,054
Later than one year and no later than five years	16,216	16,216
Later than 5 years	20,270	24,324
Total	**40,540**	**44,594**

During the year, the lease agreement for Air Street offices were transferred from Telefonica UK to Telefonica Digital UK. Therefore, the lease incentives were transferred from intercompany payables to trade payables (£682k) and other liabilities (£6,309k)

20. Pension costs

Pension costs

The Company participates in an unfunded defined benefit scheme. In addition, Telefonica Europe plc, its immediate and ultimate UK parent company, sponsors a group-wide defined benefit scheme, the Telefonica Pension Plan, in which employees of the Company are members and therefore the Company has been recharged the contributions payable into the scheme for the period. The retirement benefit obligation of this scheme is recorded on the statement of financial position of Telefonica Europe plc.

The Telefonica Pension Plan

The Company participates in the Telefónica UK Pension Plan ("the Plan"). Telefónica Europe plc (the Company's ultimate UK parent company) acts as Sponsor and Principal Employer of the Plan, and the Plan is divided into defined contributions and defined benefit sections.

The net defined benefit cost of the defined benefit scheme, as assessed in accordance with the advice of a qualified, independent actuary, measuring actuarial liabilities using the projected unit method and taking assets at market value, is recognised by the sponsoring employer, Telefonica Europe plc. Accordingly the defined benefit liability and assets of the Plan are not recognised on the statement of financial position of the Company, but are instead reported by Telefónica Europe plc as the Plan's Sponsor.

The Plan provides the pension benefits for the majority of Telefónica's UK employees, including those the Company. Participating companies whose employees are members are the Plan account for the defined benefit sections of the plan as though it were a defined contribution plan as there is no contractual arrangement or stated policy for charging out the net defined benefit cost between participating employers. The Company therefore expenses any contributions payable to the defined benefit sections of the plan.

20. Pension costs (Continued)

The total charge included in the Company's statement of comprehensive income of Telefónica UK for the Plan are as follows:

	2016 £m	2015 £m
Defined benefit scheme contributions expensed	-	80
Defined contribution scheme contributions expensed	35	35
Telefonica Pension Plan cost	**35**	**115**

With effect from 28 February 2013 the defined benefit sections of the Plan closed to further benefit accrual. 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 remain open to new entrants and further contributions. The assets of the Plan are held independently of the Sponsor's finances

Actuarial valuation

A full valuation of the defined benefit scheme of the Plan was undertaken as at 30 September 2014 by a suitably qualified independent actuary. The valuation used the projected unit method.
The full valuation was completed in line with the current investment strategy of the Plan which is predominantly a corporate bond basis initiated following the 2008 valuation.
No payment was made to the defined benefit scheme in the year ended 31 December 2016 (2015: £80m).
The main financial actuarial assumptions used in the valuation were as follows:

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

The initial results of the actuarial valuation of the Plan as at 30 September 2014 have been updated to 31 December 2016 by third party qualified actuary in accordance with the requirements of IAS 19. The defined benefit liabilities have been measured using the projected unit credit method. Plan assets are stated at fair value.

80% of the assets are invested in sterling-denominated bonds with 20% invested in synthetic global equities
Plan assets are valued by reference to quoted market prices in active markets. No assets of Telefonica Europe plc are held by the Plan.

20. Pension costs (Continued)

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

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

At 31 December 2016, the weighted average duration of the defined benefit obligation of the funded plan was 23 years (2015: 23 years).
The position and results reported are subject to the accuracy of the assumptions used.

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

	2016	2015
	Funded	**Funded**
	£m	**£m**
Present Value Movements of Defined Benefit Obligations:		
At start of year	**1,180**	**1,183**
Interest expense	44	44
Actuarial (gains)/losses on demographic assumptions	-	(8)
Actuarial (gains)/losses on financial assumptions	382	8
Actuarial (gains)/ on experience adjustments	(20)	(28)
Benefits paid	(21)	(19)
At end of year	1,565	1,180

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

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

20. Pension costs (Continued)

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

	2016	2015
	Fundcd	Fundcd
	£m	£m
Fair value of assets comprises:		
Equities	306	257
Corporate bonds	1,117	949
Cash and net current assets	(1)	80
Fair value of assets	1,422	1,286
Present value of defined benefit obligations	(1,565)	(1,180)
Net (obligation)/asset recognised in statement of financial position	(143)	106

A reduction in the discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the discount rate will have an opposite effect of similar magnitude. An increase in the inflation rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A reduction in the inflation rate will have an opposite effect of similar magnitude.
There is also uncertainty around the future life expectancy of the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

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

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

21. Share based payments

Introduction

There were two share schemes in operation in Telefonica Digital Limited during the year ended 31 December 2016: the Global Employee Share Plan and the Telefonica Performance Investment Share Plan. These are described in more detail below.

