

Chief Executive Officer's review

- Strong revenue and profit growth
- Accelerated investment in Germany
- Focus on enhanced customer experience
- Airwave service fully operational
- Increased take-up of data services

In 2004/05, O2 has delivered further strong revenue and profit growth across all our businesses. In the face of determined competition, we had a record year for customer additions and achieved a significant increase in earnings before interest, tax, depreciation, amortisation and exceptional items (EBITDA), and operating profit. Group revenue from continuing operations grew by over £1 billion and pre-tax profit more than trebled to £309 million. Underlying earnings per share were 63 per cent ahead of last year and net debt was reduced by £288 million to £78 million.

The uptake of data services accelerated. These now generate revenues of over £1.4 billion per annum and account for more than 23 per cent of our gross service revenues. During the year, we launched our business and consumer 3G services in the UK and Germany, with Ireland to follow later this year. Our data offering will be significantly enhanced in the second half of 2005 by our agreement with NTT DoCoMo to provide its mobile internet service in all our key markets.

O2 UK

In a highly competitive market with ten players, O2 UK showed good momentum, adding 1.1 million new customers – made up of 785,000 pre-pay and 335,000 contract additions – taking its customer base to 14.4 million. We have reduced the number of pre-pay net additions to allow for an element of double counting when existing pre-pay customers buy a new handset or SIM card. Despite the impact of the termination rate cut imposed by Ofcom in September 2004, service revenue showed further growth, due to strong voice and increasing data usage. Texting grew by 34 per cent, reinforcing our market-leading position. Data is not just about texting – more than one-third of customers used a non-text data service during the year. Our Tesco Mobile joint venture, which is reported separately from O2 UK, also continued to

perform well, with its active customer base reaching 500,000 shortly after Christmas 2004. In such a competitive market, the cost of customer churn is an issue, but at O2 UK EBITDA rose by 14 per cent to £1,183 million on a 14 per cent increase in service revenues.

We plan to deploy significant new resources into the customer-facing areas of our UK operations – including the creation of 2,000 new jobs, opening a fourth major UK customer service centre and further expanding our shop 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 2004/05.

O2 Germany

The performance of O2 Germany last year was outstanding. The business is now recognised as the most dynamic and innovative in the German market. After what was, by any measure, an extremely strong first half, growth continued over the rest of the year. Service revenue increased by 28 per cent to €2,474 million and EBITDA increased to €500 million. Our momentum in Germany has been driven by a rapid increase in the customer base – O2 Germany has a very attractive range of products and services and markets them aggressively. We added nearly 2 million new customers, approaching one-third of net new additions in the German marketplace. These are high-value customers. O2 Germany has market-leading ARPU thanks largely to our unique O₂ Genion Homezone service. In October 2004, we launched a new joint venture, Tchibo Mobilfunk, which had attracted more than 250,000 pre-pay customers by the end of the financial year. We are now aiming to continue this growth in what is Europe's largest telecoms market. Over a five-year period starting in April 2004, we aim to spend between €3 billion and €3.5 billion on increasing our investment in network quality and population coverage – this is €1 billion to €1.5 billion more than previously planned. By the end of the period, we will be able to offer high-quality mobile services across our own 3G network, underpinning further growth and also higher profitability as we reduce our reliance on roaming agreements with other operators.

O2 Ireland

Innovative and competitive services and tariffs, together with the strength of the O₂ brand, have continued to drive growth in customers at O2 Ireland, together with an on-going rise in usage levels. Customers in Ireland consistently use their mobile phones over 50 per cent more than in our other territories. This growth in customer numbers, to over 1.5 million, led to another year of strong financial performance with service revenue increasing by 13 per cent to €816 million and EBITDA 9 per cent higher at €327 million. The Irish

market is becoming increasingly competitive. Four network operators are now active and others are expressing an interest, following proposed measures to allow mobile virtual network operators access to the networks of existing players.

O2 Airwave

The roll-out of our Airwave network for the emergency services was completed, on time and on budget, at the end of March 2005. Airwave, which makes communities safer by providing communication where and when it matters most, has now been delivered to all police forces in England, Scotland and Wales. Over 150,000 police officers will have access to the service, together with more than 78 other public safety agencies that have also signed up to Airwave. The system has already contributed to a reduction in crime, improved officer safety and, in the case of Hereford & Worcester Ambulance Trust, saved over 150 lives. O2 Airwave has been shortlisted for similar contracts to provide nationwide communications for the Ambulance and Fire Services. We see many opportunities to provide secure and reliable communications to a wide range of new users.

