

# **O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich**

**Financial statements and management report  
for the short financial year from 6 March 2013 to 31 December  
2013**

*Translation from the German language*

O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH

Munich

Statement of Financial Position as of December 31, 2013

<b>Assets</b>	<b>December 31, 2013 EUR</b>	<b>March 6, 2013 EUR</b>	<b>Equity and liabilities</b>	<b>December 31, 2013 EUR</b>	<b>March 6, 2013 EUR</b>
<b>A. Fixed assets</b>			<b>A. Equity</b>		
Financial assets			Nominal capital	25,000.00	25,000.00
Loans to affiliated companies	600,000,000.00	0.00			
	<b>600,000,000.00</b>	<b>0.00</b>		<b>25,000.00</b>	<b>25,000.00</b>
<b>B. Current assets</b>			<b>B. Liabilities</b>		
I. Receivables and other assets			1. Bonds	600,000,000.00	0.00
Receivables from affiliated companies	1,642,157.11	0.00	--thereof with a remaining term of 1 to 5 years EUR 600,000,000.00--		
--thereof due from shareholders EUR 1,252,209.38--			2. Trade payables	429,657.11	0.00
II. Cash in hand, cash at banks	0.00	25,000.00	--thereof with a remaining term of less than one year EUR 429,657.11--		
	<b>1,642,157.11</b>	<b>25,000.00</b>	3. Other liabilities	1,187,500.00	0.00
			--thereof with a remaining term of less than one year EUR 1,187,500.00--		
<b>C. Prepaid expenses</b>	<b>6,566,700.00</b>	<b>0.00</b>		<b>601,617,157.11</b>	<b>0.00</b>
			<b>C. Deferred income</b>	<b>6,566,700.00</b>	<b>0.00</b>
<b>Total assets</b>	<b>608,208,857.11</b>	<b>25,000.00</b>	<b>Total equity and liabilities</b>	<b>608,208,857.11</b>	<b>25,000.00</b>

**O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH**

**Munich**

**Income Statement**

**for the Short Financial Year from March 6 to December 31, 2013**

	<b>Mar 6 - Dec 31, 2013</b>
	<b>EUR</b>
1. Other operating income	598,280.94
2. Other operating expenses	-598,348.04
3. Other interest and similar income --thereof from affiliated companies EUR 1,298,810.41--	1,298,810.41
4. Interest and similar expenses	-1,298,800.03
<b>5. Result from ordinary business activities</b>	<b>-56.72</b>
6. Income from profit and loss transfer agreement	56.72
<b>7. Net result of the year</b>	<b>0.00</b>

**O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH**

**Munich**

**Statement of Changes in Cash Flows  
for the Short Financial Year from March 6 to December 31, 2013**

	Mar 6 - Dec 31, 2013
	EUR
<b>1. Cash flow from operating activities</b>	
Result for period before loss absorption	-56.72
Increase (-)/decrease (+) in inventories, trade accounts receivable and other assets	-64,711.83
Increase (+)/decrease (-) in trade accounts payable and other liabilities	429,657.11
Costs of issuing bonds	-1,650,000.00
Cash flow from operating activities	<u>-1,285,111.44</u>
<b>2. Cash flow from investing activities</b>	
Outflows (-) for investments in financial assets	-593,322,000.00
Cash flow from investing activities	<u>-593,322,000.00</u>
<b>3. Cash flow from financing activities</b>	
Inflows (+) from issuing bonds	594,972,000.00
Outflows (-) from cash pooling	-389,888.56
Cash flow from financing activities	<u>594,582,111.44</u>
<b>4. Cash and cash equivalents at the end of the period</b>	
Cash-effective change in cash and cash equivalents	-25,000.00
Cash and cash equivalents at the beginning of the period	<u>25,000.00</u>
Cash and cash equivalents at the end of the period	<u><u>0.00</u></u>

**O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH**

**Munich**

**Statement of Changes in Equity**

**for the Short Financial Year from March 6 to December 31, 2013**

	Subscribed capital	Other retained earnings	Net income	Equity
	EUR	EUR	EUR	EUR
As of March 6, 2013	25,000.00	0.00	0.00	25,000.00
As of December 31, 2013	25,000.00	0.00	0.00	25,000.00

**O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich**  
**Notes to the Annual Financial Statements**  
**for the Short Financial Year 2013**

**I. GENERAL INFORMATION ON THE ANNUAL FINANCIAL STATEMENTS**

Telefónica Deutschland Finanzierungs GmbH, Munich, was by notary deed established on February 26, 2013 for the purpose of financing the Telefónica Deutschland Group. The nominal capital was paid in on March 6, 2013. Telefónica Deutschland Finanzierungs GmbH, Munich was renamed O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich (referred to in the following as “TDF” or the “Company”) with effect from November 7, 2013.

