

Business review

History and development of the Company

On 14 February 2005, the shareholders of mmO2 approved the proposals for a capital reorganisation to create distributable reserves through a Court-approved Scheme of Arrangement (the Scheme). The reorganisation was required in order that the Company could implement a sustainable dividend policy and make distributions to shareholders. Following shareholder approval, mmO2 was acquired by a new company, O2, which effected a reduction of its share capital to create distributable reserves. The Scheme became effective on 14 March 2005, on which date dealings in O2 shares commenced on the London Stock Exchange.

Under the Scheme, mmO2 shareholders exchanged their existing shares in mmO2 for new shares in O2 on a one-for-one basis. mmO2 shareholders also had the option of electing to receive, in exchange for their existing shares in mmO2, either new shares in O2 or cash consideration under a cash alternative. Shareholders who took no action were deemed to have elected for the cash alternative. This cash consideration consisted of the amount received through a placing in the market of the new shares on behalf of the shareholders electing for the cash alternative. The value of the cash alternative was £1.30 including the premium of 5 pence per share. The cash alternative (and therefore the size of the placing) was limited to 300,000,000 O2 shares.

The Board has also reviewed the US listing and the associated ADR programme which is a legacy of the demerger from BT. As part of the reorganisation, mmO2's ADRs were delisted from the New York Stock Exchange on 11 March 2005 and O2 has not established an ADR programme nor a US listing for the new shares in O2. The Board is currently pursuing deregistration of O2 shares from the Securities and Exchange Commission.

During the second half of the financial year ended 31 March 2004, mmO2 transferred O2 Online, Products O2 and certain other central functions to the operating businesses, to simplify lines of management, reduce costs, and improve speed of execution. This restructuring, which reduced headcount by 200, led to an exceptional operating charge of £75 million being incurred in the second half of the year ended 31 March 2004. As a consequence of this streamlining, as from 1 April 2004, O2 Online and Products O2 are no longer being operated as separate businesses.

On 20 February 2004, we announced that our Board of Directors had received and considered a proposal by Royal K.P.N. N.V., the Dutch telecommunications group. The Board carefully considered the proposal but rejected it as not being in the best interests of our shareholders.

On 14 April 2003, we announced that we had agreed the sale of O2 Netherlands to Greenfield Capital Partners, an independent private equity and finance group with interests in the telecoms sector, for €25 million in cash, which was paid on completion of the transaction on 3 June 2003.

Our Group

We are a leading provider of mobile communications services in Europe, with wholly owned businesses in the United Kingdom, Germany, Ireland and the Isle of Man.

We have almost 24 million customers and approximately 15,000 employees. We reported revenues for the year ended 31 March 2005 of £6,683 million. Data represented 23.3 per cent of gross service revenues for the financial year ended 31 March 2005.

The businesses in the UK and Ireland are both established and profitable, with a track record of revenue and customer growth and a strong presence in high-value markets, such as business and mobile data services. In the UK, our Tesco Mobile joint venture performed well, reporting that its active customer base reached 500,000 shortly after Christmas. In Ireland, the growth in customer numbers led to another year of strong financial performance.

O2 Germany remains the fastest growing operator in Germany. It experienced strong service revenue growth for the full financial year ended 31 March 2005, driven by the continuing rapid growth in the customer base. Performance in Germany has exceeded expectations thanks largely to our unique Genion service.

We announced on 1 April 2005 that O2 Airwave had completed the nationwide network – on time and on budget – to provide every police force in England, Scotland and Wales with state of the art, secure digital communications. The completion of the five-year programme that has rolled out the largest public safety mobile communications network of its kind in Europe is a milestone in the efforts being made to cut bureaucracy and improve safety for the police and the general public. Over 100,000 police officers are now using Airwave.

Manx Telecom is unique within the Group, providing mobile, fixed line and internet services in the Isle of Man. It was also the pioneer of UMTS networks, the platform on which we, in measured stages, will supply services Europe-wide. We chose Manx Telecom to run Europe's first superfast 3G trial, in partnership with Lucent Technologies, using HSDPA technology. HSDPA offers the possibility of communication speeds up to three times faster than current commercial UMTS services.

As we reported last year, we became a founding member of Starmap Mobile Alliance in October 2003, a group of independent mobile phone operators who are joining forces in readiness for the international roll-out of UMTS services. Starmap aims to provide a "home-away-from-home" experience by introducing seamless roaming and multimedia connectivity to more than 46 million customers in ten European countries. In addition, we have established the Tesco Mobile and Tchibo Mobilfunk joint venture businesses in the UK and Germany respectively.

Our technology

Our success in Germany has encouraged us to accelerate the growth of the business by means of increased network investment to deliver a high-quality customer experience from our own UMTS platform. At the same time we have launched our consumer UMTS service in the UK, a move that will be significantly enhanced in the second half of 2005 by our strategic agreement with NTT DoCoMo to provide its mobile internet service in our key markets.

We signed a long-term strategic agreement with NTT DoCoMo, Japan's largest mobile communications provider under which we will launch a mobile internet service using i-mode® capability in the UK, Germany and Ireland. This partnership will complement our existing expertise in data services with NTT DoCoMo's experience in non-SMS data and its extensive research and development capabilities. Customers will benefit from easy-to-use services, rich content applications and messaging across a range of advanced handsets.

Under the terms of the agreement, we are licensed by NTT DoCoMo to offer the i-mode® capability to our 24 million customers. Already the world's most popular mobile internet platform with more than 48 million subscribers using over 6,100 official content sites in ten countries and regions, we will make the i-mode® capability available on an extensive selection of advanced multimedia handsets and devices from major Asian, European and US manufacturers. These currently include NEC, Panasonic, Siemens, Motorola and Samsung, amongst others.

O2 UK and O2 Ireland will have exclusive use of the i-mode® brand and technology in their respective markets. O2 Germany will launch a service based on i-mode® technology under its own brand.

The appeal of these services will be significantly enhanced as we roll out HSDPA with speeds of up to 1Mbps (compared with UMTS with speeds of 384kbps) to all our customers, offering a true mobile broadband experience.

Our products and services

On 27 January 2005, we announced that we would introduce a range of attractive new handsets and an enhanced O2 Active portal over our UMTS network. The move builds on our leadership in non-voice services and unique O2 branded handsets. In the UK, UMTS services have been available for our business users since October 2004 and our consumers since 1 February 2005, and in Germany to our business users since April 2004 and all consumers shortly thereafter.

Consumers who purchase UMTS devices from us will enjoy a wider range of new and original content, including: film from Warner Bros Online (previews, behind the scenes and interviews); lifestyle from titles such as GQ, FHM and Glamour; the latest music videos and tracks from major recording artists and MTV; news from ITN; and sports, including England Rugby and Arsenal Football. They will also benefit from faster download speeds and video calling. The launch also marks the arrival of a new and improved version of the

innovative O2 Active portal, which has been re-designed to take advantage of richer, faster, more capable UMTS-based features.

To mark the introduction of our UMTS service for consumers, we launched the only own-branded UMTS handset in the UK market to date – the competitively priced O2 X4.

Based on the highly successful design principles of our existing X-range of handsets, which includes the popular O2 Xda II®, the O2 X4 sports a sleek clamshell design with a high-quality 262,000-colour main screen display. The O2 X4 is equipped with a 1.3 megapixel camera with an 8x zoom lens and advanced “flash mechanic”; it also includes an MP3 music player, video downloading and streaming capabilities, 10Mb of phone memory and 64Mb of additional capacity via a removable memory card.

