Phones 4u – in administration

Questions & Answers

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Introduction

This document has been prepared in response to questions received following the presentation on 15 October 2014 to senior secured creditors of Phones 4u Finance plc (in administration) and its subsidiaries.

The Joint Administrators act in accordance with the powers set out in Schedule B1 of Insolvency Act 1986.

The financial information reflected below has been drawn from books and records of the Phones4u group ("P4u"), and has not been audited or otherwise verified. It is provided for illustrative purposes only and may be subject to material change. Possible financial outcomes, where provided, are estimates only at this stage and should not be relied upon for the purposes of investment decisions.

Responses to certain questions have been provided in general terms, as certain information is commercially sensitive and we consider disclosure may result in a reduced return for creditors.

Mobile Network Operator Receivables

1) Please provide more detail on those factors which might increase or decrease the MNO Receivables.

P4u had separate and unique agreements with mobile network operators ("MNOs"). The principle on which these agreements were based was that where P4u procured a connection for an MNO, P4u would share in the net revenue earned by the MNO.

Broadly, the key variables which affect the revenue P4u earns from an MNO with regard to a connection are (a) the length of the customer's contract with the MNO, (b) the amount of the monthly bills which the customer receives from the MNO, (c) the fees for the MNO providing the connection to a customer, and (d) the decision of when and with which MNO the customer decided to renew or upgrade, including whether or not this was performed in a P4u store. The structure of each MNO agreement is different, but in general they rewarded P4u for procuring high value connections that would be renewed with the same MNO.

The value of the MNO receivable would (in general) increase as a result of actual or forecast increases in the length of customer-contracts, higher monthly bills, reduced interconnection and servicing fees, and increased levels of renewals by customers with their existing MNO.

In the mobile telephone contract marketplace, there have been key trends in recent years which have impacted these variables. For example, average contract lengths have increased as handsets have become more expensive. In addition, there has been a proliferation of data usage which has reduced text message volumes and roaming charges have decreased due to regulatory intervention. Prior to any impacts resulting from the insolvency of P4u, the evolution of the above factors over time would impact the amounts earned by P4u going forward, and *thus the level of the MNO receivable. In addition, any impact of P4u's insolvency on these factors (for example any resultant increase in the level of customer renewals or upgrades with their existing MNO) would also impact the size of the receivable going forward.*

2) **How does P4u receive usage date from the MNOs and how can you be comfortable this is correct?**

Data is received from MNOs on a periodic basis. As part of standard practice the P4u team would validate the robustness of this data using a number of methods, such as:

a. *Comparing emerging trends with historical norms: P4u has a significant pool of historical data at a connection-level such that emerging customer behaviour can be compared to historical norms to identify any anomalies or unexpected patterns.*
b. *Comparing emerging trends across networks: P4u has the benefit of agreements with a number of MNOs, covering a range of bundles and tariffs. This allows for cross-network comparison to identify any anomalous or unexplained behaviour that is MNO-specific.*
c. *Audit rights: in the event that agreement cannot be reached with an MNO on any issue which was identified as anomalous, all of the MNO contracts provide P4u or an independent third party the right to audit MNO data.*

3) **Please provide some colour on the gross payables in the overall MNO receivable balance – why were these described as being largely fixed? What elements of the MNO receivable are not fixed?**

The gross payable balance is largely fixed as it relates predominately to working capital support provided by the MNOs to P4u on connection of a new user. For example, upon connection of a new user the MNO would remit a fixed amount to P4u.

Additionally there were amounts received from certain MNOs for activities, such as marketing support, that were ancillary to procuring connections. There is an allocation exercise being undertaken now in order to identify such amounts and understand which of these have been discharged. Accordingly, it is possible that this will lead to small changes to the gross payable amount.

4) **Why has the MNO receivable reduced by £20m since the July balance which was quoted on a call shortly after administration? Does the movement relate to the reduction in cash in the same period?**

The net MNO receivable has not changed significantly since the date of appointment. The amounts due are the net of a gross receivable and a gross payable. The gross receivable is based on projected end-user behaviour over time, whilst the gross payable is largely fixed as explained above.