In November 2013, TDF issued a five-year unsecured bond (Senior Unsecured Bond) with a nominal value of TEUR 600,000 and a maturity of November 22, 2018 in the regulated market of the Luxembourg Stock Exchange.

The annual financial statements of O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich, for the short financial year from March 6, 2013 to December 31, 2013 have been prepared in accordance with the accounting principles of the German Commercial Code (HGB) and the GmbH Act (Act relating to limited liability companies, GmbHG).

As of the reporting date December 31, 2013, the Company is classified as a large corporation in accordance with section 264d in conjunction with section 267 (3) HGB.

The financial year of the Company corresponds to the calendar year.

The income statement has been prepared using the nature of expense method in accordance with section 275 (2) HGB.

**II. ACCOUNTING POLICIES**

**1. Principles and comparability**

The accounting policies used in the preparation of the annual financial statements for the period ending December 31, 2013 are in accordance with the provisions of sections 242 to 256a and sections 264 to 288 of the HGB as well as the relevant provisions of the GmbHG.

The Company was established with the notarized agreement of February 26, 2013. It was registered in the commercial register on March 14, 2013. The financial year of the Company is thus a short financial year, covering the period from March 6, 2013 to December 31, 2013. The opening balance sheet figures as of March 6, 2013 are presented for comparison purposes.

## **2. Fixed assets**

Within the financial assets, loans are shown at the lower of nominal value or fair value. Interest-free or low-interest loans are discounted to the present value.

## **3. Current assets**

The receivables and other assets are shown at the lower of nominal value or fair value at the balance sheet date. Adequate allowances have been recognized to take account of all risk positions.

## **4. Prepaid expenses**

This item includes payments made before the reporting date representing expense applicable to a specific period after that date.

## **5. Equity**

The nominal capital is stated with its nominal value.

## **6. Liabilities**

Liabilities are recorded at their settlement amount.

## **7. Deferred income**

This item includes payments received before the reporting date representing income applicable to a specific period after that date.

### **III. NOTES TO THE BALANCE SHEET**

#### **1. Financial assets**

The financial assets as of December 31, 2013 consist of a loan of TEUR 600,000 granted by TDF to its shareholder Telefónica Germany GmbH & Co. OHG, Munich. The terms of the loan correspond to the terms of the bond which TDF issued on November 22, 2013. The loan has a fixed term until the date of maturity of the bond on November 22, 2018, and is repayable in one amount on the due date plus all interest and costs which have not yet been paid. The underlying interest rate is 1.875 %, and is payable annually on November 22.

The development of fixed assets is shown in the statement of changes in fixed assets. The statement of changes in fixed assets is enclosed as an appendix to the notes.

#### **2. Receivables and other assets**

The receivables due from affiliated companies amount to TEUR 1,642; thereof, TEUR 1,252 mainly relate to interest receivables from the loan granted to Telefónica Germany GmbH & Co. OHG, Munich. TEUR 390 is attributable to the cash pooling arrangement with Telfisa Global B.V, Amsterdam, the Netherlands. The maturity of all receivables is less than one year.

#### **3. Prepaid expenses**

This item includes a disagio from the issuance of the bond originally amounting to TEUR 5,028. Issuing fees of TEUR 1,650 are also included. Both elements are released on pro rata basis over the term of the bond.

#### **4. Nominal capital**

The nominal capital of the Company amounts to EUR 25,000.00, and is fully paid up. It is held entirely by Telefónica Germany GmbH & Co. OHG, Munich.

#### **5. Liabilities**

The liabilities include a bond with a nominal value of TEUR 600,000 and a maturity on November 22, 2018. The bond is guaranteed by Telefónica Deutschland Holding AG, Munich.

Trade accounts payable of TEUR 430 relate to incidental acquisition costs incurred in connection with the bond issue.

The other liabilities include TEUR 1,188 for current interest liabilities relating to the bond.

There are no liabilities with a remaining term of more than five years.

## **6. Deferred income**

This deferred income results from the original difference of TEUR 6.678 between the nominal value of the loan and the amount paid out to Telefónica Germany GmbH & Co. OHG, Munich. The deferred item is released over the term of the loan.

## **IV. NOTES TO THE INCOME STATEMENT**

### **Other operating income and expenses**

The other operating income of TEUR 598 is attributable to costs charged on to Telefónica Germany GmbH & Co. OHG, Munich. The other operating expenses of TEUR 598 which are charged on mainly comprise consultancy and audit fees.