In addition to the O2 X4, we will offer UMTS customers a range of handsets from leading manufacturers, including the Nokia 6630, Samsung Z107, Motorola V975 and the Sony Ericsson V800. This will be expanded going forward through existing handset procurement channels and the NTT DoCoMo partnership.

In Germany we recently launched an innovative, high-speed offering, O2 surf@home, a service that directly complements O2 Genion. Using this innovative UMTS data service, O2 customers are able to connect to the internet from their homes at fixed line rates. The combination of O2 Genion with O2 surf@home will enable complete fixed line substitution and increase customer value and loyalty.

Our strategy

Our primary goal is to create shareholder value by becoming the fastest growing major European mobile operator in revenue and profitability. We have a number of specific growth opportunities including further investment in our networks in Germany, improving the customer experience in the UK and Ireland, O2 Airwave moving into full operations, and maximising the potential of key partnerships such as Tesco Mobile and Tchibo Mobilfunk.

We will continue to build on the momentum created by our successful brand, ensuring that, whenever customers come into contact with us, the expectations created by the brand are met. In this way, we aim to become an integral part of customers' lives and improve our ability to attract and retain higher-value customers.

We plan to deploy significant additional resources into the customer-facing areas of our UK operations – including the creation of 2,000 new retail and customer service staff over the next two years, opening a fourth major UK customer service centre and further expanding our retail network. By delivering a better customer experience, we aim to improve customer loyalty and develop a sustainable basis for enhanced long-term returns. The cost of this expansion has been offset by efficiencies in non customer-facing activities, resulting in a reduction of some 500 positions and an exceptional operating charge of £45 million recognised in the financial year ended 31 March 2005.

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The following table represents the turnover for each of our continuing operating businesses for the three financial years ended 31 March:

	£m	Year ended 31 March		
		2005 £m	2004 £m	2003
Continuing operations				
O2 UK	4,030	3,451	3,025	
O2 Germany	1,865	1,508	1,060	
O2 Ireland	585	529	442	
O2 Airwave	169	89	16	
Manx Telecom	53	50	48	
O2 Online	–	140	93	
Intragroup eliminations	(19)	(121)	(73)	
Total	6,683	5,646	4,611	

Operations (by country)

O2 UK

Operational performance

O2 UK delivered a strong operating and financial performance during the financial year ended 31 March 2005. Customer numbers, service revenue, ARPU and EBITDA all showed continued growth. Success was driven by innovative new services and customer propositions, a series of successful marketing campaigns and further improvements in network quality. All of these aided the continued development of the “iconic” O2 brand.

Total customer numbers grew by 1.1 million to 14.4 million helping to drive a 14 per cent growth in net service revenue to £3,627 million. The quality of our customer base also continued to improve. This was evidenced by post-pay ARPU for the financial year ended 31 March 2005 rising £17 compared with the previous year to £542, while pre-pay ARPU rose £2 on the previous year to £143. On a blended basis, ARPU was £281 at year end, an increase of £9. Rising ARPU occurred despite the impact of the regulatory price cut in September reduced our rolling ARPU by £11 by the end of the year (see “Regulation In The United Kingdom” on page 16). EBITDA, one of our key indicators of profitability, reached £1,183 million, a 14 per cent year on year increase.

We retained our focus on mobile “data” (non-voice services). The volume of text messages carried on our network hit 1 billion texts per month by the end of the financial year ended 31 March 2005. This continued focus on text and other messaging services such as e-mail and picture messages, as well as non-voice services like music, content downloads and information services helped data services revenue reach 24.2 per cent of O2 UK service revenue, an increase of 3.8 per cent over last year.

Further development of O2 Active, the simple-to-use portal for news, information and downloads, helped

drive this success. A revamped, more intuitive homepage, including a scrolling ticker of news headlines, received positive customer feedback and drove higher usage. As at 31 March 2005, O2 Active was available on 100 different handsets.

A number of innovative O2 sourced and branded devices helped us build increased brand differentiation and drive service usage. We extended our O2 Xda signature range of wireless personal digital assistants with the launch of the O2 Xda II, the O2 Xda IIs and the O2 Xda Ili. Features include web browsing, e-mail, LAN/WAN access, camera and video functionality, and a range of office applications. The O2 Xda II’s integrated digital music player also allows customers to download and play music tracks making it appealing to high-spending consumers who are amongst the most intensive mobile users. We also added three new phones to our “X” range of O2 branded handsets, the O2 X2, the O2 X3 and the O2 X4, our first own branded UMTS phone. All are unique to O2 and have a wide range of multimedia functions.

As part of our on-going investment in service capability, we rolled out the first phase of our UMTS network in the UK, launching initial services to business customers in October 2004 and consumers in February 2005. The launch of our UMTS service is an evolution of our successful services strategy. Because UMTS technology offers faster data speeds, it allows customers with UMTS-enabled devices to enjoy richer information and entertainment content, and new interactive services. For example, O2 Active can now be accessed at faster speeds, provides 3D interactive and multiplayer games, and has greater video capability and content such as film and music videos. As it is a new technology, we believe UMTS services will initially appeal to early adopters, building towards mass-market adoption in the latter part of the financial year ending 31 March 2006.

In the mass consumer market, we continued to develop innovative propositions and promotions that proved appealing to our customers. For example, we introduced O2 Friends for pre-pay customers (half-price calls and messages to three chosen numbers) and “Happy Hour” (offering free messaging between 7 p.m. and 8 p.m.) for both pre-pay and post-pay customers.

In the business market, we grew our direct sales force and introduced new pricing and service propositions. These included the O2 Welcome service for larger corporate customers, designed to make switching from other networks trouble-free by giving dedicated support, advice and information at the customer’s premises. O2 Network Manager, another innovation for corporate customers, was also launched. Network Manager measures the service level given to corporate customers to an agreed standard to enable us to improve their network experience. The O2 for Business marketing campaign promoted the quality of O2’s network.

These initiatives helped us acquire many new corporate customers such as DHL as well as growing business with customers such as Superdrug and West Yorkshire Police.

In the market for small and medium sized businesses (SME), we launched O2 Business Zones which offered 40 per cent off calls to two chosen area codes. This was introduced in response to customer feedback that many small businesses make most of their calls within their local area. We also introduced a new set of

tariffs providing “shared minutes” and “shared bundles” (for example, data minutes) for small businesses to use across all mobile phones on their account. Demand from businesses of all sizes for the BlackBerry™ mobile e-mail service increased.

In October 2004, O2 UK launched O2 Connection Manager. The service provides business customers on the move with a simple way to connect their laptop computer to the O2 data network using whichever of our UMTS, GPRS or WLAN network best suits. WLAN is a relatively new technology, appealing to early adopters from which we expect to see growth over time. Following agreements signed with WLAN operators, O2 now provides WLAN access in over 6,700 UK locations including hotels, airports, coffee shops, bars and pubs.

The percentage of total sales delivered through O2’s own channels (O2 stores, O2 Online store and O2’s direct sales force) continued to increase and we expect the proportion of sales through our own channels to continue to rise during the financial year ending 31 March 2006. We believe this will enable us to deliver a better customer relationship. The number of O2 retail stores grew by 26 to reach 257 by the year end.

A key element of our strategy is to differentiate O2 by delivering a better overall customer experience through, amongst other things, higher service quality. Improvements in overall service quality last year focused on two main areas – improvements in our network performance and enhancements to our customer service capabilities.