The balance disclosed in our calls with bondholders shortly after appointment, was extracted from the P4u management accounts as at 31 July 2014. Upon further investigation it has *transpired that this comprised the sum of 'External Commissions' of £64m (being the net MNO receivables) and 'Accrued Income' (as described below) of £20m.*

The Accrued Income balance relates to manufacturer support agreements, whereby handset manufacturers agreed to provide incentives to P4u to increase the number of their handsets sold (e.g. a 'rebate' of £10 per handset). We are currently exploring the extent to which realisations may be achieved from the manufacturer support arrangements, but we do not currently consider they will be significant given the likelihood that manufacturers can set off any amounts receivable against any trade payables with the same supplier.

The external commissions (i.e. net MNO receivables) did not significantly change from July 2014 to the date of administration. We continue to reiterate that the actual recoveries in due course could be higher or lower than the current balance which we have disclosed.

5) **What type of counter-claims have been received from the MNOs?**

There have been a range of counter-claims received from MNOs, which relate to both the impact of the administration as well as matters that pre-date our appointment. In some cases, the MNOs have not yet articulated their purported counter-claims in sufficient detail for us to assess their merits of the claim or the quantum involved.

It should be noted, however, that we are in the very early stages of the reconciliation process and that due to the complex payment mechanisms under the MNO agreements and the operational limitations of MNO payment systems, claims and counterclaims between the parties in respect of payments were often made in the ordinary course of dealings pre-administration.

6) **Are any of the MNOs creditors?**

We consider that all the MNOs are net debtors of P4u and the total balance owed of £65m is the aggregate of net receivables only.

7) **If it was determined that there was a net payable position between P4u and an MNO, would it be an unsecured claim?**

Yes.

8) **Have we started to ask for information from the MNOs?**

Yes.

9) **How is the gross balance for MNO receivables and payables in excess of £800m as that seems like very large number? According to the balances in the annual accounts, this number seems much lower?**

In the group's accounts for the year ending 31 December 2013, the net receivable from MNOs is included in the £175.3m group "Prepayments and Accrued Income". In line with established accounting standards, given the terms of the MNO contracts, the gross payable and gross receivable are recorded at the net position.

10) Is it possible to go through a worked example of one single MNO transaction to see how the gross receivable and gross payable balances evolve over time?

Set out below is an illustrative example.

We have assumed that the agreement with the MNO is only over one contract life (ie, it is not renewed at the end of the contract), and that the MNO shares 50% of the end-user's monthly billed revenue, contributes 50% to the acquisition (ie handset) cost and makes a payment of 90% of expected future revenue share upon connection.

Customer enters into a connection in a P4u store, for a 24 month contract at £40 per calendar month, and receives a free handset worth £200 from P4u.

As part of the agreement with the MNO in this illustrative example, P4u receives from the MNO either directly or via a bills of exchange facility upon connection:
(1) 50% of the handset cost (50% x £200 = £100); and
(2) a fixed amount based on the estimate of the future revenue share (90% x 50% x £40 x 24 = £432). The 90% is a protection to prevent the MNO 'over-paying' for the connection upfront.

This is recorded in the books of P4u as a gross payable (£432), a gross receivable (50% x £40 x 24 months = £480) and therefore a net receivable of £48 (£480 - £432). P4u records the estimated future connection value as turnover (£480) and includes the net cost of the handset (£100) to cost of sales.

Over the life of the 24 month contract, each month the MNO sends billing data to P4u – which shows the customer has in fact spent £40 of which Phones 4u is due £20 (50% x £40). This monthly amount due is offset against the sums already received by Phones 4u from the MNO (£18 per month) hence the MNO remits a further £2 each month.

At the end of the 24 months, the Customer is no longer part of the P4u "connection portfolio" and thus no future income is earned in this example.