### **Financial result**

The other interest and similar income of TEUR 1,299 relates to interest income due from Telefónica Germany GmbH & Co. OHG, Munich.

The interest and similar expenses of TEUR 1,299 relate to interest expense from issuing the bond due to third parties.

## **V. ADDITIONAL DISCLOSURES TO THE NOTES**

### **Supplemental disclosures to the cash flow statement**

The cash and cash equivalents presented in the cash flow statement comprise cash in hand and cash at banks. Receivable from cash pooling are not included within cash and cash equivalents.

### **Employees**

The Company did not have any employees in the financial year 2013.

### **Management**

The following persons were Managing Directors in the financial year:

Rachel Clare Empey, CFO Telefónica Deutschland Holding AG, Munich.

René Schuster, CEO Telefónica Deutschland Holding AG, Feldafing, until January 31, 2014.

Markus Haas, CSO Telefónica Deutschland Holding AG, Munich.

Albert Graf, managing director, Fahrenzhausen, since January 31, 2014.

The Managing Directors do not receive any payments from the Company.

### **Audit committee**

The audit committee in accordance with section 324 HGB comprises the following members:

Dieter, Gauglitz  
chairman,  
freelance consultant  
Munich

Eckart, Kurze  
board member  
Vice President Transformation; Telefónica Germany GmbH & Co. OHG, Munich  
Munich

Marcel, Ritter  
board member  
Vice President Legal, Telefónica Germany GmbH & Co. OHG, Munich  
Munich

### **Auditor's fee**

In accordance with section 285 No. 17 HGB, the total fee of the auditor of TDF is not disclosed since the Company is part of the consolidation group of Telefónica Deutschland Holding AG, Munich (Telefónica Deutschland Group) and the information is already included in the Consolidated Financial Statements.

### **Consolidated financial statements**

Telefónica Deutschland Holding AG, Munich, is the company which prepares the Consolidated Financial Statements for the smallest group of companies in which the Company is included. The Consolidated Financial Statements are published in the German Federal Gazette at [www.bundesanzeiger.de](http://www.bundesanzeiger.de) , where they are available for inspection. The Consolidated Financial Statements of Telefónica Deutschland Holding AG, Munich are included in the consolidated financial statements of the Spanish parent company Telefónica S.A., Madrid, Spain. Telefónica S.A., Madrid, Spain prepares the consolidated financial statements for the largest group of companies. These consolidated financial statements are available at Telefónica S.A., Madrid, Spain and are published in the Internet at [www.Telefónica.com](http://www.Telefónica.com).

### **Cost reimbursement agreement**

TDF and Telefónica Germany GmbH & Co. OHG, Munich, have concluded an agreement whereby costs are reimbursed by the shareholder.

**Profit and loss transfer agreement**

On March 20, 2013, TDF as the controlling company signed a domination agreement with Telefónica Germany GmbH & Co. OHG, Munich. In addition, on March 20, 2013, TDF also signed a profit and loss transfer agreement with Telefónica Germany GmbH & Co. OHG, Munich.

The net profit for the short financial year from March 3, 2013 to December 31, 2013 is transferred to Telefónica Germany GmbH & Co. OHG, Munich as a result of the existing control and profit and loss transfer agreement.

Munich, April 30, 2014

O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH

- Management -

Rachel Clare Empey

Markus Haas

Albert Graf

**O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH**

**Munich**

**Statement of Changes in Fixed Assets for the Short Financial Year from March 6 to December 31, 2013**

	Acquisition costs				Accumulated depreciation				Carrying amounts	
	Mar 6, 2013	Additions	Disposals	Dec 31, 2013	Mar 6, 2013	Additions	Disposals	Dec 31, 2013	Dec 31, 2013	Mar 6, 2013
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
<b>Financial assets</b>										
Loans to affiliated companies	0.00	600,000,000.00	0.00	600,000,000.00	0.00	0.00	0.00	0.00	600,000,000.00	0.00
	0.00	600,000,000.00	0.00	600,000,000.00	0.00	0.00	0.00	0.00	600,000,000.00	0.00

# Management Report

## O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich

### Management Report for the Short Financial Year from March 6, 2013 to December 31, 2013

#### 1. Business and frame conditions

O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich (TDF) acts as the financing company for the Telefónica Deutschland Group and its operating entities. The following economic and legal framework conditions for the operating entities are thus indirectly also relevant for TDF.

The world economic environment has gradually brightened somewhat during the course of 2013. The Euro area is increasingly coming out of the recession and the average annual economic performance for the Euro area fell by only 0.4% in 2013 in comparison to the previous year.

