Telefónica Deutschland
Magazine

2014

BUILDING THE LEADING DIGITAL TELCO

Telefónica
Deutschland

The Cloud – Symbol of the Digital World.

The graphics on the cover and inside this year's annual report were generated with the help of mathematical algorithms. As artistic visualizations, they highlight the complexity, changeability and flexibility offered by the cloud. In short, they are snapshots of the digital world.

For us, the cloud is much more than just a storage facility. It stands for mobility, individuality and connectivity. It is the infrastructure of tomorrow's world. It is a symbol of the digital transformation on the road to the future.

BUILDING THE LEADING DIGITAL TELCO

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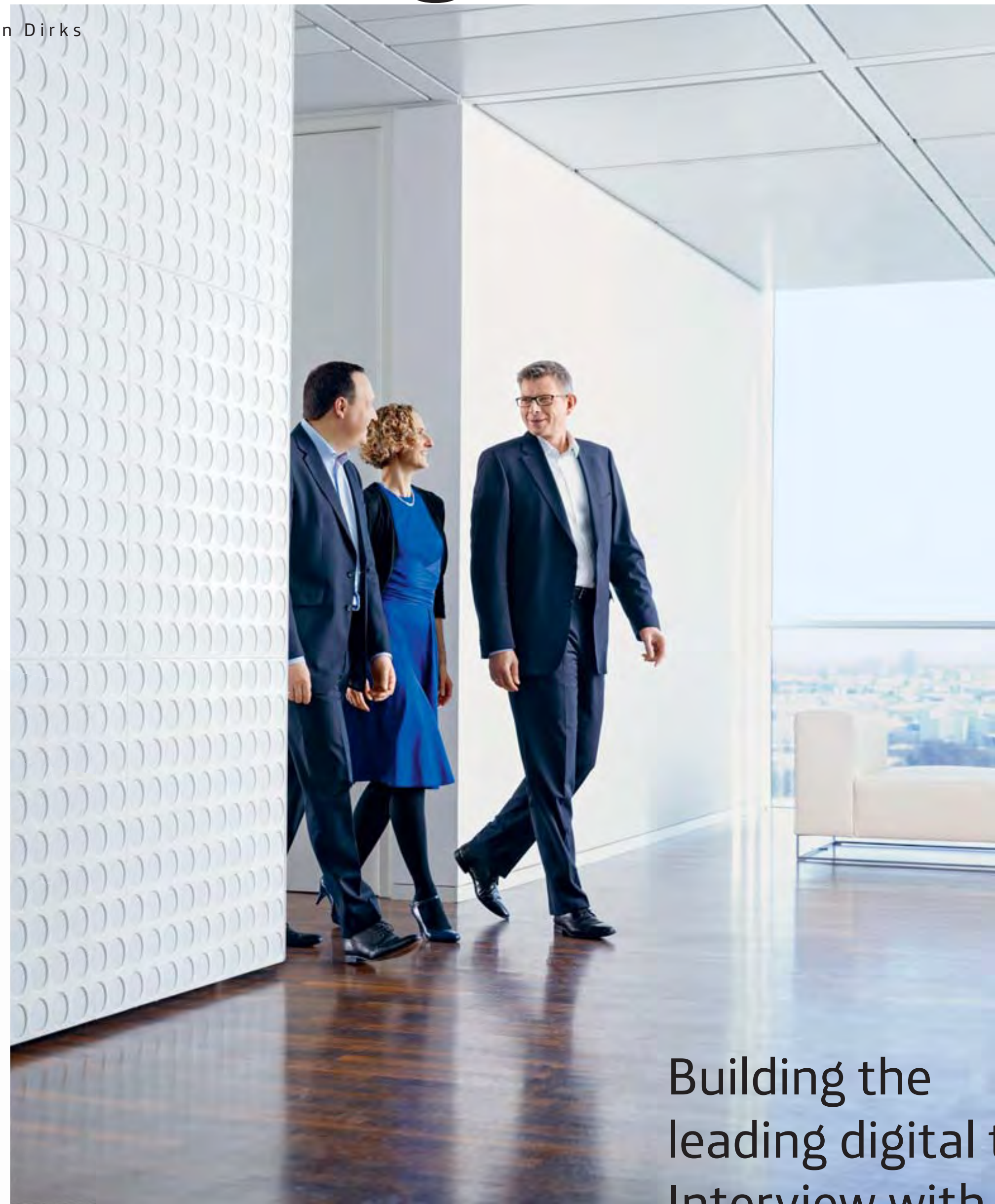
BUILDING THE LEADING DIGITAL TELCO

We have a clear vision: Our mission is to become the leading digital telecommunications company. The journey to this goal is equally clear: We must align our company systematically to the needs of our customers in the digital world.

To this end, we are building a new company with even more efficient structures and processes. In doing so, we are focusing consistently on the digital domain. We are turning two good wireless networks into one exceptional network and are investing significantly in LTE broadband technology. We give our customers easy access to the digital world, offer them guidance, and are available to assist at any time, across fixed-line or digital networks. In this way, we want to offer our customers the best experience on the market – on our network, with our service and from our products.

» We see ourselves as the pacemaker pushing forward digitalisation. «

— Thorsten Dirks



The Management Board
of Telefónica Deutschland:
(from right to left)

— Thorsten Dirks
Chief Executive Officer (CEO)
— Rachel Empey
Chief Financial Officer (CFO)
— Markus Haas
Chief Operating Officer (COO)

Building the leading digital telco — Interview with the Management Board of Telefónica Deutschland.

» We are combining the strengths of two companies. «

— Rachel Empey

Telefónica Deutschland has set itself the goal of becoming the leading digital telecommunications company in Germany. What does that mean?

— Thorsten Dirks: Digitalisation is transforming more and more areas of everyday life. This is something that is particularly apparent in our sector. The telecommunications market is going through a period of radical change with mobile internet, new digital services, and new competitors. The usage behaviour of our customers is shifting rapidly from voice telephony to mobile data services. Revenues from traditional communications services are dwindling. However, we see this challenge as a unique opportunity. Following the merger with E-Plus, we have completely repositioned ourselves as Telefónica Deutschland and can therefore actively shape this digital transformation. We have set ourselves a clear objective: We want to become the leading digital telecommunications provider. We see ourselves as the pacemaker pushing forward digitalisation in Germany. To achieve this, we will systematically streamline and digitalise our products, our processes, and, ultimately, our entire business model and the way in which we work. We believe we can leverage the integration of both companies to roll out digitalisation at full speed.

— Rachel Empey

What are the tangible benefits of digitalisation?

— Thorsten Dirks

— Dirks: Digitalisation, be it for business or pleasure, is a reality of everyday life for all of us. The core issue for us is to support the digital lifestyle of our customers as best we can. These days, they expect maximum flexibility, swift responses, and customised offerings – naturally, ones that are user-friendly and as attractively priced as possible. Those who refuse to accept this reality will sooner or later disappear into obscurity. This is why we need to be closely aligned with our customers, why we need to see things from their perspective in everything we do – which is where digitalisation has a key role to play. It offers the opportunity to create individual customer benefits on an industrial scale. This applies to our entire brand family as well as to innovative products. Our goal is therefore quite clear: by 2018, we will be the leading digital telecommunications company in the German market. At the same time, we will strengthen our position as the largest wireless provider on the market in terms of subscribers.

How will this benefit investors?

— Rachel Empey: It is obvious, that only the company that best meets the needs of its customers will also be financially successful at the end of the day. However, our investors will also benefit on other levels from the merger. Firstly, we will realise synergies with a current net value of more than five billion euros. From as early as the second year of integration, we expect to achieve a reduction in costs on a net basis. From the fifth year, we want to achieve ongoing savings in operating cash flow of around 800 million euros annually. At the same time, we will be bringing about a fundamental improvement of our competitive situation. We are bundling the strengths of two companies with combined revenues of 7.79 billion euros last year. In wireless communications, we are even the new number one based on customer numbers. This allows us to exploit economies of scale.

— Rachel Empey, Thorsten Dirks, Markus Haas

» Regardless of what the customer chooses – we want to offer the best service experience across all channels. «

— Markus Haas

Which areas are delivering the greatest synergies?

— Empey: The biggest contributor is the network. The technical consolidation and improved utilisation of our network capacities result in greater efficiency and profitability. At the same time, our customers are already set to benefit from a significant improvement in network quality over the coming months. But there are also significant synergies in other areas, such as our sales structure. Here too, as with the network, we will select the best locations to ensure that we end up with an outstanding retail network. And finally, we also see interesting growth opportunities, for instance, through increased cross-selling or in the business sector, where our new size gives us added clout.

What does the merger mean for customers?

— Markus Haas

— Markus Haas: As Thorsten has already outlined, everything we do revolves around the customer. We want to offer the best experience from our network, products, and services – at an excellent price-performance ratio as before. This means clear and straightforward offerings with a high level of flexibility. The focus here is on what we call the digital customer journey, which involves us seamlessly integrating off-line and on-line services. Regardless of what the customer chooses – we want to offer the best service experience across all channels. This also includes enabling our customers to make increased use of self-service apps in future, for example, to book tariff options. Conversely, we will make our stores appeal to the senses and offer greater scope for service and worlds of experience. We will continue to roll out and refine our successful multi-brand strategy. We will provide every customer with an offering tailored to their needs. And because we know that these needs can change quickly, we will stay in constant communication with the customer. As I said, we will support our customers with every step in their digital lifestyles.

You have set the bar very high. How do you intend reaching it in such a highly competitive environment given that you still need to complete the integration?

— Dirks: With the new management team at Telefónica Deutschland, we set ourselves three objectives: momentum, integration, and transformation. Momentum means that we set ourselves the target of not relinquishing market share from day one of the new company. But, that is not all. There are areas in which we want to systematically expand our position. Examples that come to mind in this context include the business with SME customers and our partner business. In other words, we will maintain the high performance in the market that we demonstrated prior to the merger. The second goal is the successful integration of the two companies. We want to exploit the synergies and economies of scale arising from the merger quickly and systematically, which is why we embarked on the integration immediately after the regulatory approval.

Thirdly, we intend to successfully implement our transformation into the leading digital telecommunications company. We have a head start on the competition. We are using the merger as a turning point and lever with which to position the entire company so that it can best serve the needs of customers in the digital world. Customer orientation, simplification, and digitalisation are the triad of ideas that determine our actions in the pursuit of these goals.

Speaking of momentum: Where is Telefónica Deutschland, some six months after the merger?

— Empey: With a total of 47.7 million accesses, we are – for the first time in our history – on a par with our two competitors. Consequently, we are much better able to exploit our economies of scale, and we have a very different position in the market. Based on the size of our wireless access base, we are the market leader. The focus in recent months has been to continue business operations with a high level of market success – and we succeeded in doing this. From this strong starting position, we will now continue to capitalise on our performance in the market.

What strategy are you pursuing in order to integrate the two companies?

— Dirks: With regard to the integration, there are two central principles of action at play: simplification and digitalisation. Of course, we are going to build on the strengths of both organisations. We are not simply joining the two companies together, that would be missing the point. We said from the outset that no process is set in stone. We are scrutinising each process and are putting our organisation on a new footing. It's about identifying customer needs more effectively and quickly while at the same time combining this with business excellence. Only in this way – simplification – can we create an efficient, responsive and flexible company. At the same time, we are using the integration process as a means of ensuring systematic digitalisation. This applies to every area of the business. With this in mind, we are changing the way in which we work from the ground up in order to create maximum benefit for the customer. Therefore, the integration for us is also not a sprint but a marathon. There is also something else that is very important to me in this context: As a company, we must act in a fair and transparent manner – as we have in the past. This is why we were very quick to inform the employees and all other relevant stakeholders about the next steps in the integration process.

— Rachel Empey

What has already been achieved during the integration?

— Haas: We have made a positive start – and have been driving the integration process forwards with the utmost consistency from day one. We had already appointed the first three management levels at the outset, which meant that we were able to hit the ground running. For a merger of this complexity, that is a very important factor. Just two weeks after completion of the merger, we also announced key points of our reorganisation. In early February of this year, we agreed on a framework social plan following constructive negotiations with the works councils. As a consequence, we are already in the implementation phase. There is also a lot happening on the operational side of the business. Since mid-November, for example, our sales teams have been serving business customers with a uniform product portfolio. E-Plus customers can already book DSL tariffs, and a corresponding O_2 tariff portfolio was also introduced through BASE stores several weeks ago. And the agreement with Drillisch as a partner and competitor in the telecommunications market helps us optimise our store network and brand architecture. In short, everything is proceeding fully according to plan.

When will the new wireless network be in place?

— Haas: Our current wireless networks are already extremely good, particularly with regard to customer perception. However, the merger gives us the opportunity to become even better. This is a unique opportunity for us. We are selecting the best of the existing locations and combining them to create one cutting-edge network. At the same time, we are accelerating the

— Markus Haas

roll-out of the new LTE wireless standard. Our customers will notice significant improvements as early as in the first half of 2015. We will catch up to the competition very quickly.

How are you positioning yourselves with regard to convergence?

