

Business review

History and development of the Company

On 10 May 2001, BT announced its intention to demerge our businesses. This was effected by a reorganisation, a scheme of arrangement and, on 19 November 2001, the demerger transaction. As a consequence, our operations have been conducted as an independent entity, mmO₂, with key subsidiaries in the United Kingdom, Germany, the Netherlands, Ireland and the Isle of Man. In September 2001, we announced a new brand, O₂, for the Group. This was introduced in May 2002 and, in support of that introduction, each of the principal country company operating names, except for Manx Telecom Limited in the Isle of Man, were changed to include the brand in their names. Accordingly, references throughout this annual report to the country operations, where appropriate, refer to the new operating company names.

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. 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 mmO₂ shareholders.

The following is a brief summary of the development of our key businesses:

O₂ UK

O₂ UK is our main UK business and presently our most significant business in terms of its contribution to our revenues and profitability.

O₂ UK was formed as a joint venture between BT and Securicor Group plc in January 1984, with BT owning 51 per cent, and, prior to May 2002, was called BT Cellnet. In April 1986, BT increased its stake to 60 per cent. In November 1999, BT acquired Securicor's remaining stake in the business for £3,173 million including expenses. The business was managed separately from the businesses of either of its former shareholders.

O₂ UK provided analogue mobile telephone services from January 1985 until October 2000 and has provided GSM services since July 1994. In April 2000, O₂ Third Generation Limited, one of our subsidiaries, was awarded one of the five UMTS licences in the United Kingdom for £4.03 billion, which was paid in May 2000. On 17 July 2003, the UMTS licence was transferred from O₂ Third Generation Limited to O₂ UK. In June 2000, O₂ UK launched GPRS services to the UK market.

Our mobile internet portal, O₂ Online, was originally developed in 1997 as part of O₂ UK in the United Kingdom, and prior to 2002 was called Genie. O₂ UK continues to provide online distribution of its devices and services through this channel.

During the second half of the year, the Group transferred the 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, and is expected to generate annual cost savings of £40-45 million. As a consequence of this streamlining, as from 1 April 2004, O₂ Online and Products O₂ will no longer be operated as separate businesses.

O₂ Germany

Our German business, O₂ Germany, was launched in May 1995 as a joint venture between BT and Viag AG, with BT holding a 50 per cent stake, and prior to 2002 was called Viag Interkom. Pursuant to agreements made in August 2000 and January 2001, BT acquired a controlling stake in O₂ Germany. In February 2001, BT acquired the remaining share capital of the business from E.ON AG (formerly known as Viag AG) for £4,562 million.

Initially, the business provided fixed line services only, but in May 1997 O₂ Germany was awarded the fourth German GSM licence and launched GSM mobile services in October 1998. In August 2000, O₂ Germany was awarded a UMTS licence in Germany. The cost of the licence was £5.16 billion, which was paid in September 2000. In January 2001, O₂ Germany launched its GPRS service.

O₂ Ireland

Our Irish business, O₂ Ireland, was formed in June 1995. In April 2001, BT acquired the entire share capital of O₂ Ireland.

O₂ Ireland launched its commercial GSM services in March 1997 and its GPRS service in January 2002. On 2 October 2002, O₂ Ireland was awarded one of four UMTS licences offered by the Irish government.

O₂ Airwave

In November 2001 BT transferred the Airwave business to us. O₂ Airwave provides TETRA network services to certain Public Safety Users in England, Scotland and Wales. Prior to that, BT already had transferred to us its contracts to provide network services to a number of police authorities within the United Kingdom.

Manx Telecom

In 1987, our business in the Isle of Man, Manx Telecom, was awarded a 20-year licence to operate the Isle of Man telecommunications network. The licence originally covered fixed line telephony, but was expanded in 1994 to include GSM mobile services and in 1999 to include UMTS services. Manx Telecom launched Europe's first UMTS network in December 2001. On 1 January 2004, Manx Telecom was awarded a licence extension for 15 years.

O₂ Netherlands

O₂ Netherlands was founded in September 1996 as a joint venture between BT and Nederlandse Spoorwegen N.V., the Dutch railway company, with BT holding a 50 per cent stake, and prior to 2002 was called Telfort Mobiel. In July 2000, BT completed the acquisition of the remaining 50 per cent interest in the business for £1,207 million. 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.

Business overview

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.

Together these target a total population of 148 million people. For the first time our total subscriber base broke through 20 million during the year and we now provide international mobile roaming to 150 countries worldwide.

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.

O₂ Germany is now the fastest growing operator in Germany. Its 6 million customers account for the highest ARPU ratio of any German operator, a major factor in the ongoing transition to EBITDA profitability during the year.

O₂ Airwave, which is supplying a network of secure communications to the police forces and other Public Safety Users in England, Scotland and Wales, has continued to develop rapidly.

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.

Our technology

At the heart of our improved performance is GPRS. This achieved market maturity and rapid growth during the year.

GPRS provides “always on” connectivity for office services, media/picture messaging, e-mail, e-commerce, banking, online billing, entertainment, mobile internet and other data services. Fuelled by the launch of affordable colour screen handsets and new multimedia applications, the number of customers using GPRS more than tripled in the year and applications and services were taken up enthusiastically across all territories.

The trend enabled us to launch Europe’s first mobile music service, allowing customers to download a choice of over 40,000 tracks to their mobile phones. Video streaming was also launched, bringing Rugby World Cup highlights and other sports to mobile handsets operating on our network.

Only a few years ago, all our revenues came from traditional voice telephony. Today our customers spend more than £1 billion a year on other services, including text messaging, e-mail, games and internet surfing.

Such innovations are essential for achieving our strategic goal of growing our revenues from more sophisticated data services. Nevertheless, we continue to benefit from simple text messaging, with our networks carrying over 11 billion texts during the financial

year to 31 March 2004. We also saw the rapid growth in participation TV programmes. The final of Pop Idol 2, a TV programme, for example, attracted 1.4 million text votes in the first hour.