The German economy recorded stable development in 2013 with stronger economic growth than in the other Euro countries. After a weak start to the year the German economic situation improved again in the second half of the year. According to the Federal Ministry of Economics and Energy, 2013 saw the gross domestic product (GDP) increased by 0.4%, primarily supported by robust private consumption.

Source: Deutsche Bundesbank (German Central Bank), German Federal Ministry for the Economy (BMWi)

#### GDP development 2011-2013

In %	2011	2012	2013
Germany	3.3	0.7	0.4
Euro area average	1.6	(0.7)	(0.4)

Source: Deutsche Bundesbank (German Central Bank), German Federal Ministry for the Economy (BMWi)

### ***General trends on the German telecommunications market***

In the German telecommunications sector, alongside continuing customer demand for more bandwidth, various other trends can be observed. Thus convergent products and services are becoming ever more popular. The strong demand for wireless data usage and increasing smartphone and tablet penetration enable the wireless telecommunications network operators with further opportunities for growth, which will also continue into the future. Smartphones and tablets are becoming the trailblazers for the digital revolution in Germany. At the same time, the monetization of the wireless data business will continue to gain strongly in significance for wireless telecommunications providers. The increasing availability of Cloud Services is responsible, according to the industry association Bitkom, for a profound change in information technology. With Cloud Computing the use of IT services occurs according to demand via decentralized computers that are connected via data networks (in the "Cloud") instead of on local computers. A further trend is the growing market of machine-to-machine communication (M2M) with countless application possibilities.

The mobile telecommunications market was very dynamic in 2013 and characterized by intense competition, primarily driven by the strong demand for smartphones and the increasing number of smartphone tariffs. According to Yankee Group Research, by now around 50% of all mobile phone owners use a smartphone. At the same time, according to industry association Bitkom, the number of tablets sold increased from 4.4m in 2012 to around 8m in 2013.

The increasing penetration of wireless end-devices with internet capability such as smartphones or tablets and the increasing use of wireless data services also showed itself in the strong growth of revenues from wireless data on the German market: In 2013, according to Analysys Mason, wireless data revenue increased by about 19% in comparison to the previous year. By contrast, revenue from wireless telephony and SMS declined, driven by price erosion, regulatory effects and changed customer behavior.

The German wireless telecommunications market is an established market with four wireless telecommunications network operators. As of December 31, 2013, the Telefónica Deutschland Group held, with 19.4m connections, a market share of 16.8%.

(Source: Corporate data, Analysys Mason, Bitkom)

## ***Regulatory influences on the Telefónica Deutschland Group***

Telecommunications services and the operation of telecommunications networks are subject in particular to the regulation of the German Telecommunications Act of June 22, 2004 in the version of August 7, 2013 and certain complementary regulations to the Telecommunications Act.

The Telecommunications Act contains provisions that affect the following, among other things: (i) the organization and authority of the regulatory authority, (ii) registration obligations, (iii) the granting of easements, (iv) the allocation of frequencies, (v) access obligations, (vi) fee regulation, (vii) misuse oversight, (viii) consumer protection as well as (ix) data protection and public security. Some of these obligations apply only to service providers who have significant market power in their relevant market. Other obligations apply or can be imposed by the German Federal Network Agency (Bundesnetzagentur – BNetzA) even if the corresponding operator has no particular market power.

## **2. Areas of operation**

O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich (formerly Telefónica Deutschland Finanzierungs GmbH, Munich) was established as a wholly owned subsidiary of Telefónica Germany GmbH & Co. OHG, Munich, on February 26, 2013. It is thus part of the Telefónica Deutschland Group. O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich handles major financing activities of the Telefónica Deutschland Group. The necessary resources can be financed and procured by way of issuing bonds eligible for trading on the capital market. The Company is authorized to carry out all activities and measures which appear to be appropriate for directly or indirectly serving the business purpose of the entire company. In particular, it is permitted to establish and acquire other companies, to obtain equity participations in other companies, to manage such companies or restrict its activities to managing such participations.

In November 2013, TDF issued a five-year unsecured bond (Senior Unsecured Bond) with a nominal value of TEUR 600,000 and a maturity on November 22, 2018 in the regulated market of the Luxembourg Stock Exchange. The annual nominal interest of the bond is 1.875 %. The bond represents unsecured and senior liabilities of TDF, which are of equal ranking with each other and with all other unsecured and senior liabilities of TDF, unless these liabilities enjoy priority as a result of mandatory stipulations. Each bond is repaid on the due date in the amount of its specified denomination unless it has been previously repaid or purchased and invalidated.