— Dirks: Convergence is not a new concept for us. Unlike our competitors, we think about it consistently from the perspective of our customers. Telefónica customers who opt for a combination of wireless and wireline offerings have long since enjoyed benefits. We are very active in this area and will further strengthen this approach during the course of the merger to open up additional revenue potential from cross-selling and up-selling activities. Our strong cooperation with Deutsche Telekom provides us with all the technological requirements in this area, not to mention optimum flexibility in terms of configuration and scaling. This is important because customers in Germany still want flexibility, and they want the freedom to choose what meets their needs. This is why we do not offer rigid packages but combinations of individual tariffs that the customer actually needs. I would describe our approach as flexible convergence. And that is exactly what meets the needs of our customers.

The keywords from the Telefónica Deutschland strategy are customer orientation, simplification and digitalisation. How are you actually implementing these?

— Haas: Following the merger, we are positioning ourselves so that we can offer our customers the best experience, and are focusing on digitalisation. Not only are we offering digital services and solutions on the market, but we are also applying them to our own workflows. This ensures lean, efficient and flexible procedures across all parts of the business. Specifically, we have divided the market-related part of our organisation into three major segments: the private consumer segment, the business customer segment and, finally, the partner business. It is important that each of these segments takes end-to-end responsibility for the customer. In this way, we can ensure that, from marketing and sales to service, we operate consistently for each target group.

How is the company positioning itself in the business customer segment and in the partner business?

— Haas: We see significant potential with business customers. In the past, we lacked the scale to hold our own with the competition. This will change quickly as a result of the merger. With O_2 Unite – a new pool-based offering for business customers – we also have a unique product that delivers genuine added value to the customer. It has a really disruptive impact. We will leverage our newly acquired scale and the global strength of the Telefónica Group to gain market share, particularly among customers in the SME sector in Germany. In the partner business, we will continue with our tried and tested strategy. With partners such as Drillisch, freenet, Aldi/Medion, Tchibo and other strong brands, we are better positioned in this segment than any of our competitors.

— Thorsten Dirks

— Dirks: Be it the partner business, business customers, or the end users – there is one concept that will drive these areas forward in future. More than any other provider, Telefónica Deutschland will focus consistently on the various aspects from the customer's perspective. That is the difference.

» We are positioning ourselves today to take our place among the leaders of digitalisation. «

— Thorsten Dirks

What does this mean for the profitability of the company?

— Empey: It must and will grow. We have the right strategy to significantly improve our profitability. However, in a mature market such as Germany, it is just as important to increase value and, with it, the cash flow. To achieve this, we will increase revenues from our existing business while at the same time cutting operating costs. Our clear objective is to be the market leader in terms of cost.

You can scarcely rely on market momentum to achieve this. The telecommunications sector in Germany has had to contend with consistently declining sales over the last few years ...

— Empey: Monetising the data business has a key role to play in this regard. We need to continue with our strategy and further intensify its systematic implementation. Our performance in the final quarter of 2014 shows that we are succeeding. Adjusted to take account of regulatory effects, service revenues in the wireless segment from October to December even show a slight increase. This is an extremely positive development that had already been indicated in the preceding quarters. Incidentally, we also anticipate a largely stable trend over the medium term. Overall, we are consistently improving our ability to generate revenues from customers' increased data usage. In this context, our focus is clearly on the existing customer base. As the number one in the wireless market with 42.1 million wireless accesses, we have enormous potential in this area – potential that we have yet to fully exploit.

What does this mean for the dividend?

— Empey: For the 2014 financial year, it is our intention to suggest to the Shareholders' Meeting a cash dividend of at least 700 million euros. And we intend to offer our shareholders attractive dividends in the future. We will definitely be maintaining our high

— Rachel Empey, Thorsten Dirks, Markus Haas

pay-out ratio in relation to free cash flow. In addition, we might consider the synergies expected to be realised from the integration when making a dividend proposal.

Let us take a look into the future: What will Telefónica Deutschland look like as a company in the medium term?

— Dirks: The fast pace of development in our industry makes it impossible to predict everything. However, one thing is clear: In three years, many areas of Telefónica Deutschland will look different than they do today. Irrespective of this, we will remain fast, agile and innovative. This is the daring spirit that is deeply rooted in our corporate culture. We are positioning ourselves today to take our place among the leaders of digitalisation – of that I am absolutely certain.

The first steps towards a major optimisation of our services have already been taken: In order to merge the networks, we identified the best 25,000 wireless telecommunication sites and are now bringing them together as we forge ahead to build the optimum network for our customers. Customers will already notice some initial improvements in the network experience as early as the first half of 2015. Products such as O_2 Unite and O_2 DSL have also been available to E-Plus customers since the end of 2014. Consequently, our customers can already experience the first positive effects of the merger.

But we want to do more: Our customers should have the best all-round service experience. We want to make it as easy as possible for them to book tariffs, order handsets, solve problems, or get in touch with us – at our shops, on the phone, or via digital channels. One factor is the need to develop an optimum infrastructure for our network of branches so that we can provide exactly what customers really need on the spot. The optimization of our brand portfolio for each target group and the ongoing expansion of our partner business ensure that our offerings reach as many people as possible.

MO MEN TUM

Digital living – well connected throughout everyday life

— We are living in the age of digitalisation. With smartphones and tablets as our permanent companions, we can communicate at all times, wherever we may be. But today's mobile technologies can do a whole lot more besides. Junior manager Anna from Berlin shows how intelligent digital solutions based on telecommunications services can enrich our everyday life.

A day with Anna.

7:00 AM WAKE UP

A BOOST TO START THE DAY.
I am a bundle of energy and love making the most of every second. But sometimes you need a bit of help to get out of bed. In my case, that help comes from my smartwatch, which makes sure that my day begins at 7 a.m. exactly. A quick chai tea and I'm nice and awake.

Smartwatch

— Mobile fitness device, music player, alarm clock and much more
— For Android and iOS operating systems
— Growing number of new app-based functions

Napster Music
flat-rate with O_2

— Share and listen to music anywhere
— 25 million songs
— For smartphone, tablet and PC

8:30 AM
EARLY EXERCISE

A BREATH OF FRESH AIR.
The best ideas come to me when I am outside jogging. The landscape, the people, the architecture – all of this inspires and relaxes me. With my favourite music in my ears, the thoughts flow freely. A convenient touch: My smartwatch is my alarm clock, mp3 player and personal trainer, all in one.

Zattoo Live TV from BASE

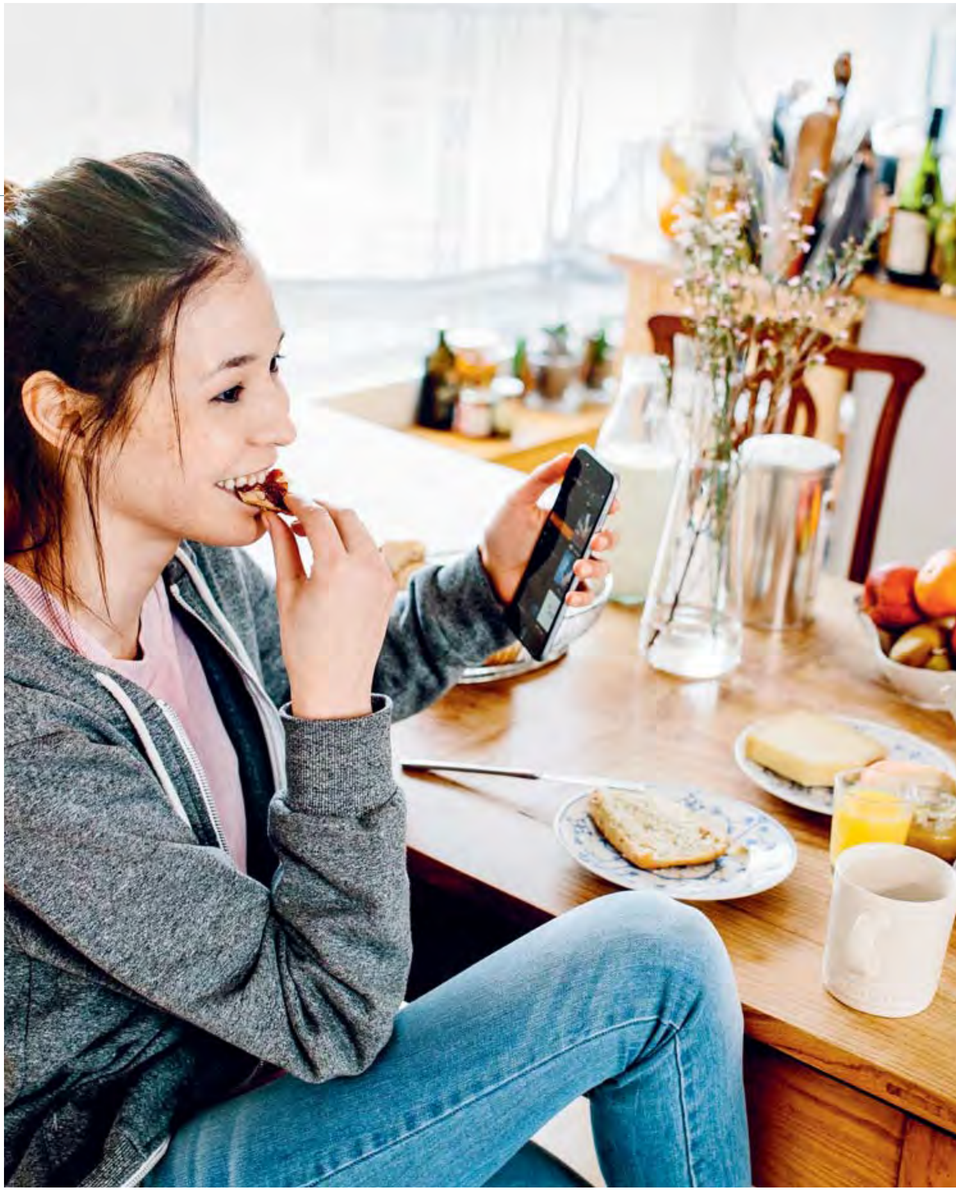
— Television for home and when travelling
— 28 channels in HD quality
— For all devices: Smartphone, tablet, computer, Xbox or smart TV

ALWAYS UP-TO-DATE.

You can't beat a varied breakfast. I do my planning for the day over orange juice and muesli. And I even have time to catch up with the favourite show I missed yesterday on my smartphone. Zattoo Live TV means I am always up-to-date.

10:00 AM

BREAKFAST



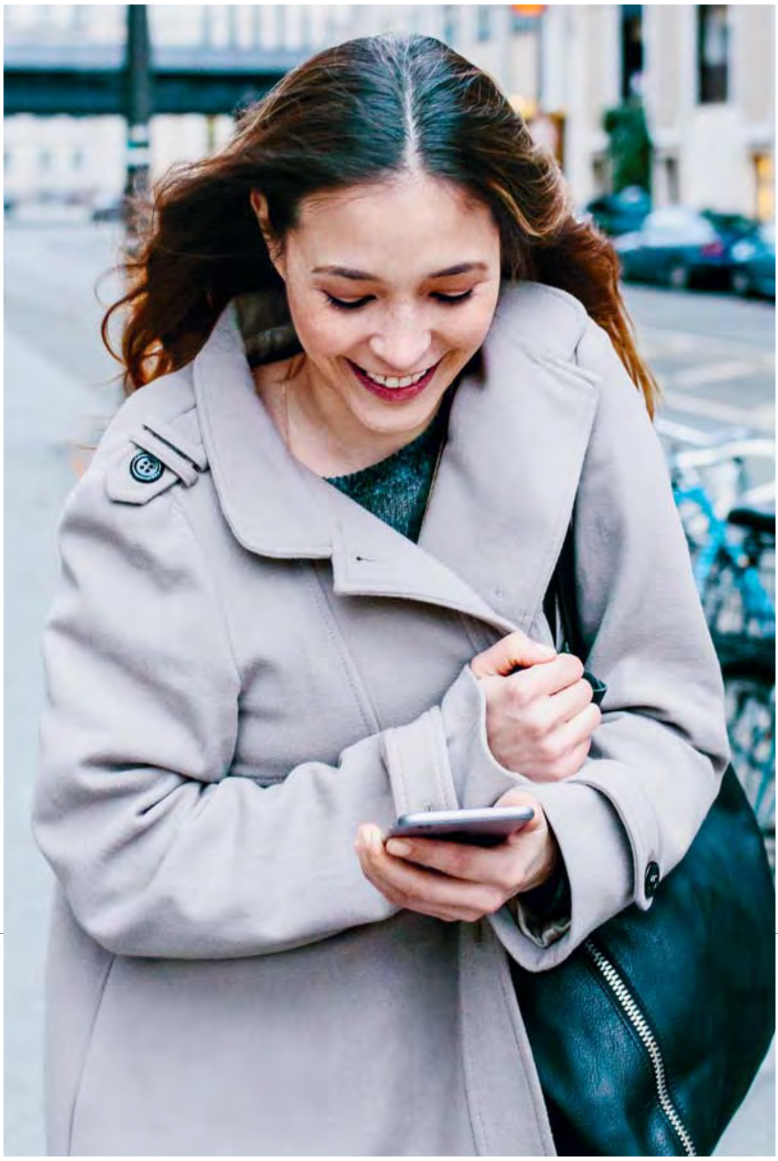
O₂ Car Connection

- Turns every vehicle into a connected car
- Vehicle diagnosis, driving style analysis, vehicle locator and much more
- Gives tips for optimising driving and saving fuel

11:45 AM ON THE MOVE

WHERE IS MY CAR?