Our main indicator of network performance and quality is minutes per drop (MPD) – the number of minutes between dropped voice calls. This improved through the year and is now at its highest ever level.

In the area of customer service, we continued to make significant investment in our single billing and customer relationship management system across all O2 UK operations. Work already completed on the project has, for example, enabled on-line customers to view their bills online. Also a new web-based tool in retail stores allows new customers’ mobile phones to be set up and activated on the spot. As we implemented these during the year, we encountered a number of challenges around service and billing communications. We have now tackled these and put increased focus on managing service and billing quality.

The strong appeal and distinctiveness of the O2 brand also continued to help us differentiate from our competitors. Brand awareness continued to climb last year and brand consideration is at an all time high. This has been assisted by O2 UK’s sponsorships of the World Cup winning England rugby team, the 2004 Football Association Premiership champions Arsenal, and Capital Radio’s drive-time and a host of music events, as well as the strong appeal of our market propositions. Recognising the contribution made by the O2 brand to its business performance, O2 UK won the Institute of Practitioners in Advertising’s (IPA) prestigious Grand Prix award for 2004. This award recognises companies that have marketed their brand most effectively with the best return on investment. We also won the Mobile Data Association’s “Best Network of the Decade” award for being the most innovative in “encouraging the uptake of mobile data over the past ten years.”

Market dynamics

Our performance was achieved against the backdrop of stiff and increasing competition. Traditional competitors including Vodafone, Orange and T-Mobile continue to grow. 3, the newest network operator with a purely UMTS network, has built strong momentum. 3 has been growing through a mixture of aggressive tariffs and high handset subsidies and we expect them to continue this strategy. Tesco Mobile, our 50/50 joint venture with Tesco, has delivered sustained growth. In December 2004, 14 months after its launch, Tesco Mobile had attracted over half a million customers. The joint venture addresses sections of the family market that we do not currently target with the O2 brand through Tesco’s network of supermarkets and “Metro” stores. We expect competition to intensify again this year with several new MVNOs entering the market, which coincides with slowing overall growth in new customers.

Corporate responsibility

We believe that companies who respond to the needs of the communities in which they work are more likely to deliver good business results. We look in particular to support initiatives where mobile services can be used to tackle social needs, where our employees can become involved, and where we can raise the profile of O2 as well.

In July 2004, O2 UK launched its new charity partnership with Weston Spirit, the charity co-founded by Simon Weston OBE to help young people at risk of social exclusion reach their full potential. Over the next two years, our new partnership aims to deliver a ground-breaking mentoring programme to support personal development of young people. We have already recruited more than 70 O2 UK mentors who have been trained to provide advice, support and encouragement to young people assigned to them through a series of local school partners. Elsewhere, we are supporting HM Prison Service’s “Prison Me No Way” campaign. O2 UK employees have joined forces with the emergency services to provide crime and safety awareness workshops to schools throughout the UK. Following the successful “Teach UR Mum 2 Text” campaign during the financial year ended 31 March 2004, O2 UK last year supported Milly’s Fund’s “Summer Textin’ Tips” campaign which provides personal safety advice to young people while they are travelling. We are also funding the development of medical devices using mobile technology to monitor asthma and cystic fibrosis patients remotely. Trials with asthma patients have already proved a success with many more patients monitoring their breathing on a regular basis compared with conventional methods.

We are aware that mobile phone masts are not always popular and we work hard to address people’s concerns. Opposition to masts, does, however, have to be balanced with the strong demand from over 50 million UK users of mobile services and extensive research showing no known health risks.

We have consistently taken a proactive approach to the issue of child safety and mobile phones. As the first mobile operator in the UK to join the Internet Watch Foundation, and a signatory to the industry’s Code of Practice for the self-regulation of new forms of content, O2 UK has introduced controls to allow parents to manage their children’s access to inappropriate content or experiences. In addition, we have sought to provide customers with advice on the nature and use of mobile services and have also published a series of

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leaflets giving advice to children on issues such as the sensible use of camera phones, safety in chatrooms, and dealing with nuisance calls and bullying.

Regulatory issues

In January 2005, Ofcom began consultations on the release of future mobile spectrum over the next five years. Of particular importance will be the UMTS expansion band (2500MHz-2690MHz). There is likely to be a protracted public debate on the timing and terms for future spectrum releases.

Looking ahead

We will continue our focus on improving profitability by growing our base of high-value customers and improving business efficiency. A key priority will be customer retention as more intense competition has increased pressure on the rate of churn. In order to deliver an enhanced customer experience and strengthen customer loyalty, we plan to redeploy significant additional resources into customer-facing areas including the opening of a fourth major call centre in the UK, and further expanding the O2 retail network. To support these initiatives, we plan to hire over 2,000 new retail and customer service staff over the next two years, offsetting the cost of this expansion by targeting efficiencies across a wide range of managerial and administrative functions. This is expected to result in a reduction of up to 500 permanent non-customer facing positions in the financial year ending 31 March 2006.

Investment in our UMTS network will continue as we expand the network across the UK, initially focusing on the areas of greatest demand. The range of UMTS capable phones in our handset portfolio will increase as will the content offered through our O2 Active portal.

We plan to launch a mobile internet service based on i-mode® capability later this year in an exclusive agreement with the Japanese operator NTT DoCoMo. This will give us competitive differentiation by providing our customers with access to the most comprehensive and flexible internet service available on mobile phones, on a wide range of handsets from several vendors. The i-mode® capability is a mature service that has been proved to generate higher ARPUs in other countries than any other competing technology or platform. Already the world's most popular mobile internet platform, it has more than 48 million subscribers using over 6,100 official content sites in ten countries. We believe this will be a compelling mobile internet service.

O2 Germany

Operational performance

O2 Germany has established itself as the most dynamic and innovative operator in the German market, which is the largest in Europe. In the financial year ended 31 March 2005, both revenues and customer numbers grew at an accelerating pace throughout the year, outstripping both our expectations and the growth of other competitors, leading to further improvements in market share. By attracting a significant proportion of high-value customers and tightly controlling operating costs, O2 Germany has translated this rapid growth in subscribers into a substantial improvement in profitability. Overall customer numbers grew

by 33 per cent. Blended ARPU decreased by €3, for two reasons. Firstly, ARPU (especially postpaid) decreased in the final quarter of the financial year ended 31 March 2005 due to termination rate cuts in the German mobile market. Secondly, O2 acquired a higher share of prepaid customers, which had an effect on overall blended ARPU despite an increase in prepaid ARPU. Service revenues at constant exchange rates were 28 per cent higher at £1,687 million and EBITDA reached £341 million with a margin of 18.3 per cent. In the light of this accelerating growth, over the next five years the business will step up the rate of investment in its UMTS network to reduce national roaming costs, enhance customer experience and secure population coverage that is competitive with the market leaders.

Our customers' experience of the O2 brand is central to our growth strategy. In addition to our increasing focus on customer segmentation, and on identifying and meeting the needs of our various customers, we have directed a stronger focus towards direct sales channels. O2 has increased the number of O2 shops to 119 and other points of sale to more than 9,000. Our O2 Online shop has continued to show a strong performance with a high rate of net new additions as well as low SACs, and good ARPU. Our customers also value a real face-to-face presence. To enhance customer experience and further build brand image, the first flagship O2 store was opened in Munich in December 2004.