Cash and Banking

1) Please provide an updated cash balance as of today (15 October 2014)?

The table below sets out cash balances on appointment, after set-off by Lloyds Banking Group and as at 15/10/2014.

Real values	15/09/2014 £'m	Set-off	Post Lloyds set off £'m	As of 15/10/2014 £'m			
				Lloyds	Barclays	Solicitors' accounts	Total
Phones 4U Limited	126	(34)	92	65	22	15	102
Policy Administration Services Limited	14	-	14	8	7	-	15
MobileServ Limited	(15)	20	5	5	-	-	5
Subtotal (in the security net)	*125*	*(14)*	*111*	*78*	*29*	*15*	*122*
Life Mobile Limited (outside security net)	(14)	14	-	-	1	-	1
Jump Limited and 4U Wi-Fi Limited	1	-	1	1	-	-	1
Total group cash	**112**	**-**	**112**	**79**	**30**	**15**	**124**

Jump Limited and 4U Wifi Limited have been included in the above table for completeness of total group cash. They are outside the security net and the balances have not changed since administration.

On 16 September 2014, the Administrators transferred £25m (£20m from Phones 4u Limited and £5m from PAS) from Lloyds to Barclays, for operational reasons.

On 18 September 2014, Lloyds bank set off cash balances to eliminate any gross borrowing positions amongst entities in the P4u banking group. The post-Lloyds set-off balances presented in the presentation to bondholders on 15th October were slightly misstated by £5m for MobileServ Limited ("MobileServ"), although the net balances were correct. As at the date of administration, MobileServ had a current account with an overdrawn balance of £19.6m and another account with a credit balance of £4m. MobileServ also held foreign currency balances of £0.75m at accounts with Lloyds. As part of the set-off, Lloyds elected to clear the £19.6m overdrawn account using funds from Phones 4u Limited, leaving MobileServ with credit cash balances of £4m alongside the foreign currency balances of £0.75m. As MobileServ is within the security net this does not affect the cash balance available to secured bondholders.

The total cash in Phones 4u Limited from the date of appointment to 15/10/2014 has increased by net £10m as set out below.

Phones 4u Limited	£'m	£'m
Opening cash position		92
Receipts		
Sales proceeds	15	
Rent contribution from Vodafone and EE	3	
Cash in stores	1	
Debtor receipts	1	
Total of receipts	*20*	
Payments		
Rent payments	(3)	
Payments to employees	(5)	
IT cost	(1)	
Duress payments	(1)	
Total of payments	*(10)*	
Total cash movement	**10**	
Cash as at 15/10/2014		**102.4**

*The other key trading entity being Policy Administration Services Limited ("**PAS**") has a net movement of £1m which is summarised below.*

Policy Administration Services Limited	£'m	£'m
Opening cash position		14
Customer receipts	5	
Payments to suppliers	(4)	
Total cash movement	**1**	
		15

2) How did the £15m overdraft position at MobileServ arise?

MobileServ Limited ("MobileServ"), although not a trading business, was party to the cash-pooling arrangement, alongside other companies in the wider group structure. MobileServ's accounts were used where required to settle transactions for those group companies which were not party to the group's cash pooling arrangement and which did not have sufficient funds in their bank accounts to settle particular transactions (e.g. financing costs) themselves.

In the months up the appointment of the Administrators, the significant transactions that account for the overdrawn position include:
1) transfer of funds to Phones 4u Finance plc (£10.25m) which was ultimately used to pay PIK interest by way of reversing a previous capital contribution from Phosphorous Holdco plc.
2) intercompany financing charges paid to PAS and P4U (£6.97m).