Yes, I can be forgetful. But since getting O_2 Car Connection, I can always find my car. A click on the smartphone app and I can see where I parked last night straight away. No more need for searching – which helps me get to work on time.



1:30 PM
SHOPPING

O_2 More Local

- News and special deals from stores in the area
- Attractive offers by SMS or MMS
- Free service that can be cancelled at any time

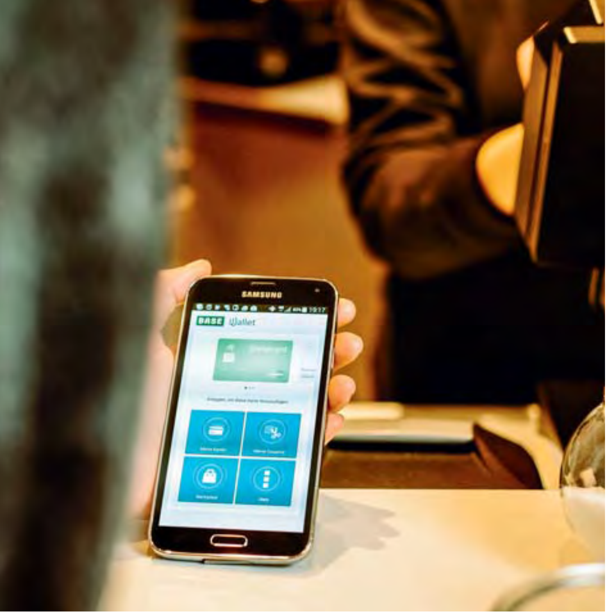
A BIT OF SPONTANEOUS LUNCHTIME SHOPPING.
Because my job tends to keep me busy, I don't like wasting my time on shopping. Instead of walking around crowded stores for hours, I prefer to shop with a specific aim in mind. This is where O_2 More Local comes in. Offers and discount campaigns from stores in the area are sent straight to my smartphone – giving me time for a bit of spontaneous shopping even in my lunch break.

Tablet with tariff
from O_2 or BASE

— High-speed surfing
— Mobile streaming of videos
and music
— Various tariff options

3:00 PM
MEETING

MEETING AT A CAFÉ.
I like technology that is intelligent and makes my life easier. As well as letting me surf the Internet and read newspapers, my tablet serves as my mobile office. So I can go through a presentation with my colleague and complete a calculation for a customer, all while sipping on a cappuccino.



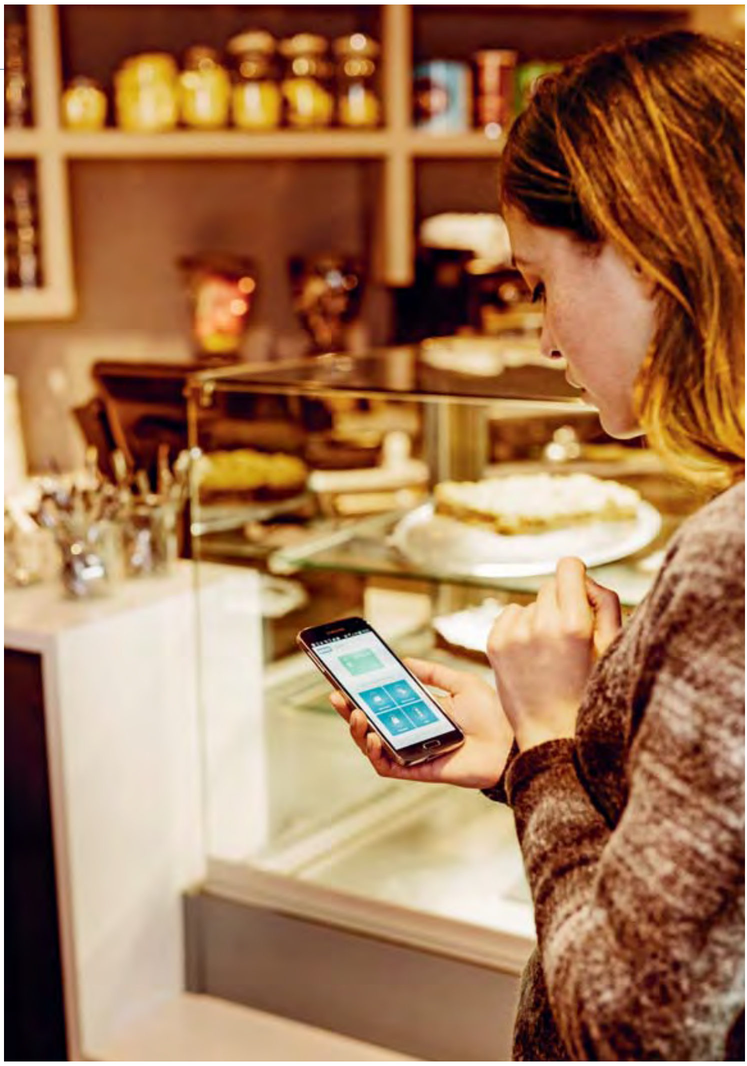
BASE Wallet/O_2 mpass

- Cashless payments by smartphone
- Secure data encryption
- Membership cards and bonus programmes are stored digitally (BASE Wallet)

5:45 PM CLOCKING OFF

ALL CLEAR …

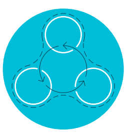
… for the end of my working day. I pay my bill at the café quickly and easily with the BASE Wallet on my smartphone. The digital wallet means I don't have to carry loose change around with me. The plan for tonight is a trip to the cinema and a leisurely meal with my boyfriend. We've already arranged when to meet by telephone – a comparatively analogue way of doing things, I suppose.



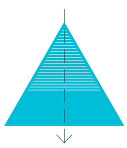
Digital Simplicity – Less complexity for our business customers

— Following the merger with E-Plus, Telefonica Deutschland has also set itself ambitious targets in the business segment. With the help of innovative products such as O_2 Unite and Digital Phone, we offer companies optimized solutions for digitalisation.

The digitalisation of communication is becoming an increasingly important issue for companies. Greater mobility is not just confined to data. With increasing regularity, today's employees are also working at locations and on devices that can change. Telefónica Deutschland is repositioning itself as a leading digital telecommunications provider, making it the ideal partner for companies negotiating this fundamental shift in communication. »We call it digital simplicity,« says Timo von Lepel, Director of Business Customers. The goal in this case is to reduce complexity for the customers. Accordingly, most products can be managed digitally and adapted to the changing needs of the digital world. »Our customers should be able to concentrate on their core business. Everything else is up to us,« emphasises von Lepel. As part of the international Telefónica Group, Telefónica Deutschland is also well positioned to serve the telecommunication needs of multinational enterprises. —— The growth targeted in the business segment is supported with expanded personnel and structural resources. Above all, Telefónica offers new and innovative products for businesses. O_2 Unite is one example. With the new pool-based tariff, companies no longer need to agree an individual contract for every employee. Instead, they can book an overall pool of voice and data connections that is then shared among all employees. »As a company, I am now much better able to plan and optimise the use of the capacities purchased,« says von Lepel. Customers of O_2 Unite include companies such as Heraeus and westrans Speditionsgesellschaft. Another example is Digital Phone: This innovative solution puts the telephone system into the cloud. As a result, employees can always be reached on the same number – regardless of whether they are communicating via mobile phone, fixed lines, or another device. —— The merger with E-Plus is opening up new horizons. Since November last year, business offerings from Telefónica Deutschland are also available from E-Plus. This will help further accelerate the company's growth path in the business segment.

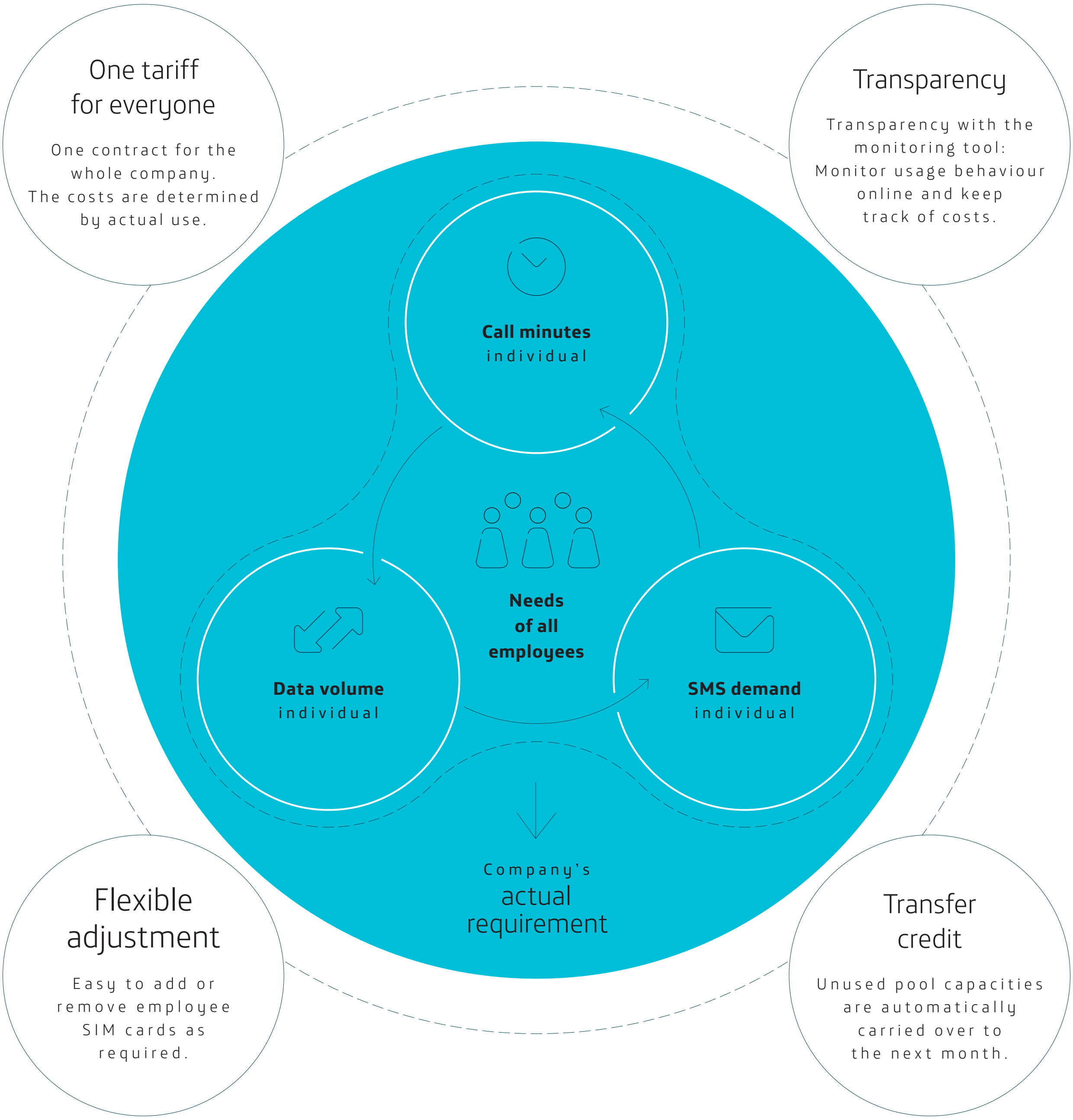


One company, one account:
With **O_2 Unite**, companies no longer need individual tariffs.