Employees of Telefonica Digital Limited who were previously employed elsewhere in the Telefonica Group transferred their contracts of employment to the Company on 2 April 2012. All share scheme rights transferred with the individual.

Accounting

The costs of share options and awards are charged to the statement of comprehensive income over the vesting period, based upon the fair value of the share award or option at the award date adjusted for the likelihood of non-market vesting conditions being met under the share award or option plan.

21. Share based payments (continued)

The amounts recognised in operating income for share based payment transactions with employees for the year ended 31 December 2016 was as follows:

	2016	2015
	£'m	£'m
Equity settled share based payments	0.6	0.5
Total share based payments	**0.6**	**0.5**
Total share based payments	**0.6**	**0.5**

Telefonica Performance Investment Share Plan

Certain employees participate in Telefonica S.A. incentive plans. From 2011 employees were awarded shares in the Telefonica Performance Investment Share Plan ("PIP").

The first PIP was approved at the Telefonica S.A. AGM held on 18 May 2011 and awarded shares in Telefonica S.A. to participants subject to the achievement of certain performance criteria but also incorporated the opportunity for enhanced award for those employees who maintained a minimum shareholding in the Company. The Telefonica S.A. General Shareholders' Meeting on May 30, 2014 approved a new instalment of the long-term share-based incentive PIP for certain senior executives and members of the Group's management team, operational on completion of the first "Performance and Investment Plan".

In all plans, the beneficiary must continue to work for the company throughout the three-year duration of each phase and the actual number of shares awarded at the end of each phase depends on success in achieving Total Shareholder Return ("TSR") performance criteria. The TSR is the indicator used to determine the Telefonica Group's medium- and long-term value generation, measuring the return on investment for each shareholder. For the purposes of this Plan, the return on investment of each phase is defined as the sum of the increase or decrease in the Telefonica, S.A. share price and dividends or other similar items received by the shareholder during the phase in question.

The TSR of Telefonica, S.A. is measured against a comparator group of listed telecoms companies over a fixed three-year period and vesting occurs as follows:

TSR ranking	% Shares vest
Below median	0%
Median	30%
Upper quartile	100%

Vesting occurs on a straight-line basis between median and upper quartile performance.

The fair value of the rights granted to the participants is measured by Telefonica, S.A. considering market conditions at grant date.

The fair values for each year of award and the number of shares granted are as follows:

21. Share based payments (continued)

Grant date	1 October 2014	1 October 2015	1 October 2016
Number of shares granted	127,518	81,200	0
Number of shares outstanding at 31 December 2015	95,033	81,200	0
Fair value	€6.82	€6.46	0
Vesting date	30 September 2017	30 September 2018	

On the completion of the three-year period following the 2010 grant period on 30 June 2013, and the 2011 grant period on 30 June 2014, and in accordance with the general conditions of the plan, none of the share awards vested and participants were not awarded any shares.

The 2012 grant expired on June 30, 2015. The maximum number of shares assigned to this phase of the plan was 427,629 assigned on July 1, 2012, with a fair value of 5.87 euros per share. At the end date of this phase, it was determined that 77% of "Total Shareholder Return" (TSR) had been achieved, under the terms and conditions of the plan. Therefore, the eligible employees received a total of 42,659 shares (corresponding to a total of 79,189 gross shares, of which 36,530 shares were withheld at the option of the employee prior to distribution). 2016 had no such scheme.

Global Employee Share Plan ("GESP")

The Annual General Meeting of Shareholders of Telefonica, SA held on 18 May 2011, approved the implementation of a share plan open to all employees of the Telefonica Group worldwide. The GESP offered employees the opportunity to acquire shares in Telefonica, SA with a commitment by Telefonica to deliver to the employee one free share for every share they have acquired (subject to certain conditions). The plan's share holding period came to an end in December 2014.

A new GESP 2015 program was approved ate the AGM held on May 30, 2014. Under this Plan, employees were offered the option to acquire Telefónica, S.A. shares during a twelve month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements. Each employee was limited to buying a maximum of 1,800 euros in Telefónica, S.A. shares, subject to a minimum of 300 euros. If the employee remains part of the Telefónica Group and holds on to the shares for one year following the acquisition period (the shareholding period), they will be entitled to receive one free share for each share they acquire and retain throughout the shareholding period.

The acquisition period commenced in July 2015. As of December 31, 2016, 49 employees were eligible who had registered for the plan. The plan will be settled through the delivery of shares to employees.

22. Parent company and controlling party

The Company's immediate parent company is Telefonica Digital Holdings S.L. (Spain). At the end of the year the ultimate parent company and controlling party was Telefonica, S.A., a company incorporated in Spain. Copies of the consolidated financial statements of Telefonica, S.A. may be obtained from Gran Vía 28, 28013, Madrid, Spain.

23. Subsequent Events

Since the year end, The Company invested a further $4.2m in Axonix in 3 different stages. Furthermore, The Company also received a cash injection from its parents in January 2017 of approximately £35m.