GPRS technology, however, is a transitional stage in the gradual roll-out of UMTS networks. Over time, these are expected to bring significant benefits to customers, such as high-resolution video, higher speed multimedia services and other enhancements.

We have secured licences to operate UMTS services in the UK, Germany, Ireland and the Isle of Man. We believe it is imperative that these roll out progressively, and only when we can offer customers a genuinely dynamic service and a range of affordable handsets with adequate battery life to support such services. As a result we do not expect to see a mass market take-up of UMTS until late 2005.

Our products and services

In line with our strategy, our internet portal is designed to attract high-value customers, reduce churn and generate revenues by providing high-quality content and closer relationships with customers. We are pleased with the success of this service, which has recorded a 27 per cent increase in online subscribers in the financial year to 31 March 2004, of which around half were post-pay customers.

We are committed to increasing the value of our offering to business. Our corporate handheld e-mail device, BlackBerry™, is central to this. Since launch, more than 55,000 devices have been sold to over 2,000 organisations.

Following the success of our Xda device, this year’s launch of our own-brand X1 picture phone and Xda II second-generation pocket PC highlighted our ability to offer innovative products to our customers.

Designed to make the mobile phone more intuitive and easier to use, O₂ Active, which is discussed in greater detail later in this review, has been an instant success. An award-winning, data services menu, it quickly became the UK’s most widely used mobile portal.

Mobile alliance

In October 2003, our German, UK and Irish operations became founder members of the Starmap Mobile Alliance, 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 10 European countries. The “home-away-from-home” concept aims to provide customers with a service while travelling that is as close as possible to that they receive at home. It will enable members to be quick to market across borders with new products and services, and will increase their inbound roaming revenues.

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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 market share growth in Germany, improving our customer mix in the UK and Ireland, O₂ Airwave moving into full operations, and maximising the potential of key partnerships such as Tesco Mobile.

We will 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. This requires us to understand clearly different types of customer, to deliver a range of targeted service packages, to develop efficient CRM systems and to transform our retail presence. 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 have already established a strong position in mobile data. To maintain this strength, we will continue to make these services more accessible and user-friendly for customers and to deliver compelling content, services and devices. We will continue to work with third parties to achieve this.

As a group, we are smaller than some of our international competitors and we will leverage this relatively small scale to our advantage. We have recently reorganised our operations to improve the speed and quality of execution while also developing and communicating a "local touch" in each market. We continue to focus on our European footprint of wholly owned businesses.

Our results this year illustrate the value of this targeted approach. We are experiencing greater customer loyalty and a richer mix of customers with more emphasis on post-pay packages, together with higher average returns, which results in greater revenues across the Group.

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

	2004 £m	2003 £m	2002 £m
Continuing operations			
O ₂ UK	3,451	3,025	2,756
O ₂ Germany	1,508	1,060	875
O ₂ Ireland	529	442	395
O ₂ Airwave	89	16	11
Manx Telecom	50	48	43
O ₂ Online	140	93	100
Intragroup eliminations	(121)	(73)	(104)
Total	5,646	4,611	4,076

Operations (by country)

O₂ UK

Operational performance

O₂ UK continued to build momentum during the financial year to 31 March 2004. Financial performance ahead of our key financial targets was matched by strong operating performance. Strong growth in customer numbers, ARPU and EBITDA was accompanied by significant improvements in network and service quality, innovative new propositions for our customers and the development of an increasingly "iconic" and distinctive O₂ brand.

Total customer numbers grew by 1.2 million to 13.3 million. Encouragingly, higher spending post-pay customers accounted for over 40 per cent of customer growth.

The quality of our customer base continued to improve, with higher ARPU for both post-pay and pre-pay customers. Post-pay ARPU for the financial year to 31 March 2004 was £525, a 4.4 per cent increase over the previous financial year, while pre-pay ARPU was £141, a 16.5 per cent rise over the previous financial year. On a blended basis ARPU was £272 for the financial year to 31 March 2004, an increase of 10.1 per cent over the previous financial year.

These increases in ARPU reflect our success in attracting large numbers of new customers from our target high-value consumer and business segments, as well as success in driving greater revenue from existing users. As a result, our net service revenue grew by 16.3 per cent year on year.

To attract high-value customers, we rolled out a number of ground breaking new services and introduced simpler new tariff packages. For example, O₂ Bolt Ons – which allow users to "bolt" additional bundles of attractively priced voice, text and other services on to their existing price plan – continued to drive higher usage and differentiate the O₂ brand in a crowded market. In September 2003, we launched O₂ Home, which uses location-based technology to allow customers to make cheaper mobile calls from their home for a fixed monthly premium.

Developing and growing the market for non-voice, or data services, also remained an area of major focus for the financial year to 31 March 2004, and will continue to be so going forward. Increased take-up of services that go beyond simple voice and text will be the key to growing ARPU in a maturing market where new customer additions will decelerate. During the year, revenue from non-voice services accounted for over 20 per cent of total O₂ UK revenue, the highest proportion among any UK mobile operator. By the end of the year, nearly 9 per cent of this revenue came from data services other than text messaging.

For the mass consumer market we introduced O₂ Active, the mobile portal, in June 2003, a simple-to-use colour menu that enables customers to access a range of multimedia services such as video downloads, news, games, picture messaging, ringtones, images and chat. As at 31 March 2004, across the Group, there were more than 2.7 million O₂ Active customers measured as the number of unique visitors during the previous 90 days.

A number of innovative O₂ sourced and branded devices also helped us drive growing service usage. The O₂ Xda (versions I and II), a wireless personal digital assistant enabling web browsing, LAN/WAN access, video, e-mail and a range of office applications, was widely recognised as the best device of its kind and helped attract some of the highest value users in the market. At the other end of the spectrum, the X1, our unique handset with a range of multimedia functions, succeeded in stimulating greater non-voice use amongst pre-pay users because of its very attractive price. We also pioneered music over mobile with the launch of the O₂ Digital Music Player, Europe's first "over the air" music download service.