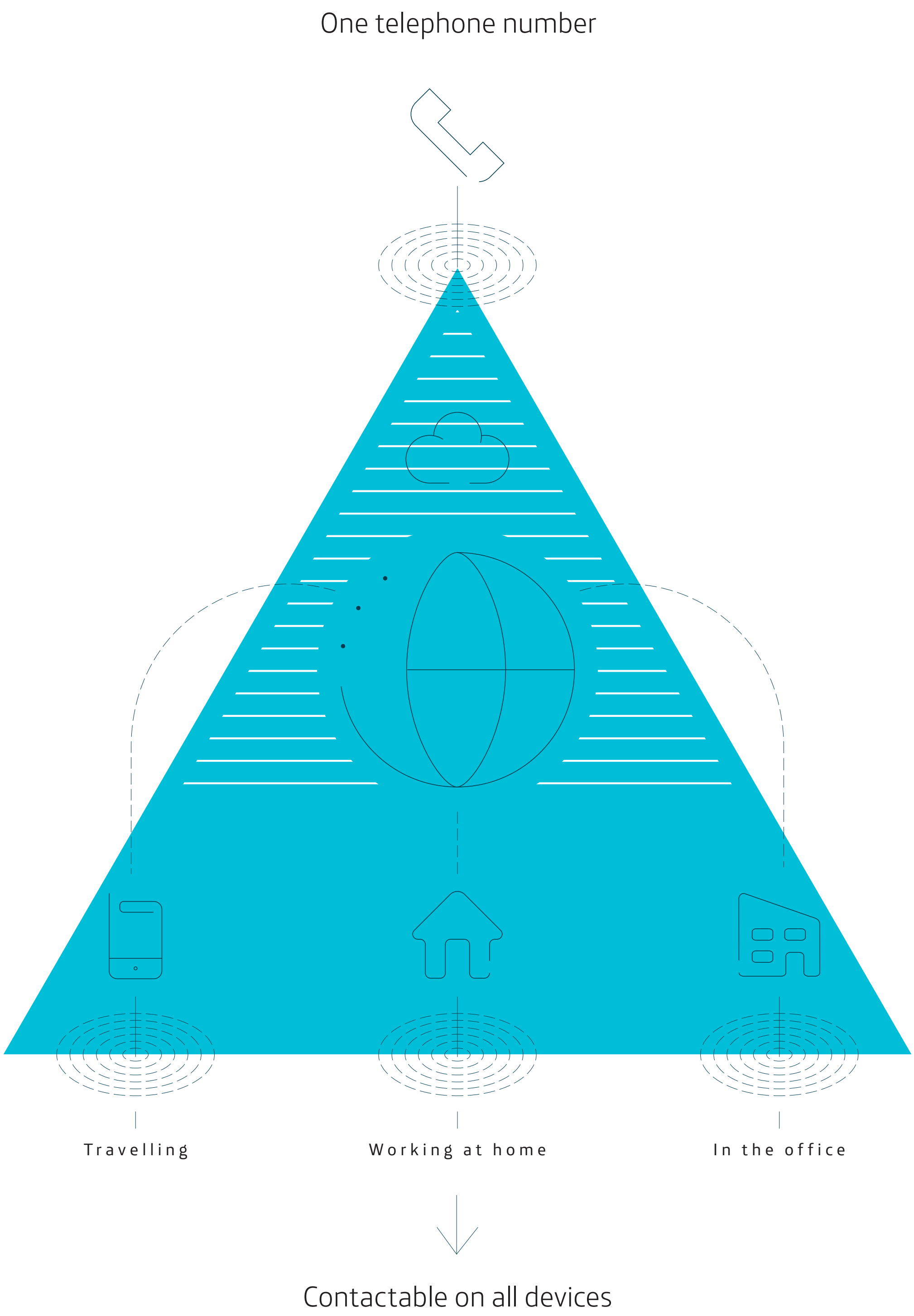
One number, contactable everywhere:
Digital Phone offers companies all the benefits of a virtual telephone system.

O_2 UNITE



— The pool-based O_2 Unite tariff is revolutionising the business segment. Instead of dealing with complex individual tariffs, companies agree an overall contract for the entire company. This enables telecommunication costs to be significantly reduced.

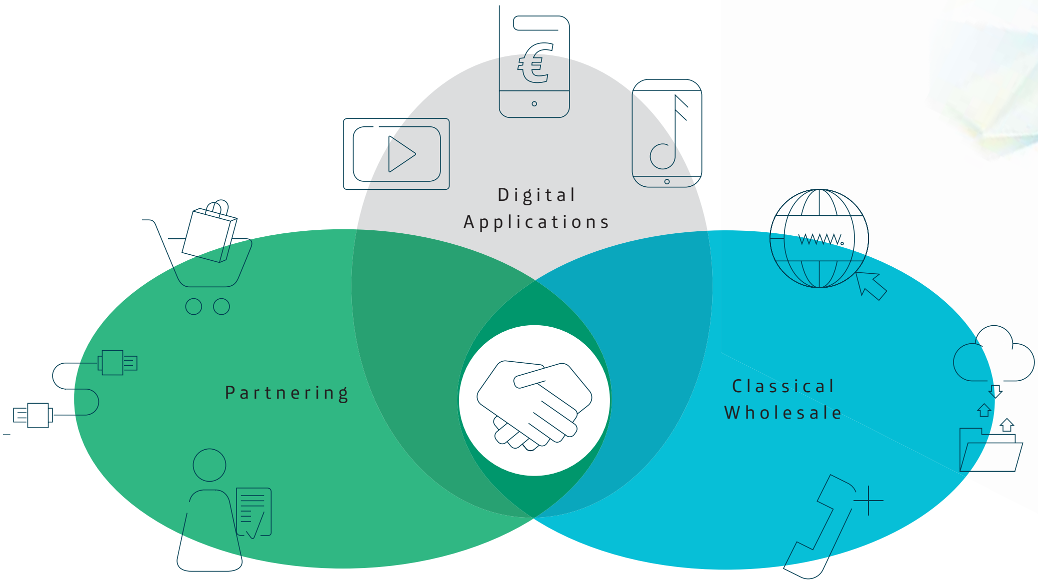
DIGITAL PHONE



— With Digital Phone, business customers receive an ultra-modern cloud-based telephone system with 160 high-end functions. Regardless of whether they are on fixed lines, mobile phones or other extensions, employees can always be reached on the same number.

Premium Partnerships

— No other network operator in Germany maintains as many successful wholesale collaborations and partnerships as Telefónica Deutschland. We will also develop this leading position consistently into the future.



A key pillar of the success of Telefónica Deutschland is the partnering business. With flexible business models such as Branded Reseller, Service Provider and Mobile Virtual Network Operators, we offer wholesale products and sales partnerships for telecommunication services to our partners, who then sell them to end users. This is based on a scalable business model that enables interested parties to enter the German telecommunications market at different value-added levels. In this case, both sides can bring their strengths to bear: Telefónica Deutschland provides the infrastructure and many years of experience acquired from successful collaborations. Our partners contribute their brand or distribution channels, for instance. Examples include telecommunications offerings for the most diverse customer segments under leading brands such as AldiTalk, Lidl Mobile, Tchibo Mobil, Ay Yildiz or Ortel Mobile, which we implement through partnerships or equity interests. Other cooperation partners from the telecommunications sector include mobilcom/debitel, Drillisch, 1&1, Versatel, Breko along with various cable providers. These partnerships enable Telefónica Deutschland to address customers across specific segments and to better serve their needs. —— We are also developing new digital applications for the entire Telefónica Deutschland brand and partner portfolio. These include digital offerings and services such as music streaming, mobile payment, digital content, and security offerings that enrich and simplify the lives of our customers. At the same time, these applications serve to strengthen customer loyalty to Telefónica Deutschland. —— Finally, our International Roaming service ensures that our customers can make phone calls, send SMS, and surf the web anywhere across the globe. We have concluded over 500 contracts with providers from around 200 countries. Another important business activity is Carrier Management, which enables telecommunications providers to ensure that their customers can make calls from one provider to another. In addition, this division allows us to market the next-generation fixed-line portfolio through which we are rolling out high-speed data connections to end users based on the VDSL broadband standard.

Experience shows that integration processes are successful when implemented according to a clear plan and, above all, quickly. During the merger of Telefónica Deutschland and E-Plus, a strong management team applied a clear strategy for the company from day one. A standardised procurement process for all parts of the business ensured that we exploited the economies of scale effectively from the outset. At the same time, the reduced complexity and increased digitalisation of processes will enable us to continue offering our customers the best price-performance ratio in the market.

The swift and determined implementation of the integration plan shows that Telefónica Germany is on the right track to realize the synergies announced with a net present value in excess of five billion Euro and a run rate of 800 million Euro operating cash flow over the next five years.

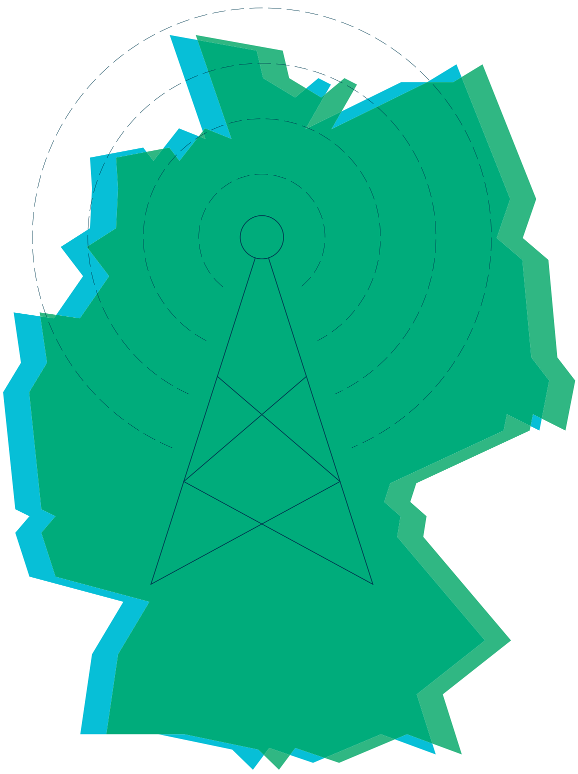
INTEGRATION

Closer to the Customer

— Telefónica Deutschland has set itself the goal of giving customers the best experience with its network, products and service. To this end, we are using the merger with E-Plus to optimise our position in the market. What this means for our customers is demonstrated by the following three examples: network, LTE roll-out, and stores.

A NEW NETWORK

How we are building the perfect wireless network from two strong networks.



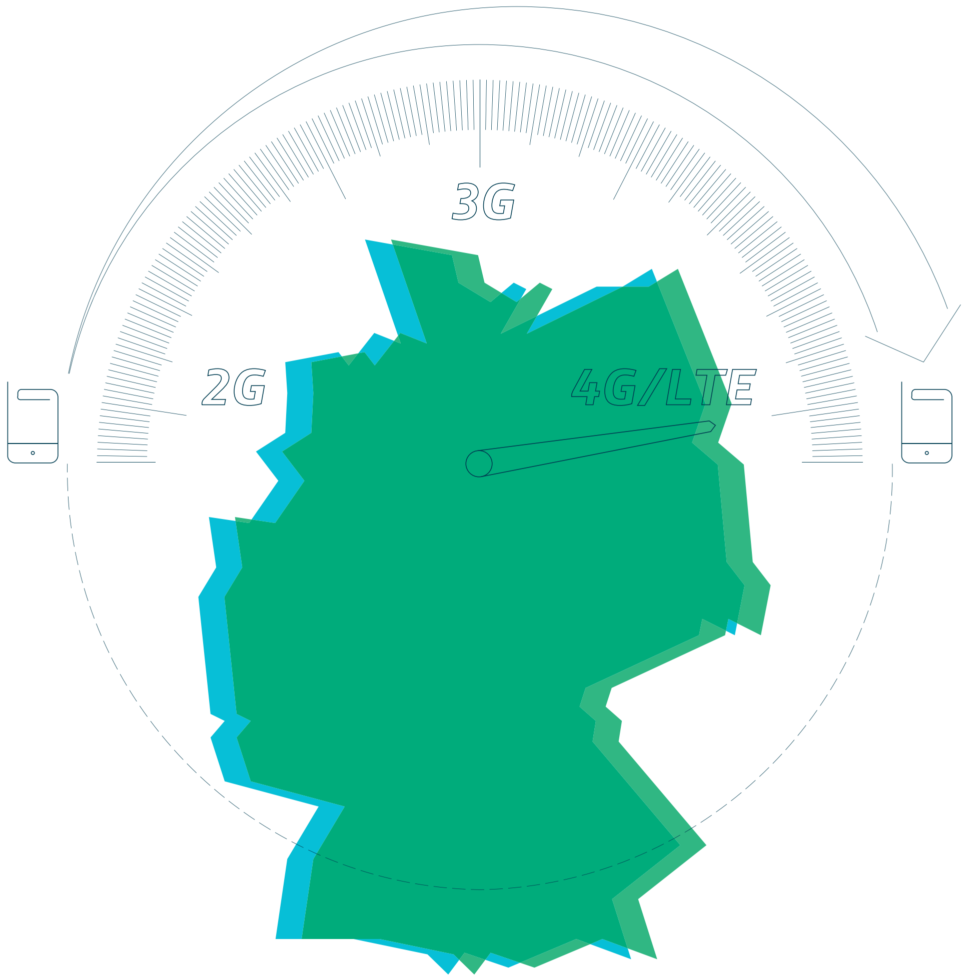
Network quality is one of the most important criteria when customers rate their wireless provider. Reliable and fast voice and data connections are the key to customer satisfaction. Telefónica Deutschland has therefore set itself the goal of providing the best network experience in the German market. The merger of Telefónica Deutschland and the E-Plus Group provides us with a unique opportunity to achieve this: We are selecting the best 25,000 sites from the existing networks and will combine them over the coming years to create a single optimised wireless network. This will improve the network's quality, that is, its coverage and capacity, while at the same time driving down costs. The merger of two networks presents a logistical and technical challenge. For this reason, our new wireless network will be carefully planned and gradually expanded, with minimum disruption to our customers. National roaming marks a first noticeable improvement. From April, customers from the O_2 network will automatically have access to the E-Plus UMTS network – and vice versa. This will deliver much-improved network coverage. In particular, delivery of 3G mobile data services will be significantly enhanced.

In the future, our customers will benefit from the best network experience. Starting in April, we will combine the two existing UMTS networks with »national roaming«.

The coming years will see us build the perfect wireless network for our customers. To achieve this, we are choosing the best 25,000 sites in Germany.