The bond is guaranteed by Telefónica Deutschland Holding AG, Munich.

### **3. Net assets, results of operations and financial position**

#### **Net assets**

*The assets are shown in the separate balance sheet, and are broken down as follows:*

The financial assets as of December 31, 2013 consist of a loan of TEUR 600,000 granted by TDF to Telefónica Germany GmbH & Co. OHG, Munich. The terms of the loan correspond to the terms of the bond. The loan has a fixed term until the date of maturity of the bond on November 22, 2018, and is repayable in one amount on the due date plus all interest and costs which have not yet been paid. The underlying interest rate is 1.875 %, and is payable annually on November 22.

The receivables due from affiliated companies amount to TEUR 1,642; thereof, TEUR 1,252 mainly relate to interest receivables from the loan granted to Telefónica Germany GmbH & Co. OHG, Munich. TEUR 390 is attributable to the cash pooling arrangement with Telfisa Global B.V, Amsterdam, The Netherlands.

Prepaid expenses include a disagio from issuing the bond in the original amount of TEUR 5,028. Issuing fees of TEUR 1,650 are also included.

*The liabilities are shown in the separate balance sheet, and are broken down as follows:*

The nominal capital of the Company amounts to EUR 25,000.00, and is fully paid up. It is held entirely by Telefónica Germany GmbH & Co. OHG, Munich.

The liabilities include a bond with a nominal value of TEUR 600,000 with a maturity on November 22, 2018.

Trade accounts payable of TEUR 430 relate to incidental acquisition costs incurred in connection with the bond issue.

The other liabilities include TEUR 1,188 for current interest liabilities relating to the bond.

Besides, there are no liabilities with a remaining term of more than five years.

Deferred income results from the original difference of TEUR 6.678 between the nominal value of the loan and the amount paid out to Telefónica Germany GmbH & Co. OHG, München. The deferred income is released over the term of the loan.

### **Results of operations**

In the short financial year ending December 31, 2013, O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich, reported a negative result from ordinary business activities of EUR 57; this was absorbed by Telefónica Germany GmbH & Co. OHG, Munich as a result of an existing domination and profit and loss transfer agreement.

*The main profit and loss items are as follows:*

The other operating income of TEUR 598 is attributable to costs charged on to Telefónica Germany GmbH & Co. OHG, Munich. The other operating expenses of TEUR 598 which are charged on mainly comprise consultancy and audit fees.

The other interest and similar income of TEUR 1,299 relate essentially to interest income from the loan which was granted to Telefónica Germany GmbH & Co. OHG, Munich and which is described under financial assets.

The interest and similar expenses of TEUR 1,299 mainly comprise interest expense from the issuing of the bond due to third parties. Interest expenses, related expenses from the release of the disagio and issuing fees are charged on to Telefónica Germany GmbH & Co. OHG, Munich.

### **Financial position**

The composition of cash and cash equivalents and the relevant movements are shown in the separate cash flow statement.

In the short financial year 2013, TDF reported negative cash flow from operating activities of TEUR 1,285. The development is mainly attributable to the increase in current trade accounts payable.

The negative cash flow from investing activities of TEUR -593,322 is attributable to granting a loan to Telefónica Germany GmbH & Co. OHG, Munich.

In the short financial year 2013, the cash flow from financing activities amounted to EUR 594,582. The cash flow of TEUR 594,972 is essentially attributable to the issuing of a bond. This was partially offset by a negative cash flow of TEUR 390 due to the increase in cash pooling receivables due from Telfisa Global B.V., Amsterdam, The Netherlands.

Overall, as a result of a cash pooling agreement with Telfisa Global B.V., Amsterdam, The Netherlands, there were no cash and cash equivalents at TDF at the end of 2013.

#### **4. Opportunity and risk report**

The activities of TDF are currently restricted exclusively to the financing of the Telefónica Deutschland Group. The main element of the assets of TDF is the loan granted to Telefónica Germany GmbH & Co. OHG, Munich. The economic existence of TDF is thus primarily dependent on whether Telefónica Germany GmbH & Co. OHG, Munich is able to meet its obligations in relation to this loan. All interest and capital payments relating to all debt securities currently issued by TDF are provided with a full and unlimited guarantee by the guarantor Telefónica Deutschland Holding AG, Munich. This guarantee is enforceable in accordance with the law of the Federal Republic of Germany.

Accordingly, the risks and opportunities of O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich as well as the measures and processes for handling these risks and opportunities are essentially the same as those applicable for the Telefónica Deutschland Group. The main Group risks are summarized in the following.