Letters of Credit

1) **The presentation showed that £15m had been called under a letter of credit – but £19.8 is the total claim?**

There are a number of letters of credit, two of which are in favour of Apple. Please see summary below:

Summary:

	Amount (£m)	Status
Apple (x2)	15.8	Called
LGI	4.0	Not called as at 16/10/2014
	19.8	

Income and Receipts

1) **Where in the EFO were the £6m of post administration receipts which were mentioned in one of the bondholder calls reflected?**

The EFO was prepared as at 13 October 2014, with £0.8m of receipts (being in store customer receipts credited to the Lloyds account the day following our appointment) included in "Other Realisations", £3.9m (which relates to PAS and is included in the PAS receipts and payments outlined in the presentation) included in "Other Costs"; and £1m of cash held in stores which was banked to that date included in "Cash on Appointment".

Policy Administration Services Limited ("PAS")

1) **Are you assuming any recovery from the £7m stock in the insurance business in the £17m or does that just diminish as the business winds down?**

No recovery from the stock was assumed in the £17m – it is anticipated that the £7m of stock will be used in the trading of the business (at nil acquisition cost) in order to meet insurance claims.

2) **Shouldn't the £14m be constantly moving and should it be £13.4m for overall recoveries?**

The £14m was the amount of cash in the business at the point of administration. The amount of cash in the business as of 7 October was £13.4m. In terms of overall recoveries, with the *same caveats as above, the business is potentially capable of additionally generating incremental net profit and cash of c.£17m over the period to 31/12/16.*

3) **Do you expect that all policies will terminate by 31/12/16 or will there be a some residual policies which will continue after this?**

The insurance policies are typically 5 year monthly renewable policies and in practice the length of these are expected to be limited by the life of the handsets. Given the typical life of handsets we have projected cash flows until the end of 2016 but there will likely be some residual policies which remain in effect after this point.

<u>Other Debtors</u>

1) **In one of the bondholder calls you had mentioned "other debtors" of £62m and that there was little or no value in them. Is that still the case as it was not obvious in the EFO?**

The "other debtors" balance referenced was as at 31 July 2014 and included:

	£'m
Corporation tax asset	13.3
External debtors	13.6
Prepayments	35.1
Total	**62.0**

The corporation tax asset shown (to the extent it exists) is likely to be offset against VAT due and hence we consider it to be irrecoverable.

Included within the external debtors were £8.8m from the P4U sales ledger relating to amounts invoiced for used phones and manufacturer support agreements, £3.3m relating to Jump4u Ltd which is outside of the security net and various other smaller amounts. Included within the prepayments are amounts relating to property rates, marketing advances, IT suppliers, insurance, etc. Where possible we have already begun the process of recovering amounts and although we may receive some monies from these assets, in our experience these are likely to be extremely limited.

<u>Leases</u>

1) **Is the potential lease premium (£1.16m) included in the EFO?**

Yes - this is accounted for within "Other Realisations".

<u>Costs of Realisation</u>

1) **Property and employees costs: Is it correct to assume that very little of this is property costs?**

From the £10m "Lower case", £4.7m relates to property being rent, rates and utilities on the store portfolio and head office costs and £5.3m is employee costs.

In the £7.6m "Upper case"; £3.1m relates to property and £4.5m to employee costs.

The key variables between "Upper" and "Lower" are the timing of surrender of leases and phasing of future redundancies.

2) **Stock repatriation and holding costs: Why is there such large difference between the 2 numbers if the stock from all but one store has been cleared out? Is it because you expect to ask the stock providers (Samsung, Nokia, HTC) to pay for this?**

The difference between the 'low' and 'upper' cases is as follows:

a) £1m - comprises a contribution we have requested upon from handset suppliers;
b) £0.6m - depends on timing of vacating the warehouse.

3) **What progress has been made regarding the transaction to sell the Apple stock currently in the warehouse?**

Since 15/10/14 the Administrators have completed the sale of the Apple handsets which were held in the warehouse at the point of administration as well as a portion of those which were in the store network. The book value of the stock which was sold was £29.4m but the terms of the sale are confidential. The Administrators continue their efforts to market the remaining Apple handsets (book value £6.5m) which have now been repatriated from the store network.