All of these services were promoted through a growing network of O₂ UK retail stores. Store numbers increased by 41 to reach 235 by 31 March 2004 and retail store sales rose by 25 per cent. Online sales also grew strongly. Our internet portal, www.o2.co.uk, signed up its one-millionth customer in October 2003, making it the most successful service of its kind in Europe.

In the business market, the financial year to 31 March 2004 saw a sharp increase in competition as other mobile operators put far heavier emphasis in this area than in previous years. To combat this change, we restructured our sales operations, improved the quality and focus of our sales force and introduced new pricing and service propositions for our customers.

Our Best for Business campaign – a series of initiatives including new tariffs, improved service quality, enhanced account management, and a multiple award-winning "2 Minute Challenge" advertising campaign – played a large part in a continued sustained recovery in our position in the UK business market. Our momentum increased during the year with customer connections and ARPU both showing steady growth as the year ended. Good demand for specialist devices such as BlackBerry™, a wireless e-mail device that utilises our GPRS data network, and the Xda also contributed to this resurgence.

Operationally, our strategy to improve overall service quality focused on two main areas: improving our network performance and increasing our customer service capabilities. Both are aligned to our continuing strategy of differentiating by delivering a better overall customer experience.

Our focus on the network led to a 25 per cent overall increase in performance and quality year-on-year, as measured through indicators such as minutes per drop, being the number of minutes between dropped voice calls. This significant improvement brought independent recognition of O₂ UK from the industry regulator Ofcom for showing the best ever published national call success rates by any UK operator. This was achieved despite lower capital expenditure on the 2G network than in previous years. Improved network and service quality were among a number of factors contributing to a year-on-year reduction in churn amongst our post-pay customers. Pre-pay churn increased slightly, in line with industry trends.

In terms of improving customer service, we continued to make significant investment in Companion, a single billing and CRM system that will be a key operational foundation for our future.

Companion will enable us increasingly to predict and meet customer needs by better aligning our billing, care and relationship management activities to their behaviour. A large number of existing customers have already been transferred from old billing and CRM systems to Companion and this process will continue during the year.

Through these and other initiatives, O₂ UK's customer satisfaction, measured using our quarterly survey, improved during the year. Through Companion and other programmes we will continue to put substantial investment into improving customer satisfaction in the forthcoming financial year and beyond.

We continued to differentiate ourselves from our competitors through the increasingly strong appeal and distinctiveness of the O₂ brand. Brand awareness continued to climb last year, assisted by O₂ UK's sponsorships of the World Cup-winning England rugby team, 2003 FA Cup winners and new Premiership champions, Arsenal, the Big Brother TV show and Capital Radio's drive-time, as well as the strong appeal of our market propositions. Spontaneous brand awareness for O₂ in the UK is currently 64 per cent – an all time high – versus 53 per cent a year earlier. In less than two years, O₂ UK has already achieved the brand awareness figures previously achieved by its predecessor, BT Cellnet.

Market dynamics

Our performance was achieved against the backdrop of stiff and increasing competition. This came from traditional competitors such as Vodafone, Orange and T-Mobile, plus the rise of several newer entrants whose presence was particularly felt during the second half of the year. 3, a new third generation mobile network operator owned by Hutchison Whampoa, launched in March 2003 and, after a slow start, has built strong momentum. BT Group also re-entered the mass consumer market as a "virtual" operator (a network reseller) in autumn 2003. We also formed Tesco Mobile, a 50:50 joint venture between O₂ UK and Tesco plc, to address sections of the family market that we do not currently target with the O₂ brand. Tesco Mobile launched in October 2003 and, by May 2004, had reached 250,000 customers, many of them new to the UK mobile market. We expect competition to intensify again during the financial year to 31 March 2005, and this will coincide with slowing overall growth in new customers as the UK market matures.

Corporate responsibility

We recognise our role in protecting the vulnerable, promoting the responsible use of mobiles, and behaving as a responsible corporate citizen. Last year, for example, we launched a national education campaign to promote safer use of mobiles and protect children from inappropriate contact via mobiles. The campaign is promoted through a range of channels, including O₂ UK stores, and includes advice on the responsible use of camera phones, personal safety, text bullying and text chat.

Together with the other networks, we have worked with the police and the Home Office to tackle mobile phone crime. We have made significant technical progress in ensuring that both handsets and SIM

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cards cannot be used after they have been stolen, and we have funded a targeted advertising campaign called "Immobilise" to publicise this change. In December 2003, in advance of the changes in the law to make it an offence to hold a mobile phone while driving, we also launched an awareness campaign to publicise this change and promote safe driving practice.

In the communities where we operate, we have focused on children and teenagers deemed to be most at risk. In Slough, where we are headquartered, we funded and launched a new Cyber Café in an area of particular social deprivation. The facility is being used by Slough Education Authority and Youth Services teams for programmes targeting teenagers who face the greatest risk of social exclusion. Similarly, we initiated a joint partnership with the International Youth Foundation and the Foyer Federation to sponsor "Safe Moves", a pilot early intervention programme for teenagers at risk of becoming homeless. The programme was piloted in West Yorkshire near our Leeds offices. We also support Milly's Fund as our national charity. Set up by the family of teenager Milly Dowler following her tragic abduction and murder, the charity aims to empower young people to better evaluate potential risks to their personal safety. In October 2003, we jointly launched "Teach UR Mum 2 Txt", a national campaign that gives simple tips to parents and children about how to use mobile phones to increase personal safety. The campaign received a global award for the best use of mobile technology in society in February 2004. Finally, as part of our community investment programme, we funded the development of a medical device using the O₂ Xda enabling doctors to monitor asthma patients remotely. The technology allows patients to manage their conditions more effectively and helps doctors to diagnose and provide timely treatment. We are currently funding a similar trial to monitor Cystic Fibrosis patients.

Looking ahead

We will continue our focus on improving profitability by growing our base of high-value customers and improving business efficiency. To achieve this, we remain committed to delivering the best possible experience for our customers through, amongst other things, continued improvements in service quality, launch of innovative new services, improvements in customer service and CRM, and continued development of the O₂ brand.