In October 2004, O2 Germany launched the Tchibo Mobilfunk offer jointly with Tchibo, a well-established consumer brand known for its value-for-money offers, as branded reseller managed by a 50:50 joint venture. This additional and exclusive sales channel complements O2's target segments and has been very successful. The product proposition was unique in Germany at launch: a Tchibo branded, transparent flat pre-paid tariff on very attractive terms. Tchibo Mobilfunk has so far attracted in excess of 250,000 pre-pay customers. In December 2004, Mobilcom was the first service provider in the German market to offer O2 pre-paid products – at first on a dealer basis. New O2 offers through service provider channels will become available in the current year.

Our unique O2 Genion product, which continues to be a key driver of gross additions, underpins our strategic focus on more profitable customers, generating higher ARPU and a considerably lower churn rate than other mobile products. Customers attracted from other operators usually generate a higher ARPU because they change their patterns of usage with O2 Genion. Thanks to its advanced technology, O2 Genion offers innovative services in combination with reduced tariffs in a geographical area chosen by the customer, usually near the home or workplace. This is a unique service in the German – and also European – market.

In our target business market, we have been winning major new customers with an expanded Business Unit team and forging new partnerships with sales channels and software suppliers. We also extended our range of tariff packages and services, both tailored to the specific needs of our business customers. During the year, O2 Germany acquired a number of new high-profile customers, including MTU Aero Engines, Tchibo and Christian Dior. Partnerships with our long-standing customers, such as BMW, have been strengthened. For example, we have equipped the world's most modern automobile manufacturing plant – the BMW production site in Leipzig – with our O2 Genion Campus solution.

O2 Germany seeks to bring solutions to its customers rather than just transmission capacity. To this end, we have stepped up our co-operation agreements with around 20 partner companies, including Siemens SBS, UNISYS, Tobit Software, Sun Microsystems and Extended Systems, to offer our business customers mobile solutions in such areas as field service control and mobile data security. Customers can use our O2 Xda, the laptop card UMTS/GPRS as well as BlackBerry™, among other platforms.

Internationally, our business customers benefit from products and services for mobile communication in more than 150 countries and the networks of over 300 roaming partners. In our partner networks within the Starmap Mobile Alliance, we are offering uniform and especially cost attractive conditions for mobile work and telephony.

Revenues from mobile data products also grew strongly with non-SMS text data usage making an increasingly important contribution. The volume of SMS text messages sent during the year increased by 33 per cent and data as a proportion of service revenue rose from 19.5 per cent to 21.8 per cent in the financial year ended 31 March 2005. Some 24 per cent of our customers now use non-SMS data services.

The launch of high-speed UMTS services in the current financial year should add increasing momentum to our mobile data revenues. O2 began its UMTS service in April 2004 offering a UMTS laptop card to its business users, and followed this with laptop and UMTS handset surfing for consumers. In addition to mobile internet access, which offers download speeds of up to 384kbps, O2 customers on UMTS have been able to make video calls and make use of a broad range of video streams.

In July 2004, we launched our first UMTS-enabled tariff – O2 Active. In a complementary way to O2 Genion, O2 Active enables us to target high-value customer groups, attracted by O2 Active's simplicity and value-for-money attributes. Minute bundles include calls to all networks, fixed line and voicemail at anytime and anywhere. Extra minutes always have the same price. As well as the usual O2 surf@home (WAP flat rate) and O2 Music packs, O2 Active customers can also book SMS and voice packs including the O2 Afterwork Pack, allowing unlimited calls in the evening to fixed and other O2 numbers and the O2 Weekend Pack, with a 1,000 minute bundle.

The high quality and appeal of our O2 Active portal service has already gained external recognition. Europe's best selling telecom magazine "Connect" gave O2 Active two awards – from both readers and experts – as the best mobile portal in Germany – ahead of Vodafone live! and other competitors' services. In November 2004, this advanced version of the O2 Active portal was also rolled out to most GPRS phones – with a speed option giving the users the choice of a faster version of that portal without losing any information. Our strategy has been vindicated by the subsequent strong growth in the number of monthly portal users who bring us higher traffic and premium content income.

Market dynamics

The German mobile phone market grew by 9 per cent last year and market penetration rose to 83 per cent in March 2005 compared with 76 per cent in March 2004. About 7 million customers were acquired during the financial year leading to about 73 million mobile connections. There are currently four mobile network operators in Germany – T-Mobile, Vodafone, E-Plus and O2 Germany. Competitiveness in the German market has increased as a result of high penetration levels and increasing market saturation. During the year, high-speed UMTS services were introduced by all operators based on combined GPRS/UMTS data cards and, since Christmas, UMTS handsets.

Corporate responsibility

O2 continued its engagement with the German Children and Youth Foundation and the SCHOLA-21 project. Following the launch of a new internet platform in English, O2 developed flyers, handbooks and contacts to international networks and schools. O2 began a schools competition in partnership with the German Olympic Association with the topic: "Olympia – more than Olympic Games". We also supported another GOA project – "Kinder bewegen" – that aims to improve the movement of children, making donations to ten "Kindergartens" for a three-year period. O2 is supporting new learning software, "Polly and Fred", that enables schoolchildren to learn how to handle their handsets properly in a play environment.

Looking ahead

For the coming year, O2 will adhere to its target of profitable growth supported by the extension of sales channels, including service providers and Tchibo. At CeBIT in March 2005, we launched an innovative, high-speed offering, O2 surf@home, a service that directly complements O2 Genion. Using this innovative UMTS data service, O2 customers are able to connect to the internet from their homes at fixed line rates. The combination of O2 Genion with O2 surf@home enables complete fixed line substitution and increase customer value and loyalty. Innovative tariff models such as bundle tariffs or tariffs driving prepaid/postpaid convergence (e.g. prepaid top-up vouchers) will further help to increase cost control for the customer, but also drive ARPU for O2.

There will be a renewed focus on customer retention (due to slower market growth and high market churn) backed by further initiatives to improve the quality of our sales channels, products and customer service. Our customer segmentation strategy will aim to drive up customer satisfaction by meeting the expectations of those asking for more simplicity on the one hand and the increasing number of customers starting to use advanced data services on the other.

In response to our success, we have launched an initiative to enable us to operate as a sustainable business in the medium term. We are stepping up the rate of capital spending with the aim of becoming a full network operator by extending and accelerating the roll-out of our UMTS network and reducing national roaming. This will enhance the customer experience by delivering higher coverage and improved download rates while, at the same time, reducing our operating costs. We will seek more aggressive growth with new products, for example by extending our unique O2 Genion offering, and continue to attract and retain high value customers, backed by superior quality at the point of sale and customer service. We aim in the medium term to match the profitability of similarly positioned network operators in other markets.

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O2 Ireland

Operational performance

The focus for O2 Ireland over the past year has been to excel in offering our customers the best possible experience each and every time they interact with O2. This focus has meant a renewed effort in improving all areas where we are in contact with our customers, from a commitment to “walk out working” products, to a superior customer care service and an efficient and customer friendly high-street presence through O2 Retail.

Throughout the financial year ended 31 March 2005, O2 Ireland has continued to improve its business performance, maintain current market share, and build upon the strength of the O2 brand.