##### *General financial market risks*

The Telefónica Deutschland Group is exposed to various financial market risks as part of its business activity. In addition there are liquidity risks for the Telefónica Deutschland Group that are connected with its credit risks and market risks or a weakening of its operative business or disruption of the financial markets.

If such financial risks occur, they may lead to a negative impact on the asset, financial and earnings position and the cash flow of the Telefónica Deutschland Group.

The Telefónica Deutschland Group has developed guidelines for risk management processes and for the use of financial instruments, including a clear separation of tasks with respect to financial activities, invoicing, financial reporting and associated controlling. Derivative financial instruments are used exclusively to manage the risks from trade and general corporate financing. The Telefónica Deutschland Group has developed guidelines derived from established standards for the evaluation of risks and the monitoring of the use of financial derivatives.

#### *Market risk*

Market risk is the risk that changes in market prices, such as changes in currency conversion rates and interest rates, will affect the value of the Telefónica Deutschland Group's financial instruments or earnings.

#### *Interest risk*

Interest risks arise predominantly from cash pooling accounts and deposits of the Telefónica Deutschland Group as well as through loan agreements as borrower and interest swaps. In November 2013 an interest rate swap was signed by one of the other group companies in connection with the issuance of the bond for a partial amount of the bond's nominal value. On the basis of this interest rate swap contract the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. This interest swap compensates, to the level of its nominal amount, the effects of future market interest rate changes on the fair value of the underlying fixed interest financial liabilities from the issuance of the bond (fair value hedge).

#### *Credit risk*

Credit risk describes the risk of financial losses from the inability of contractual partners to pay back or service debts in accordance with the contract. The Telefónica Deutschland Group considers the management of the commercial credit risk to be critical in order to achieve its goals for sustainable growth of the business and the customer base in harmony with its risk management guidelines. For the management and monitoring of the credit risk, suitable processes have been set up.

This approach for credit risk management is based on the ongoing monitoring of the expected risks and the level of default. To control the credit risk, Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and only reports adjustments for doubtful receivables with a similar credit risk.

### *Liquidity risk*

The liquidity risk includes the risk that a business cannot comply with its financial obligations. The Telefónica Deutschland Group ensures, for the management of the liquidity risk, that it has sufficient liquidity at all times to fulfill its obligations, both under normal and under demanding circumstances. The Telefónica Deutschland Group works on its liquidity management closely with the Telefónica, S. A. Group and, in accordance with the corporate policy, has concluded cash pooling and deposit agreements with Telfisa Global B.V., Amsterdam, The Netherlands.

### *Capital management*

The Telefónica Deutschland Group strives to guarantee the sustainability of the business and to maximize the business value. The Telefónica Deutschland Group monitors in particular its equity quota and the OIBDA.

### **Risk management and risk reporting**

Every business activity involves risks that can prejudice the process of goal-setting and goal fulfillment. These risks arise from the uncertainty of future events – often due to insufficient information – and have the result that objectives can be missed. If risks are not recognized and dealt with they can endanger the successful development of the corporation. In order to react appropriately to this fact, corporate management has introduced a risk management process. This should guarantee immediate and complete transparency with regard to newly arising business risks and changes to existing risks.

Risk management is an immanent component of the decision-making process with the Telefónica Deutschland Group. The process ensures that risk evaluations are taken into account for the decision-making and measures are taken early to minimize and deal with the risks. As a result the evaluation, communication and management of risks is the task of all managers of the corporation. The risk management department compiles the corporation's risk registry, which also covers the subsidiaries. As part of the creation of the risk registry it is ensured that risks of a similar type or of cumulative effect are aggregated and thus provided for overall consideration.

Risks are evaluated with regard to their effect on our business goals both from an operational as well as financial viewpoint. The risk registry is based on a data base that contains all identified risks, their status and defined action plans.

In a formal forward-looking process, the risk registry and Telefónica Deutschland's total risk and that of its subsidiaries are the subject of quarterly reporting to the Management Board. The Audit Committee is regularly informed about risks and their development.

Opportunities are not captured in the risk management system.

### *Risk evaluation*

From the combination of the potential level of damages and the estimated probability of occurrence, the individual risk points are divided into three categories (critical, moderate and minor risks). All risks with a very high potential level of damages are seen as critical for the corporation, and here the estimated probability of occurrence is not taken into account. With an increasing probability of occurrence the risk points with a high or medium potential level of damages also fall into this category.