Some of these new services will be made possible by UMTS mobile technology. Investment made in our UMTS network during the financial year to 31 March 2004 will accelerate in the financial year to 31 March 2005 as we move towards the commercial launch of our initial UMTS services in autumn 2004. However, we expect that UMTS will have a more substantial impact on the UK market after 2004.

Overall, we expect that competition in the UK mobile market will continue to intensify over the next 12 months. As such, we expect customer and revenue growth to slow in the financial year to 31 March 2005. This is why we remain focused on driving increased usage of new non-voice services to help deliver higher ARPU. We remain confident that the momentum we have established and the actions we are currently taking to continue strengthening our

business will ideally position us to emerge from a challenging market in good health.

O₂ Germany Operational performance

O₂ Germany achieved further EBITDA growth, underlining its high degree of operational efficiency and strict cost management together with its ability to generate strong top line growth, fuelled by high value customers.

Further important programmes were initiated to streamline operations, for example integrated customer care, and to increase customer loyalty. In October 2003, O₂ Germany launched an online loyalty programme aimed at driving ARPU up and churn down. Customers collecting bonus points are able to choose between different rewards. The loyalty programme is simple to understand and also brings the customer closer to O₂ Germany's product range. An "Active Lifecycle Management Pre-paid and Post-paid" programme to increase customer retention and profitability was also introduced. With service differentiation and new, extended sales channels, customer retention has been given a high priority. Integrated marketing is an additional component of the CRM concept. Having identified gaps in our distribution network we successfully increased the number of our direct outlets to 470 shops by 31 March 2004 which included partnerships with other retailers, including shop-in-shops. Our online shop has become one of our strongest direct sales channels with particular appeal to mobile data customers.

Genion, a key driver of gross additions, underlines 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 Genion. Thanks to its advanced technology, 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 market. We will be continuing to promote Genion employing an evolutionary marketing approach to widen the potential market and to address sub-segments with dedicated campaigns and special tariff offers.

In our target business market we made good progress, winning major new customers, forging new partnerships with sales channels and software suppliers, and introducing innovative new tariff packages and services specially tailored for the business customer. We acquired a number of household name customers, including Kraft Foods, Xerox, Campbells, Bayer, Blohm+Voss and Deutsche Assekuranz Pool GmbH. We also expanded our indirect sales model – the "pure business centre" – which is targeted at small and medium sized enterprises. We intend to have between 10 and 15 key partners who will, in turn, manage a further 60 to 100 sales partners. Some 20 co-operation agreements have been signed with companies including Siemens SBS, UNISYS, Tobit Software, Nextira One and Software AG. With these partners we are able to offer our business customers mobile solutions in such areas as field service control and mobile data security, using our Xda II and the

BlackBerry™, among other platforms. In January 2004 we launched customised business packages – Pro Office, Pro Company and Pro Connect – for small businesses and the self-employed. We introduced a new simple, transparent and flexible tariff scheme for medium to large companies. As an example of our focus on the customer, we were first to the German business market with an application that allows quick access to company data using UMTS. O₂ Germany customers can now use either UMTS, GPRS or WLAN for mobile data applications with the aid of new connectivity software that automatically connects customers to the network best suited to their needs.

Our growth in revenues from mobile data products continued last year, reinforced by further progress in the wholesale market. Data revenues at O₂ Germany have shown a strong increase accompanied by superior data ARPU compared with our competitors. SMS services are still the main driver of growth in data revenues, but non-SMS data services are also showing significant growth. About 20 per cent of our customer base is now using non-SMS data services. In June 2003, the O₂ Active mobile portal was launched. O₂ Active is the first full colour mobile portal to adapt automatically to the user's behaviour. It has enjoyed an excellent reception in the marketplace and from external commentators. In September 2003 we launched mobile data packs, comprising e-mail & surf pack and an e-mail pack. This is a differentiating factor for O₂ Germany compared to our competition (which followed suit), a good example of O₂ Germany's innovative marketing initiatives. It has been well received in the marketplace because mobile data packs are easy to use and offer transparent pricing. Multicard, a service enabling customers to combine between three and six SIM cards under one number, was launched in October 2003. It shows a high level of technical functionality, in particular enabling customers to surf the internet and make phone calls at the same time which is unique in the German market. Our hardware strategy also showed successes. MMS handsets with integrated cameras, which show an MMS-ARPU-share about three times higher than for handsets with click-on cameras, have become increasingly important. In November 2003 we launched the X1, the first O₂ branded phone.

As a complementary product, we have developed WLAN services. From October 2003, O₂ Germany post-pay customers have been able to tap into the service without prior registration. Pre-pay customers can access the WLAN service by using vouchers or a credit card. O₂ Germany currently has 450 hotspots, making it one of the leading WLAN providers in Germany. Our partnerships with GlobalAirnet AG, Swisscom Eurospot, ISIS Multimedia Net and NetCheckIn are driving the rapid expansion of our WLAN hotspots. Our partners deal with WLAN technology while O₂ Germany takes care of marketing and billing.

Market dynamics

The German mobile phone market grew at a faster rate last year as penetration of active customers rose to 76 per cent in March 2004 compared with 69 per cent in March 2003. During the financial year to 31 March 2004 the total number of connections grew by 6 million to 66 million. The attractiveness of the German market is underlined by its strong growth, even though the market is close to saturation. The

availability of mobile data services and increasingly attractive handsets were an important driver of market growth. Market conditions remained competitive as operators sought growth through highly subsidised handset offers and attractive tariffs, including flat rates and large volume bundles. There are currently four mobile network operators in Germany – T-Mobile, Vodafone, E-Plus and O₂ Germany.

Corporate responsibility

O₂ Germany is an active participant in the communities in which we operate. Our Schola-21 project was launched during the year. This is an internet-based school project supported by O₂ Germany in partnership with the International Youth Foundation and Deutsche Kinder-und-Jugendstiftung ("German Children and Youth Foundation") which was launched in 2003. The main features of Schola-21 are the creation of an internet portal and a virtual learning area that will be used to stimulate study and support learning on specific projects.