Manx Telecom

Manx Telecom, our subsidiary on the Isle of Man, was the first company in Europe to launch a live 3G service, in December 2001, providing O2 with a valuable learning experience and hands-on knowledge of the potential of 3G. Building on this success, Manx Telecom is now set to run Europe's first super-fast 3G service, using HSDPA technology. This offers communication speeds up to three times those of current 3G services. Once again we expect that this will provide other O2 businesses with vital insights into future mobile services. The technology will be rolled out across all of our territories from 2006.

Strategy

Our strategic framework for the coming year is driven by the same high but realistic aspirations that have delivered such strong growth to our business since demerger. To continue to meet those aspirations we will be addressing some key priorities in 2005/06.

Superior revenue and profit growth despite the competitive landscape: O2 UK continues to focus on winning and retaining more high-value customers in order to drive further revenue improvements. In Germany, there is significant room for growth at recent rates and our accelerated investment programme will provide a springboard to achieve this. O2 Airwave will be making a strong financial contribution in its first full year of operation.

Best customer experience to give substance to our iconic O₂ brand: quality, value and innovation are the keys to maintaining the strength of the O₂ brand and differentiating us from our competitors. To keep the loyalty and trust of our customers, we must give them the service that they want and products that work – which is why we have been cautious in the timing of our 3G launch. We do not necessarily want to be the first to market but we do want to be the best. Our aim is to keep the O₂ brand fresh, with fewer, better services, all designed to enhance the customer experience – we are investing in the platforms and people to achieve this.

Operationally efficient, agile and innovative organisation: we will be driving our businesses to realise efficiency gains, using our growing insight into our customers' needs and behaviour to align our costs more closely to what customers value most. We have innovative joint ventures with Tchibo in Germany and Tesco in the UK, and other multi-territory partnerships.

Mobile data services that our customers really value: "texting" has become a way of life, whether in

person-to-person messages, texting questions to the Prime Minister or voting off Big Brother contestants. We carried a record 50 million texts on Christmas Day 2004 and texting continues to grow in all markets. Driven by O₂ Active, our award-winning mobile internet portal, we are also starting to see significant growth in non-text data usage, revenues from which have increased by 50 per cent over the past 12 months. The mobile sector is poised for even more dramatic growth as we focus on developing new mobile data products and value-added services.

A high-speed network, as provided by 3G, is the key to future mobile data services, enabling customers to migrate to advanced, content-rich applications. We believe there will be a mass market for these services starting in late 2005 and building over the next few years.

We are rolling out the 3G network in all of our territories, matching capacity to known mobile data demand. We have invested in training and billing systems and we have highly specified and well-functioning devices. To complete the picture, we signed a long-term agreement with NTT DoCoMo Inc, Japan's largest mobile communications provider, to launch a mobile internet service under the i-mode® brand in the UK and Ireland in Autumn 2005. A similar service will be available in Germany from Spring 2006. This service, which will complement O₂ Active, has a proven track record in Western Europe of lifting uptake, usage and revenue from data services, due to its ease of use and huge breadth and depth of tailored internet content.

The appeal of these services will be significantly enhanced through the progressive introduction of HSDPA technology. This offers speeds significantly better than 3G and will, in effect, provide a true mobile broadband experience. In addition, we are engaged in the UK's first trial of multi-channel mobile TV.

Looking ahead

In the UK, we are expecting revenues to grow at a mid-single digit rate, reflecting the impact of the remaining five months of the call termination rate cut in September 2004 and continuing competition in a highly penetrated market. Competitive forces, coupled with O2 UK's substantial investment in customer-facing capabilities to attract and retain long-term customers, are expected to lead to a broadly stable EBITDA margin. We are expecting further strong revenue growth in Germany, driven mainly by a continued rapid growth in our customer base there. On the back of strong revenue growth, O2 Germany's EBITDA margin is expected to rise further, to around 20 per cent, after absorbing the impact of UMTS network running costs and on-going national roaming costs. Capital expenditure overall should be broadly in line with last year. Higher investment in our UMTS network, particularly in Germany, will be offset by a reduction in spending at O2 Airwave, following completion of its network roll-out.

Peter Erskine

Chief Executive Officer