For internal use and reporting within the Telefónica Deutschland Group risks are divided into business risks, operational risks, financial risks and other (global) risks and are summarized as follows:

#### Business risks

- Competitive markets and changing customer demands
- Regulatory environment (with an impact on services, products and prices)
- Licenses and frequencies (time limitation for licenses and granted frequency usage rights)
- Non-approval of planned business mergers, take-overs or cooperations (e.g. EU Commission, Federal Cartel Office, Federal Network Agency)
- Termination fees wireless communications (reductions on the basis of audits carried out by the European Commission and court proceedings for regulatory measures)
- Termination fees wireline (ex-ante price regulation for wireline termination fees for alternative operators)
- Other regulatory influences on fees
- Insurance
- Macro-economy factors

### Operational risks

- Service quality
- Supplier defaults
- Legal risks (e.g. due to misuse or loss of customer data or the violation of intellectual property rights)
- Personnel

### Financial risks

- Liquidity
- Taxes
- Other (global) risks

### **Opportunity management**

The consistent use of entrepreneurial opportunities with respect to future revenue and OIBDA potential as well as their early and continuous identification, analysis and management is a significant task of management at the Telefónica Deutschland Group. The opportunities and growth potential ascertained in the strategic goal-setting process are prioritized as part of an annual planning process in close cooperation with the individual business areas and relevant strategic goals are derived from that. To measure the strategic implementation, concrete financial objectives in the form of key finance-related monitoring figures are defined at the level of the organization units.

Opportunity management is a significant component of the entire process for strategic goal setting. It occurs both as part of the budget creation for the coming twelve months as well as within the three-year planning.

Major opportunities are summarized as follows:

- Opportunities due to greater demand for wireless data, LTE and convergent products
- Opportunities due to closer cooperation with Telekom Deutschland GmbH in the wireline network
- Opportunities due to expansion of the LTE network
- Opportunities on the B2B market
- Opportunities due to digital innovation (e.g. due to digital products and services in various areas such as communication (e.g. Joyn), Financial Services (e.g. mpass), M2M (e.g. Pay how you drive) or Digital Signage (e.g. Promotion Pad)
- Opportunities due to belonging to the Telefónica, S.A. Group (e.g. due to economies of scale in purchasing, cooperations and the development of digital products).

## **5. Essentials of the remuneration system**

TDF did not have any employees in the financial year 2013. The Managing Directors do not receive any payments from TDF.

## **6. Report of events after the reporting period**

### *Issue of a seven-year bond*

On February 10, 2014, O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich issued a senior unsecured seven-year bond (Senior Unsecured Bond) with a nominal value of EUR 500 million. The bond has a maturity on February 10, 2021; it was issued by O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG, Munich. The coupon for the fixed interest bond is 2.375 % and the issue price is 99.624 %. The issue spread was 100 basis points over the seven-year Euro mid-swap rate, resulting in a yield of 2.434 %. The bond has a denomination of EUR 1,000 and was issued on the basis of a bond security prospectus. O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich has transferred the net proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich in the form of a loan. The net proceeds generated from the bond will be used for general corporate purposes.

### *Change in management at O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH*

As of January 31, 2014, René Schuster left the Telefónica Deutschland Group and thus also stepped down from the management of O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich. Albert Graf moved to the management of TDF as of January 31, 2014.

## **7. Forecast report 2014**

The forecast report describes the probable development of O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich in the course of the financial year 2014. The report contains comments and information regarding future events. Forward looking comments and information are based on expectations and assumptions of the Company at the point at which this management and forecast report is published, on the basis of known and unknown opportunities and risks. The success of the Company, the business strategy and also the results of the Company are influenced by a wide range of factors outside the control of the Company.

If such opportunities or risks occur or if uncertain factors materialize, or if it becomes apparent that one of the underlying assumptions was not correct, the actual development of the Company may differ (positively as well as negatively) from the expectations and assumptions in the forward-looking comments and information set out in this forecast report. Forecasts available in the public domain regarding the development of the overall economy and the sector only have to be detailed to the extent which is relevant for understanding the comments regarding the probable development of the Group. They must not impair the perception of the comments regarding the probable development of the Group.

As a result of the close personnel and economic links between O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich and the Telefónica Deutschland Group, TDF is subject to the same business and framework conditions as well as the same regulatory environment as the Telefónica Deutschland Group. The future development of TDF is very much dependent on the capital requirement and the financing form chosen by the Telefónica Deutschland Group. The assessment of the future development of TDF is therefore based on forecasts of the business developments of the Telefónica Deutschland Group, which is summarized in the following.