Looking ahead

Last year we concentrated on reductions in operating costs and improvements in our core processes, together with a number of major new product launches and the launch of our customer Loyalty Programme. Corporate customers are increasingly recognising the value of our specially tailored products. In the coming year, O₂ Germany will continue to develop and enhance data products such as a surf@home (a mobile Internet enhancement for our Genion product based on UMTS) and to exploit synergies within the Starmap Mobile Alliance. The next phase of O₂ Active will provide customers with an integrated experience and offer an advanced online portal with personalised content for the next generation of handsets. We will also be developing an attractive and comprehensive UMTS service in line with availability of appropriate handsets and customer demand. We will maintain an ongoing focus on market segmentation and continue to adjust our marketing activities and organisation accordingly. Our target remains to continue to grow our market share in Germany focusing on high-value customers and a further improvement in our EBITDA margin through top line growth and operational efficiency.

O₂ Ireland

Operational performance

O₂ Ireland management maintained a focus last year on providing customers with the best possible service experience, and was recognised in a number of industry awards and commendations. In April 2003, O₂ Ireland was awarded Telecoms Company of the Year at the ICT Expo Awards. Our portal website (www.o2.ie) won Ireland's leading technology award, the Golden Spider Award, for the third year running. O₂ Ireland was also short-listed by the Irish Independent among the top 50 companies to work for in Ireland.

In the past year, the O₂ Ireland management team has continued to improve business performance, gain market share and build the reputation of the O₂ brand and the business. Through improved operational efficiencies, quality of service and innovation, we have retained our existing customers and won new subscribers. During the past 12 months, the strength of the O₂ brand has continued to grow and deliver maximum value to the business. Awareness of the brand was helped by sponsorships and associations with the Irish Rugby Football Union, the Smurfit European Open, golfer Pádraig

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Harrington and O₂ in the Park – a family musical event in Phoenix Park, Dublin.

O₂ Ireland also maintained a strong performance in its quarterly customer satisfaction survey over the past year as customers scored O₂ Ireland highly in both network quality and billing services. The increase in customer satisfaction on these two counts stemmed from continued investment in the O₂ Ireland network together with intensive efforts to make bills easier to understand and to ensure that they get to customers on time.

O₂ Ireland continues to invest in technology and improvements in the efficiency of our operations, ensuring that our people can deliver a better service to our customers. In the past year, with this aim in view, we have concentrated on customer care, IT and network technology. The new products and services that we launched last year have reinforced our strategy, which is to offer value for money, simple tariffs and services that are easy to use. In this way we retain and attract high value customers. We introduced new tariffs in 2003 for pre-pay and post-pay customers, leading to a strong increase in our customer base.

In September 2003, we introduced All Ireland, a new tariff for customers moving between the Republic of Ireland and Northern Ireland that abolishes roaming charges between the two jurisdictions. We also brought an innovative new cost-saving service to market: Group Worker enables companies to separate the mobile calls of their employees into personal and work-related calls, thereby reducing the overall cost of mobile communications to the company.

Full Mobile Number Portability came into effect in July 2003. This was a highly complex programme, successfully implemented by a large team from across our business and one which won us customers from other operators.

Maintaining the highest quality network in order to maximise customer satisfaction remains central to our business. We always seek to build our network in a cost efficient and environmentally friendly way and we therefore continued, where possible, to share existing sites of other mobile operators and utilities providers.

We have adopted the same policy in building our UMTS network. On 14 January 2004 the Commission for Communications Regulation (ComReg) formally confirmed that O₂ Ireland had reached its UMTS performance targets in relation to network coverage, quality of service and site sharing. We began limited trials of our UMTS service in January and plan to bring UMTS services to the market in late 2004.

We have built our networks in a way that is designed to be as unobtrusive as possible to local communities. We have put community relations at the heart of everything we do and we continue to play a highly visible role in many parts of Irish life from sports to entertainment to the arts.

As part of our strategy to provide wireless broadband services to the regions, O₂ Ireland became the only Irish mobile operator to receive

government funding to install wi-fi hotspots in selected locations in western Ireland. We also rolled out our own wi-fi hotspots nationwide in hotels, airports, bus and train stations and business centres. Currently we have over 20 hotspots in operation around the country and we are in discussion with other operators to seek agreement over roaming services.

Mobile data usage continued to improve owing to the success of products such as the BlackBerry™, the Xda combined phone and personal computer, and games. Growth in text messaging continued with usage up by 20.2 per cent. We had a particularly strong Christmas in 2003, with sales of camera phones and new customer acquisitions exceeding our targets. In the corporate market, we gained a number of important new customers including Campbell Soups, APC and Atlantic Industries.

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 88%. O₂ Ireland holds the second biggest share of the market at 40%. 3 (Hutchison Telecom) entered the market in January 2004 and has begun to roll out its UMTS network. Meanwhile two fixed line operators, Esat BT and Eircom, have both indicated that they intend to re-enter the mobile market.

Corporate responsibility

In Ireland, our Community Investment programme focuses on providing educational opportunities for young people in areas of social disadvantage. We have partnered with the Irish Youth Foundation in support of its CITY (Communications and Information Technology for Youth) project in North Dublin. The programme provides supervised computer access for 10-19 year olds. O₂ Ireland also sponsored the Irish Youth Foundation's Children's Hour. This is a national fundraising initiative that invites employees from large and small businesses in Ireland to donate one hour's worth of their salary to support educational and social projects for disadvantaged young people.

In November 2003, Chief Executive Danuta Gray became a board member of Business in the Community in Ireland. In June 2003, Ireland hosted the Special Olympics. Forty O₂ Ireland staff were given additional holidays to volunteer in the organisation of the event. In addition, O₂ Ireland provided its corporate box in the Special Olympics venue to entertain people with special needs during the opening and closing ceremonies.