4) **Other costs: what is included in this?**

This includes IT costs, duress payments, costs relating to insuring the business and other costs including the costs of running Head Office and stores during the repatriation period. £2.3m of the £2.4m difference between the lower and higher cases relates to how rapidly the Head Office can be vacated and related IT costs can be saved.

5) **On which line in the EFO does the customer communication cost + daily HQ/Store running cost come in?**

Employee-related costs, and costs for property (e.g. rent and rates) are included in the "Property and employee costs" line. Other costs, such as IT services, are included in the "Other costs" line.

<u>Prescribed Part</u>

1) **Which are the 3 / 4 entities in your prescribed part calculation?**

In the high case, we consider that there are 3 entities which may have a prescribed part:

a. Phones 4u Limited

b. *PAS*
c. *MobileServ Limited*

The "Lower case" has included a contingency in case there is a prescribed part in another entity (yet to be identified) caused by a floating charge realisation in the respective entity.

The prescribed part for MobileServ would arise as a result of the cash remaining in this entity (as described above).

<u>Preferential Creditors</u>

1) **Are these claims from employee tribunals regarding bonuses/commissions? How would you differentiate between them being an unsecured claim or a preferential creditor?**

On appointment, employees were owed wages, overtime, bonus and commission, all of which fall within the category of "unpaid wages". The status of unpaid wages in insolvency ranks as preferential up to a time limit and a financial limit. Claims which exceed the financial limit and fall outside the time limit are unsecured.

Having paid each employee their unpaid basic wages for 1 to 15 September and overtime for 1 to 31 August in September's payroll, the administrators believe that they have discharged what would otherwise be classified as a preferential claim for unpaid wages.

However, there is a possibility that other amounts beyond basic wages owed to employees could still rank as preferential claims and so we included provisions for these in the EFO statement.

In addition, payment in lieu of holiday accrued but not taken is also a preferential claim (with no financial cap or time limit). For employees who transferred to a new employer as part of one of the three store transactions, the holiday pay liability transferred to become a liability of the new employer.

Policy Administration Services Limited

Dan Yoram Schwarzmann, Douglas Nigel Rackham, Robert Jonathan Hunt and Ian David Green have been appointed as joint administrators of Policy Administration Services Ltd to manage its affairs, business and property as agents without personal liability. All are licensed to act in the United Kingdom as insolvency practitioners by the Institute of Chartered Accountants in England and Wales.

The joint administrators are Data Controllers of personal data as defined by the Data Protection Act 1998. PricewaterhouseCoopers LLP will act as Data Processor on their instructions. Personal data will be kept secure and processed only for matters relating to the administrations.

Phosphorous Holdco plc

Robert Jonathan Hunt, Ian David Green and Paul David Copley have been appointed as joint administrators of Phosphorous Holdco plc to manage its affairs, business and property as agents without personal liability. All are licensed to act in the United Kingdom as insolvency practitioners by the Institute of Chartered Accountants in England and Wales.

The joint administrators are Data Controllers of personal data as defined by the Data Protection Act 1998. PricewaterhouseCoopers LLP will act as Data Processor on their instructions. Personal data will be kept secure and processed only for matters relating to the administrations.

Other Entities

Robert Jonathan Hunt, Ian David Green and Robert John Moran have been appointed as joint administrators of Phones 4u Limited, Life Mobile Limited, 4u Wi-Fi Limited, 4u Limited, Jump 4u Limited, MobileServ Limited, Phosphorus Acquisition Limited, Phones 4U Group Limited and Phones4u Finance Plc to manage their affairs, business and property as agents without personal liability. All are licensed to act in the United Kingdom as insolvency practitioners by the Institute of Chartered Accountants in England and Wales.

The joint administrators are Data Controllers of personal data as defined by the Data Protection Act 1998. PricewaterhouseCoopers LLP will act as Data Processor on their instructions. Personal data will be kept secure and processed only for matters relating to the administrations.