The implications of the anticipated transaction concerning all of the assets, specific liabilities and the operating business of E-Plus Mobilfunk GmbH & Co. KG, Düsseldorf and its indirect and direct subsidiaries, which is expected to be finalized by mid of 2014 are likely to be strong on the operating business of TDH Group. Due to this no outlook covering the whole year of 2014 was provided. O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich however expects the result of the upcoming year to be zero.

#### *Economic Outlook for Germany*

The most recent forecasts regarding the development of the Euro area indicate that the upward trend will continue in 2014. For the Euro area a rise in economic output by 1.0% is forecast in 2014.

For 2014 the outlook for the German economy, according to the German Federal Ministry for the Economy, continues to be positive and it expects a growth in the gross domestic product of 1.7%. Private consumption should continue to be a strong economy driver considering continuing favorable general conditions for employment and income.

#### GDP growth 2012-2014

In %	2012	2013	2014
Germany	0.7	0.4	1.7
Euro area	(0.7)	(0.4)	1.0

Source: Deutsche Bundesbank (German Central Bank), German Federal Ministry for the Economy (BMW)

In 2014, the market development in Germany, one of the biggest telecommunications markets in Europe, will again be driven by rising customer demand for broadband services, in wireless telecommunications and also in the wireline network. The boom in smartphones and tablets as well as growing demand for LTE are driving the growth in wireless data services. Thus the market for wireless internet will soon supersede mobile telephone calls as the most important driver of revenue for German wireless telecommunications service providers. At the same time the negative trend for wireless voice and SMS will continue through further price pressure and changed customer behavior. The increasing demand for speed in wireless telecommunications and wireline networks with the strong demand for convergent solutions on the part of German consumers will similarly be a driver of growth.

(Source: corporate data)

Telefónica Deutschland Group expects the German telecommunication market to continue being active and competitive in the period under consideration, with ongoing pressure on mobile revenues from competition and changing customer behavior, for example impacting revenues from SMS. A lower year-on-year impact from the regulation of mobile termination rates is also expected (-3% rate cut from December 2013). Telefónica Deutschland Group will remain focused on the mobile market.

However, Telefónica Deutschland does not expect this to fully offset a number of headwinds, mainly the effect from customers renewing their long-term contracts to lower price levels and the general decline of SMS usage in the German market. As a result, Telefónica Deutschland expects a continuation of trends in wireless service revenue for the first half of 2014, showing a similar year-on-year performance to the last quarter of 2013, excluding the impact from mobile termination rate cuts.

Telefónica Deutschland Group continues monitoring the mobile market and anticipates an increasing level of competition around bundles of smartphone tariffs and devices with a focus on value maximization. The combination of revenue performance with higher year-on-year commercial investments and a lower margin from the sale of handsets will likely outweigh additional efficiencies in the business in the period under consideration, and thus, it is expected that OIBDA margin in the first half of 2014 will show a limited year-on-year erosion from 2013 level (23.4%), similar to the underlying year-on-year OIBDA margin performance seen in previous quarters.

## **8. Management summary**

Currently, O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich, in its capacity as a financing company, restricts its activities exclusively to financing the Telefónica Deutschland Group. In 2013, and in line with its business purpose, TDF successfully issued a bond with a nominal value of TEUR 600,000 and a maturity on November 22, 2018, and transferred the proceeds based on the same conditions in the form of a loan to Telefónica Germany GmbH & Co. OHG, Munich. The bond is guaranteed by Telefónica Deutschland Holding AG, Munich. TDF does not have any own employees currently. Due to the close personnel and economic links, the probable business development of the Company as well as the main opportunities and risks correspond to those applicable for Telefónica Deutschland Holding AG. On the basis of the issue which has been carried out, management of TDF overall considers that the business development is positive; this assessment is confirmed by the successful issue of a second bond in February 2014.

Munich, April 30, 2014

O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH

- Management -

Rachel Clare Empey

Markus Haas

Albert Graf

## **Audit opinion**

We have audited the annual financial statements, comprising the statement of financial position, the income statement, the statement of cash flows, the statement of changes in equity and the notes to the financial statements, together with the bookkeeping system, and the management report of O<sub>2</sub> Telefónica Deutschland Finanzierungs GmbH, Munich, for the fiscal year from 6 March 2013 to 31 December 2013. The maintenance of the books and records and the preparation of the annual financial statements and the management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Sec. 317 HGB ["Handelsgesetzbuch": "German Commercial Code"] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, 30 April 2014

Ernst & Young GmbH  
Wirtschaftsprüfungsgesellschaft

Dahmen  
Wirtschaftsprüfer  
[German public auditor]

Vogel  
Wirtschaftsprüferin  
[German public auditor]