In January 2004, O₂ Ireland launched a handset recycling scheme throughout its offices and shops nationwide. This scheme will support the National Tree Week, a national initiative that plants 15,000 trees throughout Ireland each year.

Looking ahead

The focus for O₂ Ireland over the coming year will be to concentrate on providing the best possible customer experience with the aim of acquiring and keeping high value customers and offering them compelling products and services. We will continue to grow basic services by increasing market share. Non-voice revenues will become increasingly important. We saw a noticeable increase in the number

of camera phones and other data devices sold towards the end of last year, which will lead to more and more revenues coming from non-voice services. While non-voice revenue will become an increasingly important part of our revenue stream, we will continue to maximise revenue from existing voice services. We have met the regulatory requirements for UMTS network roll-out and we would hope to provide commercial UMTS services to the mass market in late 2004, dependent on the availability of handsets at a price and in a form that is attractive to our customers. While we expect competitiveness in the market place to increase, we are well placed to grow the business profitably with ongoing reviews to maximise shareholder value.

O₂ Airwave Operational performance

During the financial year to 31 March 2004, O₂ Airwave accelerated the roll-out of its network and established itself as our fourth substantial business. We delivered our service to a further 25 police forces during the year, including the Metropolitan Police, taking the total of forces so far supplied to 35 with over 50,000 officers using the service. We won new customers from other Public Safety Users and launched new products and services, securing additional business. We expect to complete the roll-out of the Airwave network by the end of calendar 2005 when a further 16 forces will start using the service. The faster pace of roll-out led to a more than five-fold increase in revenues, which, coupled with tight cost controls, produced a positive EBITDA for the first time. We invested £243 million in building our network during the financial year to 31 March 2004. We will continue to invest a significant amount during the financial year to 31 March 2005, after which our capital expenditure will decline as we complete the build of our network. Under the terms of a £2.9 billion, 19-year contract with the Home Office, O₂ Airwave will be the sole supplier of core mobile radio services to all 51 police forces in England, Scotland and Wales, with the three national forces also using the service.

Opportunities for Airwave are not restricted to police forces. Airwave is currently used by the Ministry of Defence Police, the UK Atomic Energy Authority Constabulary, the Land Army, two Fire and Rescue Services and an Ambulance Trust. The Royal Navy is also contracted to use Airwave in the future. We are licensed by the DTI to offer our service to about 100 other defined Public Safety Users in the UK. In an important opportunity, O₂ Airwave is short-listed for a contract to provide the communications network for the Ambulance Service nationwide. We have also been short-listed to supply the Fire Service nationwide. During the year, O₂ Airwave won new customers among other Public Safety Users who value Airwave's ability to allow emergency services to communicate with each other. O₂ Airwave is working with the Highways Agency to put Airwave into 400 vehicles that patrol motorways and A-roads, dealing with traffic incidents and managing the road network nationwide. HM Prison Service has chosen O₂ Airwave to provide communications in the transport of prisoners. Two of our first customers for Airwave Direct, a fully-managed radio communications service enabling smaller public safety bodies to subscribe directly to the Airwave network, have been Norfolk County Council and Darlington Borough Council. Norfolk is using Airwave to improve communications within its

emergency planning team and to allow the team to communicate directly with the police when necessary. For similar reasons, Darlington has equipped its community wardens with Airwave making communication easier among wardens and with the police.

Airwave's capabilities go beyond voice transmission: they enable the secure communication of vital data across the network. Airwave allows police officers to gain access to the Police National Computer (PNC) and Scottish Criminal Records Office to carry out vehicle and personal checks directly from their Airwave handsets. Rapid access to national records not only increases the efficiency of police officers; it also reduces the workload of command and control centres. North Yorkshire and Suffolk Police Forces are using Airwave's Automatic Vehicle Location Service to track the precise deployment and status of their fleets of vehicles, about 700 vehicles in total. Kent and Lancashire constabularies have undertaken trials of our Mobile Application Gateway (MAG). The Kent Police Force used MAG to give officers access to the PNC and to its local HQ while Lancashire Police Forces accessed the PNC together with databases for firearms, arrest warrants and "missing from home" cases. Among non-police customers, Hereford & Worcester Ambulance Trust is the first NHS organisation to use a patient telemetry service over the Airwave network. 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. Shropshire Fire & Rescue has also enjoyed improved safety for its fire fighters, faster response times and better risk management by using voice and data communication over the Airwave network.

Airwave is a sophisticated, fully encrypted digital radio system, which cannot be scanned or monitored by outsiders. On completion in 2005, the Airwave network will allow the police to communicate seamlessly and securely throughout England, Scotland and Wales. Airwave's multi-functional handsets, combining a digital radio and mobile phone, also operate as data terminals – enabling officers in the field to access local and national databases. As well as making a significant contribution to the fight against crime, the system promotes the safety of officers, partly because it has better radio coverage and call clarity but also because of its emergency button feature, which enables officers to summon immediate assistance. The Airwave network is based on the open European standard for TETRA. In addition to almost 100 per cent geographical coverage, capacity will be available on Airwave whenever and wherever a Public Safety User needs it – a vital feature in emergencies. Voice quality is very clear and all communications are encrypted, which means that third parties cannot listen in, allowing the police, for example, to keep one step ahead of the criminals. Airwave will also provide a common platform for Public Safety Users, giving them true interoperability and comprehensive geographical coverage. Lack of communications at major emergencies and disasters has been highlighted as a significant factor in hampering the effective co-ordination of rescue efforts by the emergency services. 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.

Business review

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. A key target is to comply with the ISO 14001 international standard by the end of calendar 2004.

O₂ Airwave is committed to creating national coverage for the emergency services. This means that the roll-out of our network will take us into areas including national parks, other areas of natural beauty as well as major cities, that are challenging from a planning point of view. We are a signatory to the mobile phone industry's Code of Best Practice incorporating the industry's Ten Commitments on mast siting. We also operate Goldstar, a consultation programme on our network development that closely involves briefings for local and regional policymakers and representatives of local communities.