With regard to customer acquisition up to March 2005, O2 Ireland had a particularly successful year. We announced the addition of 142,000 net new customers to the O2 network, representing a 10 per cent increase from the same period the previous year. This was largely driven by a very strong Christmas period with over 91,000 new customers joining the O2 network, ahead of our competitors’ performance. In addition to gaining new customers, we also succeeded in retaining our customers despite a range of competitive tariffs in the market, and despite the ease of mobile portability (changing networks without changing one’s number).

With blended ARPU rising 1 per cent to €565, service revenue at constant exchange rates was 13 per cent higher at £556 million and EBITDA was £223 million, a 7 per cent increase with a margin of 38.1 per cent.

Bolstered by one of the most “iconic” advertising campaigns ever conducted in Ireland, Network Powered Ireland, the O2 brand has continued to strengthen apace. In the third quarter of 2004, Total Spontaneous Awareness of the O2 brand stood at 91 per cent. We were pleased that the Network Powered Campaign was named Best Integrated Campaign by Marketing Magazine.

Brand awareness was further supported by high level sponsorships and associations. These included O2 in the Park, the Smurfit European Open and our association with golf and rugby sporting stars such as Padraig Harrington and Brian O’Driscoll respectively. In the business arena, last year saw joint initiatives with Dublin Chamber of Commerce through our sponsorship of E-Week to mark the accession of 15 new member States to the European Union and our on-going support of regional Chambers of Commerce around the country.

Driven by our focus on improving our customer experience, O2 Ireland continues to excel in customer service. Customer Care satisfaction scores improved throughout the financial year ended 31 March 2005 and O2 Retail excelled among its peers, proven by high scores in mystery shop activity. We communicated the benefits to our customers of certain services, for example music, through innovative new initiatives such as the opening of the Experience Zone at Dublin’s Point Theatre in September 2004.

A significant new development last year was the introduction of a new retail concept called O2 Experience. Three O2 Experience Stores were opened – two in Dublin and one in Cork – which give customers the chance to view live demonstrations of all our products. Reaction to the stores has been very positive.

We are constantly seeking to make life and business easier for both our consumer and business customers. To this end, we introduced an exciting range of new products and services. For business customers, these included the Fujitsu Siemens – O2 Work Everywhere Package, O2 Instant and the O2 Connection Manager. These products, all of which are aimed at saving time and money, have been well received in the business and corporate markets. Our consumer customers benefited from the introduction of reduced tariffs in 2004 and an exciting range of handsets and devices including the new BlackBerry™.

Maintaining the highest-quality network in order to maximise customer satisfaction remains a key focus of our business. Central to the success of our business is the maintenance and development of our GSM and UMTS networks, which are rated among the best in the world. Last year, we invested almost €3 million a week in our network infrastructure. We continue to build our network in a cost efficient and environmentally friendly way and continue, where possible, to share existing sites of other mobile operators and utilities providers.

We made progress in the building of our UMTS network, now extending to over 35 per cent of the population. Limited trials of our UMTS service began in mid-2004 and plans are in place to bring commercial UMTS services to Ireland in mid-2005.

Market dynamics

The Irish market continues to be a highly challenging one for the mobile industry with penetration levels of mobile phones in the population now standing at over 90 per cent. O2 Ireland holds the second biggest share of the market with around 40 per cent. 2004 saw continued momentum by Meteor Mobile Communications with further gains in market share. 3 entered the market in January 2004 and has begun to roll-out its UMTS network. Meanwhile, potential competitors in the telecommunications sector have expressed an interest in the mobile market following the proposed measures by ComReg (the Irish communications regulator) in December 2004 to encourage and allow MVNOS to access the networks of both O2 Ireland and Vodafone Ireland.

Corporate responsibility

2004 saw an expansion of our CSR programme with the introduction of a range of exciting initiatives. The O2 Ability Awards, run in conjunction with The Aisling Foundation, is the first awards programme to recognise Irish businesses that demonstrate best practice in the employment of people with disabilities. Our support of the O2 Ability Awards has associated O2 in a positive way with a topical issue that is currently high on the Irish social agenda.

O2 Ireland has continued to acknowledge those of its employees who work with charities outside their working days through our Can Do in the Community Awards. These awards recognise the contribution made by employees to their local communities or selected charities outside working hours.

In June 2004, O2, working closely with the Irish Cellular Industry Association (ICIA), launched the first ever Irish Code of Practice for the responsible and secure use of mobile services. The ICIA also published a Parents' Guide and announced a joint industry trial on content filtering, led by O2 Ireland.

We are in our second year of sponsoring National Tree Week in conjunction with the Tree Council of Ireland and Coillte (the Irish Forestry Board). During National Tree Week in March 2004, over 300 events such as forest walks, talks and tree planting ceremonies took place.

2004 saw the launch of our participation in the phone-recycling scheme, Fonebak®, that enables customers to deposit their unused or broken mobile phones in recycle bins in all our O2 Retail stores throughout Ireland. The scheme also provides funding for environmental charities such as National Tree Council of Ireland and the international charity, Rainforest Concern.

Looking ahead

O2 Ireland will concentrate on maintaining a competitive edge in a highly competitive market and in a more onerous regulatory environment. We will maintain our focus on putting the needs of our customers first and offering them a superior service while ensuring that our products and services meet their requirements. We will continue to drive demand for data services and to increase revenue from this part of our business, building on the momentum gained in 2004.

O2 Ireland will be the first and only mobile operator in Ireland to bring a mobile internet service based on the i-mode® capability to customers from autumn 2005. This will bring a completely new customer experience to Irish consumers in terms of higher quality and fast access to content and an exciting range of handsets. Progress on our UMTS network continues and we are on target to bring commercial UMTS services to the market later in 2005.

Along with maintaining and improving the customer experience, we will aim to lift our operational performance again, building on last year's success by meeting our growth targets for revenue, EBITDA and customer numbers.

O2 Airwave

Operational performance

The Airwave network was completed, on time and on budget, at the end of March 2005. The Airwave service, with its commitment to making communities safer by providing communication where and when it matters most, has now been delivered to all 51 police forces in England, Scotland and Wales and the British Transport Police. The network, under the terms of a £2.9 billion, 19-year contract with the Home Office

signed in 2000, has been built in fewer than five years, during which some 3,300 masts have been erected and over 1 million miles of road driven to test the service. It is arguably one of the most successful PFI projects to date. Over 99 per cent of mainland Great Britain is now covered by the service with 100 per cent population coverage.

By the end of March 2005, O2 Airwave had more than 100,000 users, double the level of a year previously. In addition to the police, O2 Airwave has won 38 new customers outside the main Police Information Technology Organisation contract, taking the total number of additional public service customers to 78. They include the Ministry of Defence police, the Prison Service, British Energy, Mersey Regional Ambulance Service, Harley Street Ambulance Service, RAF Cranwell Police, the Highways Agency, the UK Atomic Energy Authority Constabulary and Norfolk Local Authority. Completion of the network roll-out led to a near doubling of revenues and, with tight control of costs, this led to an EBITDA of £72 million compared with £1 million in the previous year. We invested a further £218 million in the network last year but, with completion achieved, this figure will fall significantly in the coming 12 months.