EXPEDITED LTE ROLL-OUT

Since our network is becoming more efficient, we can roll out the LTE data turbo more quickly.



The ability to supply mobile data is becoming ever more important – for our customers, who are increasingly using smartphones and tablets to access mobile internet services – but also as a source of revenues for us as a company. By utilising the resources released from the network merger, we can increase our investment in new technologies. The key to this is the current wireless standard Long Term Evolution, or LTE for short. This technology not only enables much faster data transfers – delivering even better performance for mobile users of video streaming and data-intensive applications. LTE is also future-proof because it allows for a more efficient network architecture and can handle much larger data streams. Today, we already cover 62 percent of the population with LTE. By the end of 2016, we will achieve LTE coverage outside of buildings of even up to 90 percent. In the next five years, we will have implemented our vision of a fully integrated, high-speed mobile network.

With the new LTE wireless standard, our mobile customers can surf the web and stream videos even faster and more conveniently.

We already cover 62 percent of the population with LTE. In the next five years, we will have implemented our vision of a fully integrated, high-speed network.

THE STORE AS A WORLD OF EXPERIENCE

In the future, we will offer our customers even better service, advice and, in particular, experiences in our stores.

Telefónica Deutschland wants to inspire customers and at the same time provide the best experience in the market. To do this, the company is pursuing a multi-channel strategy that seamlessly integrates online and offline channels (see page 44, »The customer decides how to communicate with us«). The stores and partner stores have an important role to play in this regard. Telefónica Deutschland will develop them increasingly into experiences in which customers can not only try out products but also participate in workshops, for example. Other concepts to be rolled out include BASE wireless experts or O_2 Guru: These are interested customers or specially trained employees with expertise in particular topics, who can offer customers advice and assistance. The experience acquired from the existing Concept Stores, which already offer customers an exciting experience covering all aspects of telecommunication, will feed into the new store concept. The company will also benefit from synergies in sales. To this end, the coming years will see us divesting ourselves of around one third of the stores and partner stores that will no longer needed to provide optimum customer care. Customers will continue to find stores in their immediate vicinity. Telefónica Deutschland will continue to be represented nationwide with an excellent store network in the future.

In the future, our stores will not only offer customers service and advice but increasingly also experiences.

Workshops and events will bring people even closer to the fascinating world of telecommunications at Telefónica Deutschland.

New perspectives

— For companies, change brings challenges but also new perspectives and opportunities. Three employees report on how the merger of Telefónica Deutschland and E-Plus has changed their lives for the better.

— Stefan Kolm,
HR Project Manager
Organization & Change

Teamwork

I work in Human Resources and had contact with our new colleagues from E-Plus at a very early stage. We met in person for the first time a few days after the legal merger. I think this is important, because you have to get to know each other if you want to work together successfully further down the line. I was impressed by the strong teamwork right from the start. —— The specific project for which I am responsible concerns the introduction of a new, overarching software solution that allows all phases of the employee cycle to be managed, from appointment and further training through to the employee's eventual exit. We previously had different software for all of these areas, which is obviously far from ideal. My project has an international focus. The new software will be rolled out throughout the Telefónica Group. —— It goes without saying that we want the new Telefónica Deutschland to use the best solution right from the start. This is why I am working in extremely close cooperation with our colleagues from E-Plus. Naturally, we use digital applications to ensure that we are all on the same page even when working remotely. For teleconferencing, for example, we have a piece of software that allows desktop content to be shared in real time, so everyone can see what we are working on and is always up-to-date. —— What I like about our colleagues from E-Plus is the constructive questions they ask. It is clear that we complement each other well, and that we can achieve very good results together through pragmatic, practice-oriented action combined with the strengths of an international group and taking the needs of all stakeholders into account. For me, this represents the very ideal of teamwork.

Internationalism

Of course we had international projects and contacts at E-Plus, but the merger with Telefónica Deutschland has increased the international content of my work substantially. Right now, in fact, I am working on a project where we can play a pioneering role within the Telefónica Group in Germany. It concerns the introduction of a universal software solution for merchandise management, logistics, bookkeeping and sales. This is one of the components that will drive our development into the leading digital telecommunications company. —— I am responsible for a team of ten people dealing with SAP software within the company. This means we are building a platform to allow us to present our processes in digital form as universally as possible. What does this mean specifically? We are developing software solutions so that everything works seamlessly in the background. This means that, when a customer visits a shop, exactly the smartphone he or she ordered is guaranteed to be in stock. It also ensures that around 150 million payments can be collected from our customers at the end of the month without difficulty. At E-Plus, we had made considerable progress in this area and had already attained a high degree of automation. As well as being able to support our colleagues in Munich, this means we are also participating in a Telefónica Group project aimed at achieving an integrated solution for the European market. As we have extremely stringent data protection requirements in Germany, this is another area where we have been able to contribute our expertise. I think we will start to see solutions to this challenging task in the very near future – as is expected of us. —— I find the new role very exciting, particularly because it also gives us the opportunity to work in an extremely international environment. It sharpens our English skills and other cultures get added to the mix. You start to notice just how German you are in some ways. For me and the entire team, this is an excellent opportunity to take part in an international project of this nature. Open up your mind – that's what it's all about in the end, and precisely what makes the task so intriguing and interesting.

— Astrid Schmitz,
Team Leader
Development
Enterprise Services

— Tobias Seifert, Team Sales Manager Business Customers

Product diversity

What has improved? From my point of view, certainly the product range. I work in sales for business customers and manage a team of seven sales representatives, covering the far north. Our customers are traditional SMEs, mostly with between ten and 100 employees. Since the merger, we offer not only E-Plus products, but particularly also products from Telefónica Deutschland. This is a fantastic development because, among other things, it means we can now offer fixed-line solutions using in-house products. When I visit a customer today, I can quite simply say: Of course we also can do that for you! —— At E-Plus, we were always successful in the business customer segment. What sets us apart is our highly flexible and target-oriented approach. However, one example of something we always lacked was the right convergence offers. —— Telefónica Deutschland's products mean that we now find ourselves at least on an equal footing with the competition, if not better off. O_2 Unite is undoubtedly the best product on the market right now: As a pool-based tariff, O_2 Unite is ideal for companies because it allows them to precisely plan their consumption and their costs. Digital Phone from O_2 is another strong, innovative product. It allows customers to be reached using the same extension regardless of whether they are on their office fixed line or out of the office on their mobile phone, with capacity for up to nine devices. —— Of course, it was a big step for me to suddenly find myself selling the products of a former competitor after 14 years with E-Plus. But I can already say that it has been a positive step. It is hugely exciting and motivating for me and my team to be able to go to the customer with such a strong product portfolio. The response from businesses has been extremely positive. The planned combined network means we will soon also be one of the leaders when it comes to network quality. Then we will have all the tools we need to truly inspire and impress our customers. A success-oriented sales representative could not ask for anything more.

Innovations for our Customers

— Since their foundation, Telefónica Deutschland and E-Plus have stood for innovation and change in the telecommunications market in order to benefit customers. This questioning mindset is deeply rooted in our corporate culture and will also shape our future. We look back over two decades of innovation.

2014 — O_2 Car Connection
Remote diagnostics for passenger cars via smartphone app

2014 — curved.de
Innovative content portal for the digital lifestyle

2014 — Wallet
Mobile payment system

2014 — O_2 Unite
Abolishes individual tariffs for companies

2013 — O_2 More Local
Redeem special offers from retailers directly in the locality

2013 — O_2 Blue
Inclusive flat-rate for telephony and SMS

2012 — mpass
Mobile payment system

2009 — O_2 My Handy
Mobile phone without a contract

2009 — O_2o
Abolishes the basic monthly fee

2005 — BASE
Germany's first flat-rate wireless brand

2005 — simyo
The first online wireless discounter

2005 — Ay Yildiz
The first (ethno) wireless brand for the Turkish community

1999 — Invention of the Homezone

The merger of Telefónica Germany and E-Plus is about more than just synergies and economies of scale. We see the merger of two strong companies as a unique opportunity to drive the systematic digitalisation of our business model and our organization, and to align it with the needs of customers in the digital world. This includes and affects all areas of the business, from the network and IT infrastructure through to sales and customer services all the way to corporate processes and culture. Essentially, we are building a completely new company. A company with lean, efficient structures, and digital, service-oriented processes. As a result, we can set ourselves apart from the competition and take our place among the leaders of digitalisation.

TRANS FOR MA TION

Making things easy

— To ensure the successful digitalisation of our company, we must streamline our processes and procedures at a fundamental level. With this in mind, we are using the merger of Telefónica Deutschland and E-Plus as a platform on which to reposition our products and services so that they blend seamlessly with the usage behaviour and the wishes of our customers in the digital world. The following pages present examples of how we are already successfully implementing this transformation today.

TARIFF PORTFOLIO

LESS IS MORE: CLARITY IN THE TARIFF JUNGLE

Over the years, a telecommunications provider accumulates a large number of old tariffs and special options that have since been superseded by newer and better offers. This tariff jungle is not only cumbersome for employees and retail partners but also confusing for customers. It also ties up IT resources and slows down corporate change processes and innovation cycles. As part of the transformation project, we have therefore significantly reduced the number of tariffs and options – without curtailing the diversity of offerings to our customers.

40%

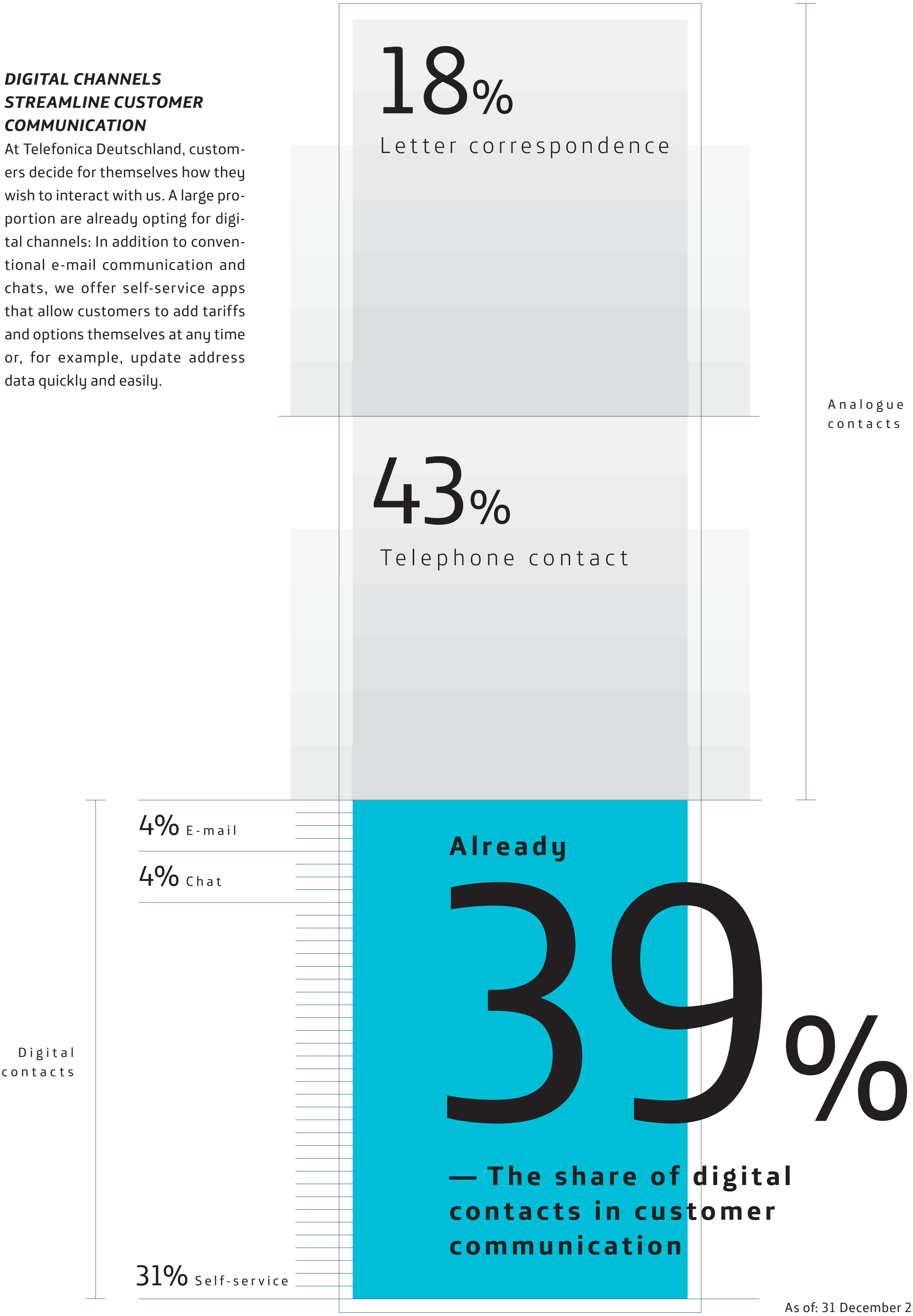
— fewer tariffs but equally diverse offerings