O₂ Airwave seeks to be an active participant in the community. During calendar 2003 we launched our Community Investment programme which focuses on the theme of Youth Inclusion. Projects we have sponsored so far include a child road safety project in Devon and Cornwall, Look Alive!, a new advice and information line for Lancashire Fire & Rescue Service and the training and naming of a police dog, Rufus, who has now started service with the Nottinghamshire Police. O₂ Airwave employees have also given their time to support London Crimestoppers, the Merseyside High Sheriff and Chief Constable's Trust, and Weston Spirit.

Looking ahead

We will continue to invest a significant amount during the financial year to 31 March 2005, after which our capital expenditure will decline as we complete the build of our network. O₂ Airwave is already EBITDA positive and network completion will allow a transformation of financial performance. In the meantime, O₂ Airwave will seek to build on its success in exploiting the expanding range of opportunities for winning potential customers among the emergency services and Public Safety Users.

Manx Telecom

Operational performance

Manx Telecom has been operating on the Isle of Man since 1987 and has provided a programme of investment to establish a world-class telecommunications infrastructure there, at the forefront of introducing new technology and services. We were the first telecommunications operator in Europe to switch on a live UMTS network, which we did in December 2001. Our experience has provided the Group with valuable feedback prior to its launch of UMTS services in Germany, Ireland and the UK.

On 1 January 2004 Manx Telecom was awarded a licence extension by the Isle of Man Government for 15 years. The licence renewal has reduced Manx Telecom's annual payment to the government to a level which covers the cost of telecommunications regulation. The savings resulting from this are being passed on to customers through a range of tariff reductions and increased discounts which will help to make our pricing very competitive.

In May 2003, Manx Telecom launched its GPRS service, Manx Pronto Connect, with Island-wide coverage, followed in July 2003 by picture messaging. We also launched a wholesale SMS service which has increased the volume of text messages generated. The average number of SMS (texts) sent per month was around three million.

Capital spending during the year was £9 million compared with £7 million in the previous financial year. In December 2003, Manx Telecom completed a programme of work that saw all its telephone exchanges ADSL-enabled, in order to provide broadband services to local customers. This means that around 98 per cent of households and businesses on the island can now access broadband Internet. This initiative, in conjunction with the launch of our competitively-priced Wires-Only ADSL service in September 2003, has seen the take-up of broadband accelerate on the island. In the past five years, Manx Telecom has invested around £50 million in the Isle of Man's telecommunications infrastructure.

We pride ourselves on our record for customer service. This year we continued to build on our reputation with figures from event-driven surveys showing that 87 per cent of customers are very satisfied with the service they have received.

Market dynamics

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

Corporate responsibility

Manx Telecom continues to play an active part in the local community. We have funded initiatives such as the Manx Telecomputer Bus, a service providing schoolchildren and others in the community with access to advanced telecommunications, which this year, we are pleased to say, won a New Statesman Contribution to Civic Society award.

Looking ahead

Our newly awarded, 15-year, licence will give us the platform to continue to offer telecommunications services of the highest quality and best possible value to the population of the Isle of Man. We will remain at the forefront of new technological developments in telecoms on the island and actively support the government's strategy to attract new inward investment to the Isle of Man. We look forward with optimism to the future.

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

The EU has adopted a new regulatory framework for the electronic communications sector (the New EU Framework) which replaces much of the previous EU regulatory regime. Member States were required to implement the New EU Framework into national law by 24 July 2003, although some have not yet completed implementation.

The New EU Framework comprises four principal Directives which are intended to converge and harmonise electronic communication regulation throughout the European Community. 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 New 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 "significant market power" (SMP). SMP, for these purposes, has been aligned to the competition law concept of dominance, which essentially means an ability to act independently of customers, suppliers and competitors.

The European Commission (Commission) has 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. The Commission has stated that it will review the need for any update to the Recommendation by 30 June 2004 on the basis of market developments.

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; 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 Framework

The New 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), which replaced the Office of Telecommunications (Ofotel), the Radiocommunications Agency, the Independent Television Commission, the Broadcasting Standards Commission and the Radio Authority. Transitional arrangements were put in place whereby Ofcom's functions in relation to telecommunications were carried out by the Director General of Telecommunications (DGT) between 25 July 2003 and 29 December 2003. Ofcom is carrying out a Strategic Review of telecommunications. This will provide us with the opportunity to inform and constructively engage with Ofcom in the shaping of future UK industry regulations.

Market reviews

In the UK, the DGT has concluded that no mobile network operator (either individually or jointly) has SMP in the market for access and call origination on public mobile telephone networks. This means that various regulatory obligations (such as requirements to meet requests for interconnection and not to show undue preference or discrimination in the supply of wholesale services provided over public mobile networks) which had previously been imposed on us and Vodafone were lifted.

Ofcom has not yet completed its review of voice call termination on individual mobile networks, but has proposed that the charges we make to other operators for terminating calls on our network (call termination) should be reduced.

Ofcom has proposed that our call termination charges should be reduced from an average of 8.03 pence per minute to an average of 5.65 pence per minute for the financial year to 31 March 2005; and that they should be reduced by a further 10.5 per cent in the financial year to 31 March 2006, after allowing for an increase in such charges equal to the increase in the UK Retail Price Index (RPI).

As at 17 May 2004, Ofcom was planning to complete its market review by the end of May 2004 and to require us to make these proposed price reductions.

National roaming

Under the previous regulatory regime, O₂ UK and Vodafone were subject to an obligation in our licences to negotiate a national roaming agreement with the new entrant mobile network operator, 3. 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.

Business review

Regulation in Germany

The New EU Framework is not expected to be implemented into German law (via a new Telecommunications Act) before June 2004. Until then, the current German Telecommunications Act will continue to govern the award of licences for the conduct of certain telecommunications activities and the allocation of frequencies. The German telecommunications regulator, RegTP, is not expected to start carrying out its market reviews (of the markets listed in the Commission's Recommendation) until the New EU Framework is implemented into German law.