Airwave is a sophisticated, fully encrypted digital radio system, which cannot be scanned or monitored by outsiders. It allows the police to communicate seamlessly and securely throughout England, Scotland and Wales. Airwave's multifunctional handsets, combining a digital radio and mobile phone, also operate as data terminals – enabling officers in the field to access local and national databases. In addition, Airwave provides a common platform for Public Safety Users, giving them true interoperability and comprehensive geographical coverage. Using Airwave, police officers from different forces can talk to one another or to officers from other emergency services, whatever their location, who can in turn communicate directly with one another. For the first time, Airwave will allow effective, and potentially life-saving, co-ordination of rescue efforts by the emergency services. The ability of networks to keep working in times of emergency is critical. The Airwave response to incidents caused by bad weather like Boscastle in Cornwall in August 2004, and Carlisle in Cumbria in January 2005, proved the network's innate resilience – the service kept going when other communications networks failed and was used by all the emergency services dealing with these major incidents.

Growth opportunities

The continued threat of terrorism, the incidence of major accidents and heightened awareness of the impact of natural disasters all demonstrate the increasing importance of secure and "joined-up" communications in both urban and more remote areas. Against this background, there are significant opportunities for growth in the Airwave service.

The Civil Contingencies Act 2004 is likely to have a significant impact on all public safety organisations in their need to comply with the new legislation as first or second line responders and will present Airwave with a wider target audience. We will also continue to market the service to other public safety users, including the utility companies, the Ministry of Defence, Health organisations, Fire Service, CCTV operators, Ports Police, and other Government organisations such as the Department of Works and Pensions, Customs & Excise, the Inland Revenue, the Immigration Service, the Environment Agency, HM Prisons, and local authorities.

Mobile data represents a significant opportunity for O2 Airwave. In December 2004, O2 Airwave began the Lancashire Police data trial with the Lancashire Constabulary, the largest ever mobile data trial in the UK, involving 280 users. Using the O2 Airwave Mobile Applications Gateway, Lancashire police officers are able to gain secure, continuous access to databases while on the move. O2 Airwave is uniquely placed to develop its market through the expansion of relevant mobile data applications for the police and other public safety customers. Currently 45 police forces have direct access from their handsets over the Airwave network to the Police National Computer, allowing interrogation of vehicle registration and peoples' names in seconds. Scottish police forces also have access to the Scottish Criminal Records Office.

In the coming year, we will be offering a portfolio of mobile data products and services for deployment in our key markets. Helping to meet the demand for greater visibility of the police within communities, our portfolio will consist of a range of data devices to meet both in-vehicle and hand-held needs. It will include a suite of mobile applications designed to reduce police bureaucracy and eliminate unnecessary paperwork – both Home Office priorities. Network-based gateways that enable feature-rich applications will be backed by the touchstones of unmatched technology and customer service for which O2 Airwave is renowned. Much of this portfolio of services has been developed from the successful experience gained from working with trial customers such as the Lancashire Police Force.

In the case of Ambulance and Fire Services, much of their day-to-day work makes use of mobile data capabilities to deliver information to where it is needed the most. Hereford & Worcester Ambulance Trust has been using a patient telemetry service over the Airwave network since May 2002. Patients' vital data can be monitored by ambulance crews and transmitted over the Airwave network directly to hospital Accident & Emergency units, enabling life-saving treatment to begin at the scene of an incident, for example the use of clot-removing drugs which dramatically improve the chances of survival and recovery. Every minute saved in the treatment of heart attack patients adds about 11 days to life expectancy. One hundred interventions were made by Hereford and Worcester Ambulance Trust using the Airwave service in the first six months of service, leading to patients' lives being saved and extended.

Airwave need not be restricted to Great Britain. Opportunities also exist to repeat our success overseas. Any venture, whether approached directly or with partners, would, however, be carefully assessed for viability and would have to fit with O2 Airwave's strategy before it went ahead.

Corporate responsibility

O2 Airwave assesses its responsibility to its customers against key performance indicators created by those customers, which we strive to meet or exceed. We have also established a reporting structure to conform with key indices developed by the Group in areas including the environment, waste management, employee satisfaction and treatment of our supply chain. In November 2004, we achieved our key target of complying with the ISO 14001 international standard for environmental management. In May 2004, O2 Airwave participated in the Corporate Responsibility audit carried out by Ernst & Young.

O2 Airwave seeks to be an active participant in the community. As part of our Community Involvement programme, we have sponsored two police dogs, the Lancashire Fire and Rescue safety help line, a Sportsmobile project with Bolton Lads and Girls Club, an Airwave Charity Golf Day, Middlesbrough Under 14s rugby club, and an anti-bullying campaign run by South Wales Police. Money has also been raised for a variety of good causes ranging from Milly's Fund to the Tsunami appeal. In September 2004, an O2 Airwave team climbed England's highest mountain and rowed England's longest lake in under 12 hours, raising £15,000 for a Mini for Milly's Fund. O2 Airwave will continue to provide a secondee to the London Resilience Team, set up to ensure London and the regions keep working at times of disaster.

Looking ahead

Increasing government funding into crime prevention, detection and improving public safety is leading to increased police numbers and a greater reliance on new technology as services such as Ambulance and Fire modernise and replace existing technology. All these developments provide opportunities for O2 Airwave to deliver new services and allow safety organisations to improve their services to the public.

As emergency services customers start to take up mobile data, there is likely to be increased competition in the mobile data market, from the traditional mobile operators as well as niche players. However, we believe O2 Airwave is well placed to penetrate the mobile data market with our unique proposition based on the Airwave network and the Mobile Applications Gateway (MAG). The MAG delivers fast access to numerous databases and the intelligence to link these together, providing safety officers with on the job remote access to critical information. O2 Airwave will become a true data solutions provider offering a unique range of mobile data services to the customers it serves.

The priorities for O2 Airwave going forward are to grow the business by meeting the needs of existing and new customers through developing propositions that improve the safety of the nation. We will enhance our service to customers through the way we manage them on a daily basis and ensure that we deliver benchmark standards for our network and service. We will invest in our operational support systems and the capabilities of our people to strengthen our business as we grow.

Manx Telecom

Operational performances

Manx Telecom is a wholly owned subsidiary of O2 on the Isle of Man, holding licences to run fixed and mobile telephony and internet services. Manx Telecom is an ISP in its own right with a portfolio of quality internet access and hosting products and services.

Because of its successful track record as the first company in Europe to launch a live UMTS service back in December 2001, Manx Telecom was chosen by O2 to run Europe's first superfast 3G trial, in partnership with Lucent Technologies, using HSDPA technology. HSDPA offers the possibility of communication speeds up to three times faster than current commercial UMTS services.

The installation of a Prepay Intelligent Network (IN) platform in November 2004 is enabling the company to offer a range of new services to its pre-pay mobile customers. MMS on pre-pay was launched in December 2004, WAP and full web access over GPRS was made available to pre-pay customers in March 2005, and the launch of outbound pre-pay roaming is planned for early in the next financial year. The average number of SMS (texts) sent per month increased to over 3.5 million by 31 March 2005.

On 1 March 2005, Manx Telecom introduced the first in a series of planned new tariff packages for its fixed line customers. Called Choice, the new tariff offers free calls to local fixed line phones at evenings and weekends, plus a 30 per cent reduction in local daytime call charges, for a monthly line rental charge of £13.00.

Manx Telecom has continued with its major investment programme to make broadband available to as many customers on the Isle of Man as possible. The installation of a number of "mini DSLAM" sites in more remote areas around the Island has increased coverage to around 99 per cent of local homes and businesses and take-up is currently around 19 per cent.

Work is well under way on a major contract, announced last year, to design, supply, implement and support, in partnership with Dimension Data, a new island-wide network infrastructure for the Isle of Man Government. A requirement of this contract was that Manx Telecom should become certified to BS7799 Security standard, and the company became the first company on the Isle of Man to achieve this in December 2004.