As of: 31 December 2014

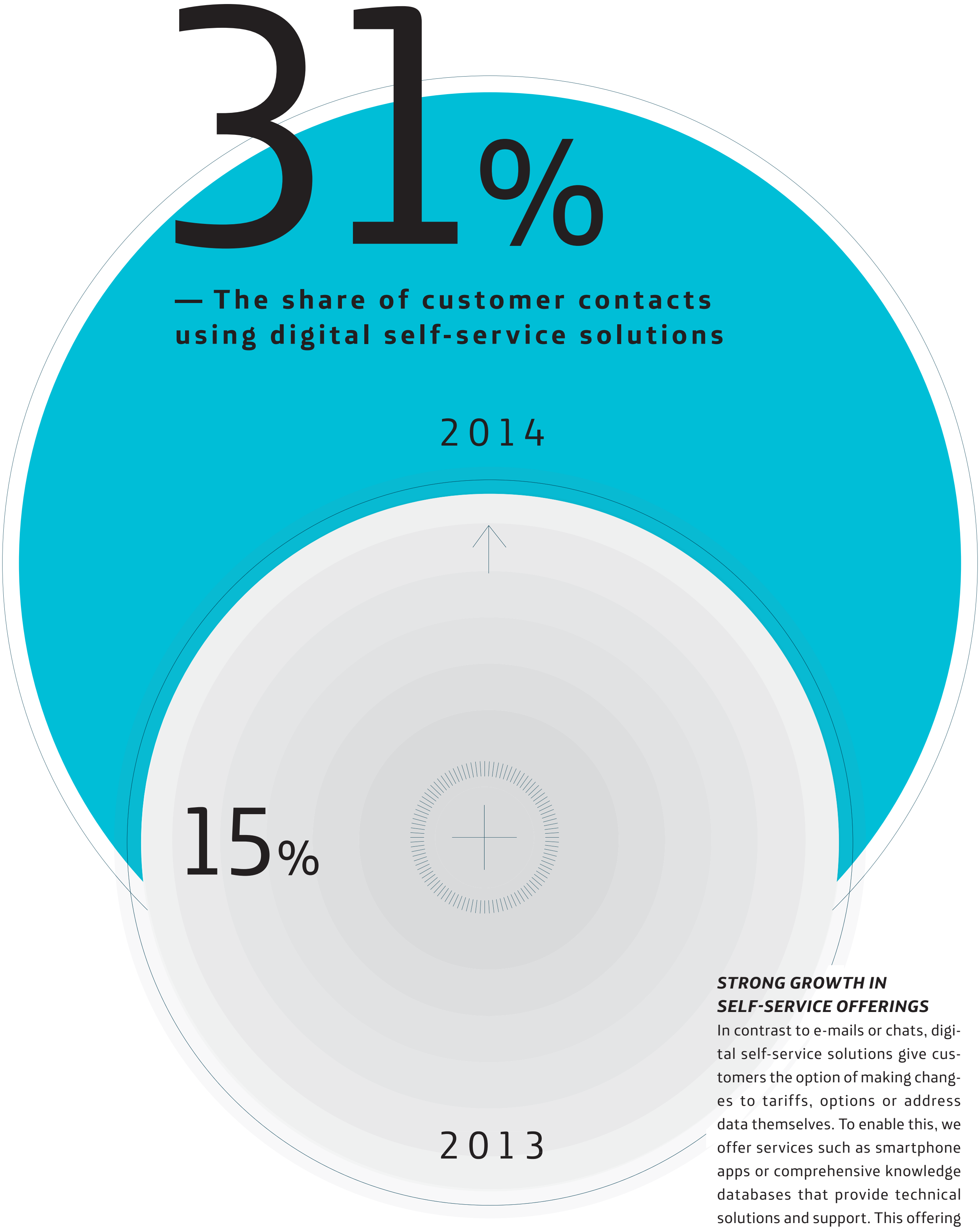
CUSTOMER SERVICE

DIGITAL CHANNELS STREAMLINE CUSTOMER COMMUNICATION

At Telefonica Deutschland, customers decide for themselves how they wish to interact with us. A large proportion are already opting for digital channels: In addition to conventional e-mail communication and chats, we offer self-service apps that allow customers to add tariffs and options themselves at any time or, for example, update address data quickly and easily.



As of: 31 December 2014



STRONG GROWTH IN SELF-SERVICE OFFERINGS

In contrast to e-mails or chats, digital self-service solutions give customers the option of making changes to tariffs, options or address data themselves. To enable this, we offer services such as smartphone apps or comprehensive knowledge databases that provide technical solutions and support. This offering is proving popular with our customers: Since the beginning of 2013, the proportion of digital self-service customer contacts has more than doubled to reach 31 percent.

As of 31 December 2014 year on year

LEAN START-UP

LEARNING FROM START-UPS: LOWER DEVELOPMENT COSTS

Speed and flexibility are increasingly important factors in telecommunications. For this reason, Telefónica Deutschland is applying strategies employed by start-ups in order to accelerate the development process and product launches. The lean start-up method begins by testing simple introductory versions of new products and services on the market. Those that prove to be sustainable are then perfected as end products. One advantage: The costs of product launches are significantly reduced.

5–10%

— The costs of a market test compared to a conventional product launch

2–6 weeks

— Time-to-market for lean start-up projects

24–54 weeks

for conventional projects

LEARNING FROM START-UPS: SHORTER TIME-TO-MARKET

Previously, Telefónica Deutschland needed between 24 and 54 weeks to roll out a new product. Thanks to the lean start-up method, time-to-market is now just two to six weeks. This was successfully applied in the past year, for example, with »Data Snacks« – where customers who have reached their data limit automatically receive an SMS offer to top up their data allowance until the end of the month. The lean start-up method also introduced a new process whereby new customers can register with the online portal from their mobile phone as soon as they activate their SIM card. New offerings are initially released to a small group of customers for thorough testing as part of what are called »Friendly-User Tests«. This enables errors to be avoided during the initial phase of development and provides developers with valuable insights into possible optimization strategies. In this way, we can react faster and better to customer wishes on the market.

The customer decides how to communicate with us.

— Telefónica Deutschland is systematically connecting its online and offline channels. Expert Michael Dyballa explains the benefits for the customer.

1 — INITIAL CONTACT

In the digital world, it is the customer who decides how to contact and communicate with the company. To get information on Telefónica Deutschland's products and services, customers can visit one of our stores, call our hotline or make contact via our web portal or social media.

2 — ADVICE

Whatever channel they choose, customers can pick the best point of contact for them at every stage of the customer journey. They will be advised with the same high level of expertise and service quality every time.

3 — PURCHASE

Here, too, customers who decide to make a purchase have the freedom to choose their point of contact. Our online prices are already also available in-store. And if a device is not in stock, it can be ordered online right there and then.

4 — DELIVERY

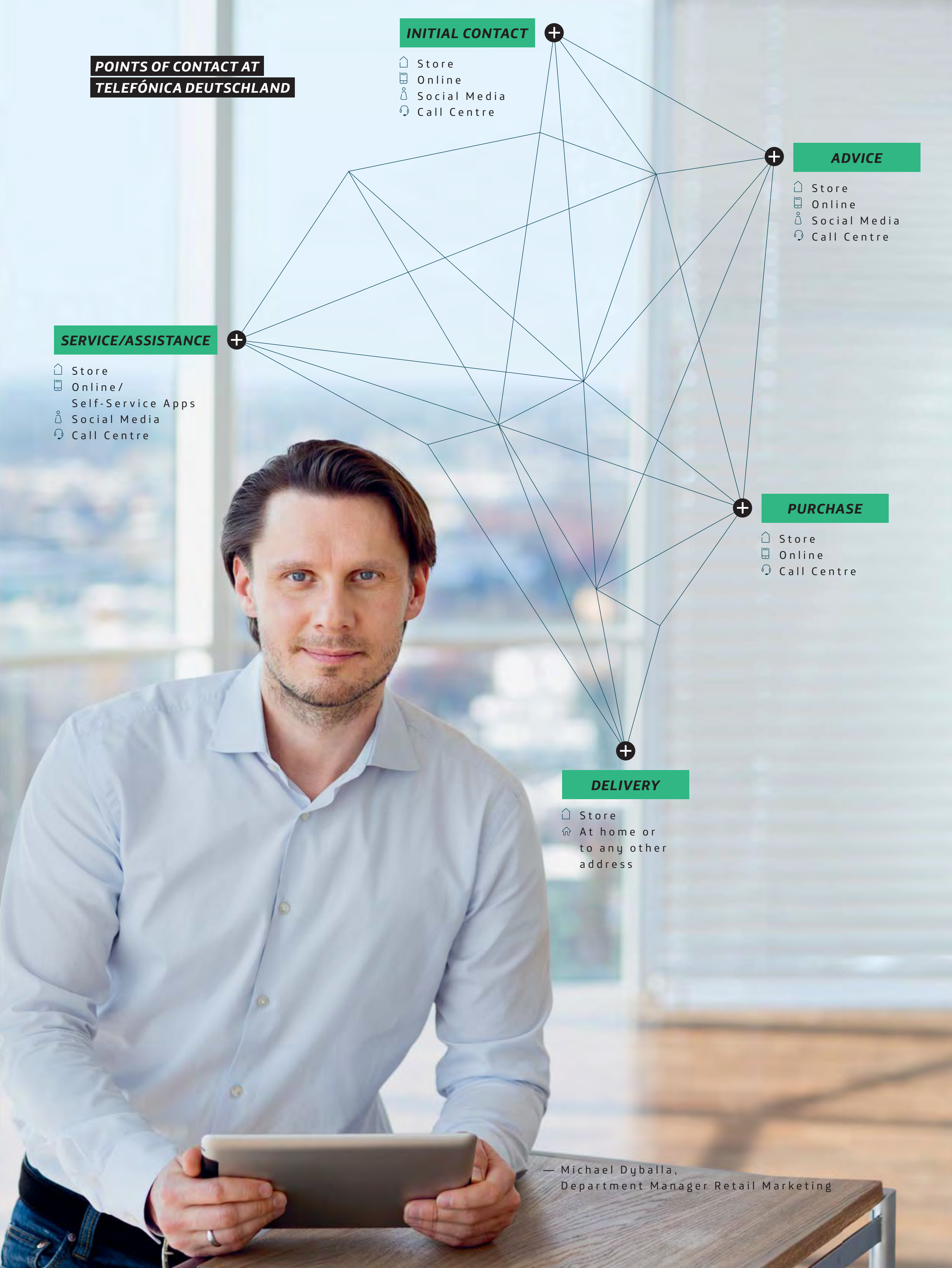
Many of our customers already prefer to collect the device they have purchased from one of our stores. As well as saving the customer a long wait, our in-store experts are provided with all of the details of the transaction in advance, allowing them to provide optimal support.

5 — SERVICE

When customers need assistance – to change their tariff or deal with a technical issue, for example – they can be sure that they will get expert help wherever they turn, regardless of the channel they used to purchase their device. For example, if customers wish to return a device they purchased online, they can do so at any store. Or they can make changes to their contact details and order additional options themselves using self-service apps. Whatever is most comfortable for them.

» A multi-channel approach is not about technical solutions. The most important thing is a focus on the customer. How and where does the customer wish to make contact with us as a company? Everything else is secondary. Online and offline channels are no longer in competition with each other, but are working hand in hand to ensure the customer ultimately gets the best service experience. «

— Michael Dyballa



— Michael Dyballa,
Department Manager Retail Marketing

THORSTEN DIRKS
has been the Chief Executive Officer of Telefónica Deutschland Holding AG since 2014. He was CEO of the E-Plus Group, which now belongs to Telefónica Deutschland, for the seven years prior to this, during which time he developed the company's successful multi-brand strategy. The qualified engineer has worked in the telecommunications industry for more than two decades. In 2009, Dirks published a book about the future of telecommunications, »Ich, Du, Er, Sie, Es und Wir: Wie wir kommunizieren werden«.

» The Internet must remain open to everybody in the future. «

— The Internet is becoming increasingly mobile, the world increasingly networked. Mitchell Baker, Chair of the Mozilla Foundation, and Telefónica Deutschland CEO Thorsten Dirks talked about the future of digitalisation and its consequences in an informal interview.

MITCHELL BAKER
is the Chair of the Mozilla Foundation, a global non-profit organisation aimed at promoting openness, innovation and equality of opportunity on the Internet. The Mozilla Foundation develops and distributes the Mozilla Firefox web browser, the Mozilla Thunderbird e-mail client and the mobile open source operating system Firefox OS, among other things, via its subsidiary the Mozilla Corporation. Baker, who is from the USA, holds a doctorate in law and is recognised as one of the most important Internet pioneers.

MOZILLA AND TELEFÓNICA ARE ADVOCATING AN OPEN INTERNET. WHAT DOES OPENNESS ON THE WEB MEAN AND WHY IS IT SO IMPORTANT?

— Mitchell Baker: The Internet as we know it today was only able to develop thanks to a philosophy of openness. It began as an unplanned mass movement, driven by human ingenuity and a refusal to settle for one central idea. This gave rise to entirely new ideas, led to shifts in markets and redefined all of our lives. Ultimately, it is not about the web but the human experience: openness gives us the opportunity to make decisions, to experiment, to influence how technology affects our lives.