O₂ Germany fulfilled its obligation, under German UMTS licence requirements, to reach 25 per cent population coverage with its UMTS network. Mobilcom handed back its UMTS licence to RegTP in December 2003.

Regulation in Ireland

The New EU Framework was implemented into Irish law on 25 July 2003. On 1 December 2002, under the Communications Regulation Act 2002, a new regulatory body was established for the regulation of the communications sector in Ireland. This new three-person regulatory body, known as the Commission for Communications Regulation (ComReg), replaces the Office of the Director of Telecommunications Regulation.

Under the old framework, O₂ Ireland and Vodafone were designated as having SMP in the mobile telephony market and the national market for interconnection in Ireland. Our SMP conditions under the old framework remain in place until ComReg has completed its market reviews.

ComReg is currently reviewing responses to its consultation document on the wholesale mobile access and call origination market. ComReg's preliminary conclusion in the consultation document was that O₂ Ireland and Vodafone are jointly dominant and should be designated with SMP in this market. If this conclusion is confirmed, ComReg proposes to impose on us SMP conditions requiring us to enter into commercial negotiations for the purpose of providing wholesale national roaming access to qualifying non-SMP operators. It may also impose on us certain transparency, non-discrimination, accounting separation and cost accounting obligations. ComReg's conclusions on its market analysis and proposed SMP designations are expected to be issued in July/August 2004.

In July 2003, O₂ Ireland 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.

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 their 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 is currently investigating whether mobile operators have infringed Article 81 and/or Article 82 in markets for international mobile roaming services in the European Economic Area. The investigation is continuing and no conclusions have yet been reached.

Infrastructure sharing and national roaming

We have entered into UMTS infrastructure-sharing and national roaming agreements with T-Mobile in the UK and Germany. The agreements were formally notified to the Commission for negative clearance or exemption under Article 81. The Commission formally cleared the UK arrangement by Decision of 30 April 2003, and the German arrangement 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 of the German decision 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.

UK margin squeeze investigations

Ofcom has been investigating whether O₂ UK, Vodafone, Orange and T-Mobile have conducted a margin squeeze in breach of UK competition law. The investigation concerns whether the prices we charge certain retail business customers for calls from fixed lines to mobiles could represent a margin squeeze, when compared to the wholesale prices we charge to others for terminating calls on our network.

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

Our mobile businesses cover two of the largest markets in Europe, with the UK and German markets giving us access to a total population of over 144 million people. All our markets have seen growth over the last few years in the number of mobile telephone users, in large part reflecting strong demand for competitively priced pre-pay offerings. Our markets are seeing the emergence of additional wholesale opportunities for network operators. Through wholesale agreements, network operators are able to sell capacity and services on a large scale to other service providers and mobile virtual network operators.

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

The table below presents selected data regarding the principal countries in Europe in which our businesses operate. Due to the sale of O₂ Netherlands, this table does not present data for that business.

Country	Population ¹ (in millions)	Active mobile ¹ customers' penetration at 31 March 2004		mmO ₂ customers at 31 March 2004 (in 000's)
			(%)	
Germany	84	76		5,982
United Kingdom	60	91		13,264
Ireland	4	88		1,391
Total	148			20,637

¹ Source: EMC Worldwide Cellular Database, May 2004.

Employees

The Group had the equivalent of 12,905 employees at 31 March 2004, as set forth by country in the table below:

Country	Number of employees
United Kingdom	7,576
Germany	3,517
Ireland	1,534
Isle of Man	278
Total	12,905

For the year ended 31 March 2004, the aggregate number of temporary staff employed by our businesses was 2,124.

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

As a result of the initiative to move forward with a common infrastructure which supports the development of services and applications across the Group, a Nortel GPRS core network has been installed and is now operational in the UK, Germany and Ireland. Common UMTS core (Nortel) and radio (Nortel and Nokia) has also been installed over the last year in these operating businesses. Adopting this approach has brought economies of scale to the costs of infrastructure roll-out across the Group and supports a pan-European approach to services while enabling tailoring for local market requirements.

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:

- >> maintain a firm level of cost control, whilst supporting overall business growth;
- >> ensure investment is maintained in the most strategic systems; and
- >> work together to leverage cross-Group benefits.

Business review

Following a successful Group-wide initiative to reduce costs in line with our peers, a variety of initiatives have been pursued. These include renegotiating and consolidating supplier contracts, tightly managing contract renewal and deploying new equipment to reduce maintenance costs.

This cost control has allowed a shift in investment to strategic projects, for example to enhance content billing, to consolidate multiple legacy billing systems, to address new market segments and to enhance significantly the CRM capability in each of our businesses.

The IT community from each of the operating businesses has worked together where benefits have been clearly identified. This has enabled us to deploy common infrastructure, use common products and re-use custom developments. There has also been a joint approach to our key suppliers, providing benefits to both sides and enabling the introduction of framework contracts across the Group.

Looking ahead, our businesses have major IT projects to underpin the business strategy. These include projects to further enhance CRM, ensure a consistently high quality end-to-end customer experience and support key business programmes. Within the IT units there are initiatives to increase responsiveness to change, ensure the long term value of our systems through adherence to architectural policies and to work with our partners in the Starmap Alliance.

Intellectual property

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

We are aware that various third parties use O₂ or similar brands in connection with other goods and services. We have entered into agreements with some such third parties, which permit the brands to co-exist. These agreements contain some restrictions on use of our brand, but we do not believe that these restrictions conflict with our business model or day-to-day activities. It is not our intention to trade under the O₂ brand in the United States, where our securities trade under the mmO₂ plc name.

Meanwhile we have just been granted a European Patent relating to technology used in our HomeZone service. The HomeZone service is one of our products marketed in Germany. A third party owns two patents which cover the technology used in the HomeZone service. To date, this third party has not sought to challenge our patent applications or prevent us from using the HomeZone technology. We believe that it is unlikely to take any such action in the future. However, if that third party sought successfully to do so, we might have to stop using the HomeZone technology or find an alternative solution with the third party or use an alternative technology which serves the HomeZone functionality.

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.