Capital spending during the year was £10 million compared with £9 million in the previous financial year. We constantly monitor how well we are performing in the view of our customers. Regular surveys throughout the year measuring customer satisfaction showed that 85 per cent of customers were "Very Satisfied" with the service they had received.

Market dynamics

Manx Telecom is the only provider of mobile and fixed telephony on the island.

Corporate responsibility

Manx Telecom, in association with the Isle of Man Government, has provided a number of wireless (WiFi) hotspots at key locations around the Island, including at Isle of Man Airport. As part of the Isle of Man Government's E-Island strategy to encourage the use of Internet technology on the island, Internet access at these sites is being provided free to users for the first year.

In December 2004, Manx Telecom completed its certification to ISO 14001, the international standard for environmental management.

Manx Telecom continues to sponsor the Manx Telecomputer Bus and a number of other local charities, organisations and events, especially those involving young people, information technology and sport. These include the Road to Wimbledon junior tennis tournament, the Isle of Man junior cricket team tour of Holland, a junior cricket coaching programme and a local cycling Time Trial League. The company also provided mobile phone equipment for a new college course relating to mobile technology for students with learning difficulties.

Looking ahead

We are looking forward to offering our customers the chance to trial the new superfast 3G services which will make available exciting new, video-based applications and services. We will also continue our active support of the Isle of Man Government in offering a world-class telecommunications infrastructure to help attract new companies and inward investment to the island in support of the Island's e-business strategy.

Regulation

We conduct most of our business in the United Kingdom, Germany, Ireland and the Isle of Man. We are therefore subject to national regulation in each of those countries as well as European Union-wide regulation.

Regulation in the EU

Regulation in the EU is governed by the EU regulatory framework for the electronic communications sector (the EU Framework). The EU Framework comprises four principal Directives. Amongst other things, the Directives set out policy objectives and regulatory principles that National Regulatory Authorities (NRAs) must follow: they provide for a new authorisation system for companies which provide electronic communications networks and services, contain measures to ensure the universal provision of basic services to consumers, and set out the terms on which providers may access each other's networks and services. Importantly, the EU Framework also harmonises the rules for deciding when regulation may be imposed on electronic communications providers. In particular, it provides that electronic communications providers can usually only be subject to specific regulation in markets in which they have SMP. SMP, for these purposes, is aligned to the competition law concept of dominance, which essentially means an ability to act independently of customers, suppliers and competitors.

The European Commission (the Commission) identified in a Recommendation (published in February 2003) a list of markets which may be such as to justify the application of specific regulation (the Recommendation). The Recommendation includes the following mobile markets: (i) access and call origination on public mobile telephone networks; (ii) voice call termination on individual mobile networks; and (iii) wholesale national market for international roaming on public mobile networks.

NRAs must conduct market reviews in order to determine whether any companies have SMP in any of the markets identified in the Recommendation. NRAs may also, with the Commission's consent, review markets that are not listed in the Recommendation. Where a company is found to have SMP in any market, the regulator must impose one or more of the following SMP conditions on it: transparency; non-discrimination;

Business review continued

accounting separation; access; price control and cost accounting. In exceptional circumstances, a regulator may impose additional or alternative obligations, but these have to be approved by the Commission. If a company is found not to have SMP in a market, then SMP conditions cannot be imposed on it, and existing regulation must be removed.

Regulation in the United Kingdom

Implementation of the New EU Regulatory Framework

The EU Framework was implemented in the UK by the Communications Act 2003 (Communications Act) on 25 July 2003. Under the Communications Act, responsibility for the regulation of electronic communications networks and services lies with the Office of Communications (Ofcom).

Market reviews

In the UK, the regulator concluded in November 2003 that no mobile network operator (either individually or jointly) had SMP in the market for access and call origination on public mobile telephone networks. This meant that various regulatory obligations which had previously been imposed on us and Vodafone were lifted.

In June 2004, Ofcom completed its review of voice call termination on individual mobile networks. As a result of that review, Ofcom concluded that the charges we made to other operators for terminating calls on our network (call termination) had to be cut. From 1 September 2004, Ofcom required us to lower our call termination charges from an average of 8.03 pence per minute to an average of 5.63 pence per minute. Ofcom recently indicated its intention to apply the charge control until March 2007, and to conduct a wide-ranging review of voice call termination regulation with a view to determining the regulatory regime with effect from April 2007.

Ofcom has also commenced a review of the wholesale international roaming market in the UK. This review is being co-ordinated with a number of regulators in other EEA member states, all of which sent questionnaires to operators in their respective countries in December 2004. On conclusion of the review, regulators will decide whether it is necessary to regulate wholesale roaming.

National roaming

O2 UK and Vodafone are subject to an obligation to negotiate a national roaming agreement with the new entrant mobile network operator, 3 (the National Roaming Condition). In accordance with this obligation, we entered into an agreement with 3 to permit it to use our second generation network to originate and terminate calls to and from its subscribers while it builds its own UMTS network. On 22 December 2004, 3 invited mobile operators to tender for the supply of second generation roaming services to 3 when the exclusivity period in their agreement with O2 expires. Although Ofcom proposed discontinuing the National Roaming Condition in July 2004, its decision on this issue has been postponed pending the outcome of 3's tendering exercise.

Regulation in Germany

The EU Framework was implemented in Germany at the end of June 2004 by the Telecommunication Act (TKG). Responsibility for regulation of electronic communications networks and services lies with the telecommunications regulator, RegTP.

RegTP is currently reviewing the three relevant mobile markets (access and call origination, voice call termination and wholesale international roaming), and is not expected to conclude these reviews before the second quarter of 2005. As part of its review of voice call termination, RegTP has reached the preliminary conclusion that all mobile operators have SMP in the market for call termination on their own networks. RegTP is currently consulting with third parties on this preliminary position.

During the fourth quarter of 2004, we agreed with the German fixed network operator (T-Com) to reduce our wholesale termination charges in Germany. However, at the end of 2004 a fixed operator known as "01051" asked us to offer them a lower termination charge. The matter was referred to RegTP, which approved our German termination charges. 01051 has appealed RegTP's decision.

Regulation in Ireland

The EU Framework was implemented into Irish law on 25 July 2003. Responsibility for regulation of the communications industry in Ireland lies with a three-person regulatory body, known as the Commission for Communications Regulation (ComReg).

Following its market review, on 22 February 2005 ComReg issued a decision designating us and Vodafone with SMP in the wholesale mobile access and call origination market in Ireland.

On 9 December 2004, ComReg also issued a consultation on appropriate remedies in the wholesale mobile access and call origination market. It proposed to place obligations on us and Vodafone to provide access to our networks on reasonable request (and not to withdraw access services already provided, such as the national roaming services provided by O2 Ireland to Meteor), as well as certain non-discrimination, cost-orientation, accounting separation and cost accounting obligations. ComReg proposes to issue a further consultation on the detailed draft measures relating to price control and cost accounting issues.

On 21 March 2005, we notified the Minister for Communications, Marine and Natural Resources, and ComReg of our intention to appeal ComReg's SMP decision. We expect the Minister to convene an Appeal Panel, which must endeavour to determine the appeal within four months.

In July 2003, we agreed with ComReg to reduce mobile termination rates by Retail Price Index minus 8 per cent per annum for the period 31 August 2003 to 31 August 2005. In 2004, ComReg found that all four mobile operators in Ireland have SMP on the market for call termination on their own networks. This decision has been appealed by 3 to the national Appeal Panel, which has yet to reach a decision on the matter. ComReg has yet to publish its decision on the remedies to be imposed.