— Thorsten Dirks: Openness means that the possibilities of technology should be open to everyone. We are committed to this goal. As an example of this commitment, Telefónica invested around 9.5 billion euros in broadband infrastructure worldwide in 2012, with South America accounting for around 60% of this figure. —— But network access is not the only factor. Openness also means optimal interconnectivity: e-mails and text messages can be sent and received worldwide, regardless of the e-mail provider or device used, because they are based on international and open standards. These standards are essential for a truly global Internet. At present, however, proprietary systems are becoming increasingly important, thereby placing this principle of an open web at risk.

WHY IS OPENNESS ALSO IMPORTANT FOR INNOVATION?

— Dirks: History has shown that open systems are the best way to enable and accelerate innovation – Mozilla is an impressive example of this. In my view, closed systems, and particularly technological ecosystems, are not beneficial to social development in the long run. And that is what an economic system is ultimately based on: combining benefit for consumers and society with business success and technological progress – and finding the right balance between them.

— Baker: That's true. As a small, unknown start-up, we were able to develop the Firefox web browser with the help of unpaid programmers around the world and compete with the then-dominant browser on our own terms. Without an open Internet, this would not have been possible. Innovation is difficult if you have to ask two, five or ten of the top dogs for permission first. They may have a real economic interest in keeping business to themselves to the greatest possible extent.

— Dirks: Patents are another mechanism that can be used to restrict competition and slow innovation. Patent disputes must not be allowed to prevent the digitalisation of our society and technical progress. After all, one of the defining characteristics of the Internet is that it is based on licence-free standards. These open standards also ensure the compatibility of different services and products, leading to bigger markets and more incentive for innovation.

— Baker: In the short term, a closed, centralised system may appear superior; in the long run, though, it becomes increasingly difficult to change anything, and innovation comes to a standstill. When around 97% of users had Microsoft Internet Explorer installed on their computers, development in the browser sector slowed abruptly. Now that the Internet is increasingly accessed via mobile phones and tablets, it is important that we do not repeat the same mistakes we made with the desktop.

IS THERE A RISK OF THIS HAPPENING?

— Dirks: Not immediately, but things are moving in a critical direction. Today, 90% of all smartphones run on just two operating systems: Google's Android and Apple's iOS. You are forced to use the apps for the system you choose – other apps will not work on your device. App developers are also tied to the respective system. Such market concentration has undesirable effects on competition, consumer choice and innovation.

— Baker: This is why we have developed Firefox OS, a new, open operating system for smartphones using the web as a platform: in order to show that the devices in our pockets can be as open as the web on our desktops.

— Dirks: Telefónica has supported Firefox OS from the very beginning. We want to drive the use of open technology in the smartphone sector in order to give consumers independence and freedom of choice. In many countries, particularly in South America, devices with Firefox OS are already enjoying considerable success on the market. Of course, consumer behaviour will ultimately decide. And we will follow what the consumer wants. All we can do is provide clarity and highlight the alternatives.

SMARTPHONES WITH OPEN OPERATING SYSTEMS ARE CHEAPER, TOO.

— Dirks: This is an important aspect when it comes to open access to the Internet: smartphone prices remain a significant barrier to participation in digitalisation in many parts of the world. —— Developments in the smartphone sector have a wide-ranging impact and, as Mitchell has already mentioned, we are approaching a tipping point where the majority of Internet usage will happen via mobile devices. The next two billion people will go online using their mobile phones. As such, the future of the Internet is closely linked to the future of mobile phones and operating systems.

WITH THESE DEVICES AS OUR PERMANENT COMPANIONS, WE ARE ALSO SURRENDERING MORE INFORMATION ABOUT US …

— Baker: An explosion of data, yes. What isn't clear is how this will impact the human experience on the web.

— Dirks: All surveys show that data protection is extremely important to consumers, and we feel the same way. And young people are nowhere near as careless in this respect as they are often thought to be, although it remains a very human balancing act between security and comfort. Consumers want control over their data, and they want to take their data with them when they switch devices. Ensuring that people have control over their digital life is the only way to build confidence – and confidence is essential for the continued growth of the digital economy.

» Ensuring that people have control over their digital life is the only way to build confidence – and confidence is essential for the continued growth of the digital economy. «

— Thorsten Dirks

SECURITY AND PRIVACY ARE ALSO KEY ASPECTS OF INTERNET GOVERNANCE. HOW DO YOU THINK INTERNATIONAL COOPERATION ON THE REGULATION OF THE INTERNET SHOULD BE ORGANISED?

— Dirks: Any regulatory system must take account of the rapid technological and social changes in the digital era. It must be flexible enough to enable further development, and it must create fair conditions that provide security for private investors and ensure equality of opportunity for all. In our view, a multi-stakeholder model that also involves civil society and various stakeholders is more suitable than cooperation at governmental level alone.

— Baker: I agree entirely. I find it impossible to imagine how a government-only process can result in anything other than big trouble for Internet development.

THIS DEVELOPMENT IS ALSO AT THE HEART OF THE CURRENT DEBATE ON NET NEUTRALITY, I.E. THE EQUAL TREATMENT OF ALL DATA IRRESPECTIVE OF ITS CONTENT, SENDER OR RECIPIENT. WHAT DO YOU THINK OF THE IDEA OF DIFFERENTIAL INTERNET SERVICES – IF YOU PAY MORE, YOU GET A BETTER SERVICE?

— Baker: I truly hope that net neutrality will be maintained. Net neutrality is essential in order for someone with no money but a good, innovative idea to be able to reach potential consumers, like they can now.

— Dirks: We are in favour of net neutrality insofar as we believe customers should have unrestricted access and there should be no discrimination of any kind. However, there should also be room for new business models that allow differential pricing and quality at the express wish of the customer or service provider. This requires clear and transparent information so that consumers can select the service that is most suitable for them – and it also requires fair competition on the market. The aim must be to provide the best possible solutions for the customer at all times within the competitive environment.

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Telefónica Deutschland
Annual Report

2014

BUILDING THE LEADING DIGITAL TELCO

Telefónica
Deutschland

BUILDING THE LEADING DIGITAL TELCO

Telefónica Deutschland Group has set itself the goal of becoming the leading digital telecommunications company in Germany. We want to make it possible for all people in Germany to have access to the digitalisation of their living world – with the best experience relating to products and services, the best price-performance ratio and a network corresponding to the actual wishes of the consumer. We regard coming together with the E-Plus Group as an opportunity to push forward digitalisation more quickly than the competition and to take us to the No. 1 spot. For this reason, we consider the integration of the two groups not only from the perspective of leveraging synergies, but also as a way of simplifying and digitalising our business model. Over the next five years, we expect to realise synergies with a current net present value of more than EUR 5 billion. At the same time, we are using our potential as the largest wireless provider in Germany in terms of subscribers to generate economies of scale and to increase our profitability. To do this, we will continue to leverage potential in the existing customer base and further advance the monetisation of the growing data business. In this way, we will create long-term values for our shareholders.

www.telefonica.de/annualreport2014

Financial Highlights_

Financial Overview

(Euros in millions)	1 January to 31 December 2014	2013	% Change
Revenues	**5,522**	**4,914**	**12.4**
Mobile service revenues	3,580	2,989	19.8
Operating income before depreciation and amortisation (OIBDA)	**679**	**1,237**	**(45.1)**
OIBDA margin	12.3%	25.2%	(12.9%-p.)
Operating income	**(646)**	**105**	**> 100.0**
Profit for the period	**(721)**	**78**	**> 100.0**
Basic earnings per share (in Euros)[1]	**(0.45)**	**0.07**	**> 100.0**
CapEx	**(849)**	**(666)**	**27.5**
Operating cash flow (OIBDA-CapEx)	**(169)**	**571**	**> 100.0**
Free cash flow pre dividends[2] and pre-acquisition of E-Plus net of cash acquired	**719**	**699**	2.9
Free cash flow pre dividends[2]	**(2,521)**	**699**	**> 100.0**
Total accesses as of 31 December (in thousands)	**47,662**	**25,167**	**89.4**
Mobile accesses (in thousands)	42,125	19,401	> 100.0
Postpaid (%)	**44.6%**	**53.0%**	**(8.5%-p.)**
Total ARPU (in EUR)	**11.8**	**12.7**	**(7.1)**
Postpaid churn excl. M2M (%)	**1.9%**	**1.6%**	**0.3%-p.**
(%) **non-SMS data over total data revenues**	**71.2%**	**66.5%**	**4.7%-p.**
Employees as of 31 December	**10,936**	**5,940**	**84.1**

	As of 31 December 2014	2013	% Change
Net financial debt[3]	**3**	**468**	**(99.3)**
Leverage[4]	0.0x	0.4x	(99.2)

1 Basic earnings per share are calculated by dividing profit (loss) after taxes for the period by the weighted average number of ordinary shares of 1,620 million for the year 2014 and 1,117 million for the year 2013.

2 Free cash flow pre dividends is defined as the sum of cash flow from operating activities and cash flow from investing activities.

3 Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities, cash and cash equivalents.
- Current and non-current financial assets include handset-receivables (current: EUR 454 million in 2014 and EUR 188 million in 2013; non-current: EUR 236 million in 2014 and EUR 83 million in 2013), positive fair value hedge for fixed interest financial liabilities (current: EUR 2 million in 2014 and EUR 0 million in 2013; non-current: EUR 12 million in 2014 and EUR 0 million in 2013) as well as loans to third parties (current: EUR 1 million in 2014 and EUR 0 million in 2013; non-current: EUR 1 million in 2014 and EUR 0 million in 2013)
- Current and non-current net financial debt include bonds issued (EUR 1,115 million in 2014 and EUR 594 million in 2013), other loans (EUR 726 million in 2014 und EUR 851 million in 2013) as well as finance lease payables (current: EUR 374 million in 2014 und EUR 2 million in 2013; non-current: EUR 197 million in 2014 und EUR 1 million in 2013)

Note: Handset-receivables are shown under trade and other receivables in the Consolidated Statement of Financial Position.

4 Leverage is defined as net financial debt divided by LTM (Last Twelve Months) OIBDA (EUR 679 million in 2014; EUR 1.237 million in 2013) before extraordinary effects.
Please note that solely for purposes of calculating the leverage for any twelve month period which includes historical periods prior to the closing of the Transaction, a combined[5] OIBDA will be applied. This combined OIBDA includes the OIBDA of the E-Plus Group under Telefónica Deutschland Group accounting policies for the entire twelve month period as if the closing of the Transaction had occurred at the beginning of such twelve month period.

5 Combined figures for 2013 and 2014 are approximate and the result of the aggregation and then consolidation of Telefónica Deutschland Group and E-Plus Group financials according to Telefónica Deutschland Group accounting policies. The combined figures are further adjusted by material extraordinary effects, such as capital gains or restructuring costs based on estimates made by Telefónica Deutschland management and resulting in combined figures we believe are more meaningful as a comparable basis.

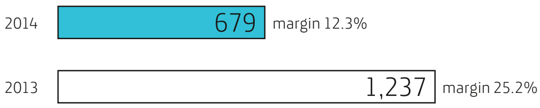
Mobile Service Revenues
(Euros in millions)

+19.8%

Mainly driven by the integration with E-Plus Group as of 1 October 2014. Fourth quarter mobile service revenues confirming the improving year-on-year trend

OIBDA/OIBDA Margin (after extraordinary effects)
(Euros in millions)

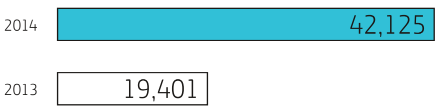
–45.1%



Continuous high commercial investments to maintain trading momentum in the market plus restructuring costs (EUR 409 million, mainly in the fourth quarter of 2014) related with the integration of E-Plus Group

Mobile Accesses
(in thousands)

+117.1%



Mainly driven by the integration with E-Plus Group as of 1 October 2014

Non-SMS Data over Total Data Revenues
(in %)

+4.7%-p.

Continuous focus on data monetisation across brands, leveraging higher smartphone penetration in customer base and the increasing demand for LTE

— **Contact for institutional investors:**
ir-deutschland@telefonica.com

— **Contact for private investors:**
shareholder-deutschland@telefonica.com

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The figures in the following have been rounded in accordance with established commercial practice. Figures or additions within a table may therefore result in sums different from those shown in the same table.

The Annual Report is available online
in German and in English:

www.telefonica.de/annualreport2014

Information for our Shareholders_

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Information for our Shareholders_

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Dear Shareholders of Telefónica Deutschland,
Ladies and Gentlemen,

The successful merger with the E-Plus Group on 1 October has put Telefónica Deutschland on a level playing field with the competition. With 47.7 million customer connections, we are the new strong player in the German market and the market leader in mobile communications. For us, this starting position means just one thing: An obligation to meet our customers' requirements even better in future and at the same time to generate attractive returns for our shareholders.

In July last year, the Supervisory Board of Telefónica Deutschland Holding AG nominated me as CEO of the new company. I thank them for the confidence they have shown in me. After 18 years at E-Plus, I have been welcomed openly and warmly by my new colleagues. Together with this strong and dedicated team, I want to proactively shape the transformation of our industry.