ComReg has also commenced its review of the national market for wholesale international roaming. This review is being co-ordinated with a number of regulators in other EEA member states, including Ofcom in the UK. On conclusion of the review, regulators will decide whether it is necessary to regulate national markets for wholesale international roaming.

Regulation in the Isle of Man

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

On 1 January 2004, our new licence extension, awarded by the Isle of Man Government for 15 years, came into force.

Competition law

EU competition law

We are subject to the general competition law of the EU and, in particular, Articles 81 and 82 of the EC Treaty (Article 81 and Article 82), which prohibit anti-competitive agreements or concerted practices and the abuse of a dominant position respectively where there is an effect on trade between EU Member States.

EU competition law is enforced by the Commission and, since 1 May 2004, has also been enforced by national competition authorities and national courts. Companies which breach EU competition law can be subjected to fines of up to 10 per cent of a group's worldwide annual turnover. They may also be sued in national courts by third parties which suffer loss as a result of the breach.

We are also subject to the national competition law of the countries in which we operate. In the UK, Germany and Ireland, national competition law broadly mirrors the provisions of EU competition law, prohibiting anti-competitive agreements or concerted practices and the abuse of a dominant position.

International roaming charges

The Commission has been investigating the price of wholesale international mobile roaming services in the UK and Germany. In the context of this investigation, on 26 July 2004 the Commission sent us and Vodafone two separate "statements of objections" in the UK. The statements of objections allege that our wholesale international roaming charges were excessive from 1998 until September 2003 and that this amounted to an infringement of Article 82. However, the Commission has not yet reached a final decision on whether there was an infringement. O2 is currently responding to the statement of objections.

Infrastructure sharing and national roaming

We have a UMTS infrastructure-sharing and national roaming agreement with T-Mobile in Germany. The agreement was formally notified to the Commission for negative clearance or exemption under Article 81 and cleared by Decision of 16 July 2003.

The Commission took the view that the infrastructure sharing aspects of the agreements did not restrict competition. National roaming, on the other hand, was considered restrictive of competition, but was granted exemption from Article 81 for certain specified time periods. We lodged an appeal with the European Court of First Instance on 25 September 2003.

We also have a 2G national roaming agreement with T-Mobile in Germany. The German competition authority indicated in August 1999 that national roaming agreements may infringe competition laws but that, in the case of our agreement with T-Mobile, this was unlikely to be the case at that time. However, it reserved the right to review this position.

Key markets

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

Our mobile businesses cover two of the largest markets in Europe, with the UK and German markets giving us access to a total population of approximately 148 million people. All our markets have seen growth over the last few years in the number of mobile telephone users, in large part reflecting strong demand for competitively priced pre-pay offerings. Our markets are seeing the emergence of additional wholesale opportunities for network operators. Through wholesale agreements, network operators are able to sell capacity and services on a large scale to other service providers and mobile virtual network operators.

Historically, the number of customer connections to mobile telephone networks in the markets where we are present has been greater during the second half of the financial year than during the first half, primarily due to increased sales during the Christmas period. See "Operating and financial review and prospects – Factors affecting our business".

Business review continued

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

Country	Population ¹ (in millions)	Active mobile customers' penetration at 31 March 2005 (per cent)	O2 customers at 31 March 2005 (in 000's)
Germany	84	83	7,976
United Kingdom	60	103	14,384
Ireland	4	97	1,533
Total	148		23,893

¹Source: EMC Worldwide Cellular Database, May 2005.

Note: The number of customers shown in the table above is equivalent to the number of active SIM cards. Hence, where some people have more than one active SIM card, it is possible for penetration to exceed 100 per cent.

Employees

The Group had the full time equivalent of 14,914 employees at 31 March 2005, as set forth by country in the table below:

Country	Number of employees
United Kingdom	9,141
Germany	3,919
Ireland	1,577
Isle of Man	277
Total	14,914

For the year ended 31 March 2005, the aggregate number of temporary staff employed by our businesses was 1,686.

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

Network and service platform technology

Transforming our networks to mobile broadband has continued with the build out of UMTS across the UK, Germany and Ireland to give data speeds up to 384kbps. This is being extended into the Isle of Man later this year (Lucent core & radio) with an upgraded UMTS deployment that will incorporate HSDPA technology with customer speeds up to 1Mbps and IMS (Internet Protocol Multimedia services) that provides richer services. As this is rolled out to all our customers it will enable them to quickly and easily download DVD-quality film clips, audio and video, interactive multiplayer games, multimedia music tracks, "push-to-watch" services as well as access large email attachments – three times faster than today's commercial UMTS networks. These speeds have already been extended this year by giving access to our customers to public WLANs in transit areas. This has been added to in Germany with O₂ surf@home to give home internet access via our UMTS network. All these enhanced capabilities require an easy-to-use customer experience for the ever increasing array of internet services. Therefore, we are adding Japan's successful NTT DoCoMo i-mode[®] technology to give superior performance from a tightly specified device to network service. This will be launched in UK and Ireland second half of 2005 and under our own brand in Germany next year.

Information technology

The information technology deployed in the Group is critical to the efficient and effective operation of the businesses. The focus for each business has been to:

- continually raise the standard of our service to our customers and the processes within our organisation;
- maintain tight cost controls;
- exploit investment in new systems, with development aimed at increasing our agility; and
- work together to leverage cross-Group benefits.

IT systems are fundamental to the delivery of high standards of service to our customers, in our shops, in billing, in customer care and in use of our services. It remains a priority to ensure these systems operate effectively and there have been a number of initiatives to ensure they perform as well as the best in the industry. Additionally, improvements in internal processes and reporting are being strengthened through the Group's compliance with the Sarbanes-Oxley Act of 2002.

While we have ensured that our IT costs are competitive within the industry, increased competition within our geography is driving tighter controls, and greater effectiveness. Recent strategic investments are now on-stream and are being exploited. Investment in new systems will continue where this is required to support our business priorities.

The IT community from each of the operating businesses has continued to work together where benefits have been clearly identified. This has enabled us to improve our common infrastructure, use common products and to deploy Group-wide systems where a common approach is required. Additional framework contracts with key suppliers have been agreed including HP, Sun and Oracle.

Looking ahead, our businesses have major IT projects to underpin the business strategy. These include initiatives to improve our agility and time-to-market, which are expected to impact the coming year, and projects to further enhance billing and care, and to ensure a consistently high-quality end-to-end customer experience.

Intellectual property

We have actively taken steps to protect our brand, including the acquisition of core trade mark registrations for the O₂ brand and related brand materials. In addition, we have other pending trade mark applications in ancillary classes in the UK, the European Community and other countries worldwide.

In the last year we have also strengthened the monitoring procedures in respect of the use of our brand and have increased the amount of enforcement action we take in response to infringement.

The steps we are taking to protect our brand include litigation and we are currently pursuing two significant trade mark infringement actions through the courts: one in the UK for infringement of our “bubble” imagery and one in Europe for infringement of “O₂”.

Insurance

We maintain the types and amounts of insurance customary in the industries and countries in which our Group operates, including coverage for employee-related accidents and injuries and property damage.

We consider our insurance coverage and that of our operating businesses to be adequate both as to the nature of the risks covered and amounts insured for the business conducted by us.