2014 showed that digitalisation is advancing at a tremendous pace. New digital technologies are changing more and more areas of our customers' lives – both in private and in business. Our mission is therefore to make Telefónica Deutschland the leading digital telecommunications company. Our strategy centres on customers. We want to offer them the best experience – in terms of products, network and service.

In order to achieve this goal, Telefónica Deutschland will reposition itself in the years to come. We will create a business model that stands more consistently than before for speed, flexibility, user-friendliness and cost leadership. The merger with E-Plus is a unique opportunity here. It gives us the chance to set up our structures and processes to make them a perfect match for our customers' requirements in the digital world.

We have defined three priorities: momentum, integration and transformation. Momentum stands for our focus on day-to-day business, with which we are pressing ahead regardless of the integration work. As for the integration, our goal is to use synergies and economies of scale as quickly as possible. Without exception, our customers should experience the integration measures as improvements – such as better network quality. Finally, we want to and must tackle the transformation of the company. For this purpose, we will consistently streamline and digitalise processes and procedures.

Our employees are working on these tasks daily – in addition to the extra workload from the integration and transformation process. This gives me all the more reason to thank, on behalf of the entire Management Board, all colleagues for their work and dedication.

The results of the past year show that we, as Telefónica Deutschland, are on the right track. The positive trend is revealed by the final quarter in particular, which unlike the first nine months comprises the joint results including the E-Plus Group for the first time. Adjusted for regulatory effects, wireless service revenues on a like-for-like basis grew by 0.3% year on year. For the year as a whole, Telefónica Deutschland is reporting total revenues of EUR 5.52 billion and OIBDA of EUR 679 million. As already announced, the Management Board will propose a cash dividend of at least EUR 700 million for the shareholders for the past financial year.

The global trend of the digitalisation of all areas of life will continue to accelerate in this financial year. In the German telecommunications market, too, unabated demand for mobile data can be observed in a fiercely competitive environment. Increasing smartphone and tablet penetration gives mobile network operators sustained opportunities for growth. As a result, the monetisation of the wireless data business will become even more significant in future.

In light of this, we are confident that we are right to pursue the objective of establishing the leading digital telecommunications company. In line with this vision, we will focus more sharply on the development of the existing customer base in the 2015 financial year, especially with regard to the monetisation of rising data volumes. We will build on business with SME customers (B2B) and the partner business (B2P). We offer all our customers good value for money. As a result, we expect largely stable revenues from wireless services. At the same time, we anticipate a gradual improvement of operating income (OIBDA), which will be driven chiefly by synergies from the merger of the organisation and initial projects to combine the networks.

A business combination of this size is not a sprint, but a marathon. A challenging course still awaits us down the road. We are delighted that you, dear shareholders, are joining us on this journey, and we thank you for the trust you have placed in us. The successful start in the last financial year fills us with optimism that we will win this marathon and achieve our goals.

Yours sincerely, Thorsten Dirks

Management Board_

Management Board of Telefónica Deutschland
(from left to right)

Thorsten Dirks
Chief Executive Officer (CEO)

Rachel Empey
Chief Financial Officer (CFO)

Markus Haas
Chief Operating Officer (COO)

Supervisory Board Report for the 2014 financial year_

Eva Castillo Sanz,
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG

Dear Shareholders,

In the interests of good corporate governance, the Supervisory Board collaborated well with the Management Board on the basis of trustful cooperation, advised it and fulfilled its controlling responsibilities in the reporting period with regard to all significant concerns – not least in connection with the successful closing of the acquisition of E-Plus. The Supervisory Board of Telefónica Deutschland Holding AG consistently and responsibly performed its duties as set out by law, the Articles of Association and the by-laws.

Composition of the Supervisory Board

At the beginning of the 2014 financial year, the Supervisory Board consisted of twelve members, being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Angel Vilá Boix, María Pilar López Álvarez, Patricia Cobián González, Michael Hoffmann and Enrique Medina Malo, as well as the employee representatives Imke Blumenthal (Vice Chairperson of the Supervisory Board), Marcus Thurand, Thomas Pfeil, Dr Jan-Erik Walter, Christoph Heil and Claudia Weber.

The Annual General Meeting on 20 May 2014 resolved to increase the Supervisory Board from twelve to 16 members and elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as additional members of the Supervisory Board of Telefónica Deutschland Holding AG representing the shareholders. Their term of office began on 18 September 2014 when the amendment to the articles of association regarding the increase of the Supervisory Board from twelve to 16 members was registered. Joachim Rieger and Jürgen Thierfelder were appointed as additional employee representatives on the Supervisory Board by decision of the Munich Local Court on 31 October 2014. Since that date, the Supervisory Board has consisted at full strength with 16 members (eight shareholder representatives and eight employee representatives).

The German Stock Corporation Act determines for listed companies that at least one independent member of the

Supervisory Board must have expertise in the areas of accounting or auditing. In the Supervisory Board of Telefónica Deutschland Holding AG, Michael Hoffmann performs the function of the independent financial expert within the meaning of section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

At the beginning of the 2014 financial year, the Management Board comprised three members (René Schuster, Markus Haas and Rachel Empey).

With effect as of 1 February 2014, René Schuster left the Management Board by mutual agreement. Markus Haas and Rachel Empey then jointly took over the responsibilities of the CEO in addition to their other responsibilities. Since then, Markus Haas took on the function as labour director.

On 2 July 2014, the Supervisory Board of Telefónica Deutschland Holding AG resolved to appoint Thorsten Dirks as the future Chief Executive Officer (CEO). Following the closing of the E-Plus transaction, Thorsten Dirks was then formally appointed as a member of the Management Board and as CEO pursuant to the Supervisory Board resolution of 9 October 2014.

By way of a Supervisory Board resolution of the same date, the appointment of Rachel Empey and Markus Haas as members of the Management Board was extended. All members of the Management Board are appointed for the period up until 30 September 2017.

The Management Board currently comprises three members: Alongside Thorsten Dirks as CEO, Markus Haas is responsible for the operative business as Chief Operating Officer (COO) and Rachel Empey for finance and strategy as CFO.

Cooperation between the Management Board and Supervisory Board

The Management Board provides the Supervisory Board with a monthly written report, which covers in particular relevant financial key performance indicators (KPIs).

The Chairperson of the Supervisory Board and the entire Management Board are also in constant contact outside Supervisory Board meetings. Here they discuss in particular the current position and future development of the company as well as the progress of current projects, in the reporting period especially the E-Plus acquisition. The Chairperson of the Supervisory Board informs the other members of the Supervisory Board of important issues discussed in that context.

In the reporting period, the Management Board involved the Supervisory Board in due time in all actions requiring its approval. For this purpose, it submitted reports and documents to the Supervisory Board in due time and provided additional information when required. When necessary, the Supervisory Board was also able to refer to the expertise of external consultants.

Meetings of the Supervisory Board

In 2014, five ordinary meetings of the Supervisory Board took place, namely on 18 March, 13 May, 25 July, 25 September and 3 November 2014. Meetings of the Audit Committee were also held on these days. In addition, there were eight extraordinary meetings of the Supervisory Board (some of which by telephone), further informational video and/or telephone conferences and resolutions of the Supervisory Board outside of meetings.

So far there have been three Supervisory Board meetings in 2015: on 12 January, 19 February and 23 March 2015 (meeting on the financial statements for the 2014 financial year; “Bilanzsitzung”).

Fundamental issues dealt with by the Supervisory Board

The first ordinary meeting of the Supervisory Board in the 2014 financial year on 18 March 2014 was the meeting regarding the financial statements for the 2013 financial year (“Bilanzsitzung”). In addition to the items associated therewith, such as the approval of the financial statements and management reports (Group and of the corporation) for the 2013 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), the agenda and resolutions motions for the Annual General Meeting on 20 May 2014, issues of Management Board compensation and – like in nearly all other meetings with changing focus – the E-Plus transaction were dealt with in particular.

The agenda of the ordinary meeting of 13 May 2014 included the first quarterly results for 2014, compliance, corporate governance and the efficiency of the Supervisory Board. The discussion on the latter and other issues was continued in a Supervisory Board workshop following the Annual General Meeting on 20 May 2014.

The ordinary meeting of 25 July 2014 dealt with, inter alia, the half-year financial figures, the approval of relevant contracts (option for shop transfer to Drillisch and data center transformation) and governance issues.

The ordinary meeting of 25 September 2014 – which was the first meeting after the formal commencement of the terms of office of the two new additional shareholder representatives Sally Anne Ashford and Antonio Manuel Ledesma – dealt with matters such as financial issues (especially budget, network investments) and updates to contracts as well as corporate governance. Also at this meeting, the Supervisory Board resolved to support the request for the court appointment of Jürgen Thierfelder and Joachim Rieger as two further employee representatives, and there was an opportunity to talk with the new future management team (so-called ExComm below management board).

The ordinary meeting of 3 November 2014 was the first ordinary meeting following the successful closing of the E-Plus transaction, the formal appointment of Thorsten Dirks as CEO and the court appointment of Jürgen Thierfelder and Joachim Rieger as additional members of the Supervisory Board. In addition to financial issues (including Q3 results, budget update), in particular resolutions were passed on Management Board compensation issues, first steps to simplify the new organisational and corporate structure and the date for the Annual General Meeting on 12 May 2015.

At extraordinary meetings (sometimes by telephone, sometimes in presence meetings), the Supervisory Board discussed in particular the negotiations with the European Commission and corresponding remedies in connection with the merger clearance of the E-Plus transaction as well as Management Board issues. When necessary, the Supervisory Board gave its approval to relevant operating contracts and transactions such as the sale of yourfone GmbH on 27 November 2014, discussed the new organisational and corporate law structure and approved the budget for the 2015 financial year at such meetings.

Furthermore, the Supervisory Board made decisions at extraordinary presence meetings on the composition of the Management Board: At the meeting on 29 January 2014, the Supervisory Board decided on René Schuster leaving by mutual agreement and at the meeting on 2 July 2014 on the nomination of Thorsten Dirks as future CEO.

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, the market positioning and the telecommunications business were examined and discussed.

All Supervisory Board members in office for the entire 2014 financial year participated in more than half of the meetings in the reporting period.

Outside of the meetings the Supervisory Board passed resolutions, to the extent required, for example by e-mail. For instance, resolutions were passed in this way – following appropriate preparation at meetings – on the new Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG), the formal Management Board appointment of Thorsten Dirks and the implementation of the so-called Capital Increase Committee.

Committees of the Supervisory Board

As determined in its by-laws, the Supervisory Board has a Nomination Committee, a Mediation Committee and an Audit Committee. Another committee was implemented in the reporting period: The Capital Increase Committee.

The Audit Committee is responsible in particular for advice on and the passing of resolutions in accounting matters. It deals with issues relating to accounting, internal control systems and auditing, risk management, compliance and the financial, asset and earnings situation. It also examines the required independence of the external auditor and is responsible for coordination with the external auditor. The Committee consists of four members:

- Michael Hoffmann (Chairperson)
- María Pilar López Álvarez
- Thomas Pfeil and
- Christoph Heil.

In 2014, the Audit Committee met five times. In addition to financial results, auditing, risk management and compliance, it dealt in particular with valuation and accounting issues in connection with the closing of the E-Plus transaction.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:

- Eva Castillo Sanz (Chairperson)
- Imke Blumenthal
- Angel Vilá Boix and
- Marcus Thurand.

Furthermore, there is a Nomination Committee. The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González is the Chairperson of the Nomination Committee. In the 2014 financial year, the other members were María Pilar López Álvarez and Enrique Medina Malo. In 2014, the Nomination Committee dealt with the election proposal to the Annual General Meeting on 20 May 2014, at which the candidates Sally Anne Ashford and Antonio Manuel Ledesma Santiago were elected.

Another committee, the so-called Capital Increase Committee was formed in connection with the E-Plus transaction. Its members are:

— Patricia Cobián González (Chairperson)
— María Pilar López Álvarez
— Marcus Thurand
— Thomas Pfeil.

In accordance with its role, this committee dealt in particular with the specific implementation of the cash capital increase and the capital increase against contribution in kind in connection with the closing of the E-Plus transaction.

Corporate Governance

Good corporate governance is essential for corporate success and is therefore in the interest of the company's shareholders. Further details on the corporate governance of Telefónica Deutschland Holding AG can be found in the Management Declaration in accordance with section 289a German Commercial Code in the Annual Report and on the company's website at **WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION** and in the Management Boards' Corporate Governance Report in the Annual Report and on the company's website at **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT**

On 3/4 October 2014, the Management Board and the Supervisory Board approved a new Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG) and approved an update thereto on 19 December 2014. The Declaration of Compliance and its update were both published immediately. They can be viewed in the Annual Report or at the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**. Earlier versions thereof can be also found at this website.

Seven of the now 16 members of the Supervisory Board held positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies in 2014. Both the Supervisory Board members and the Management Board members disclose potential conflicts of interest promptly to the Supervisory Board. In the reporting period, no conflicts of interest arose within the meaning of the German Corporate Governance Code.

Review of the Financial Statements 2014

The 2014 annual financial statements for Telefónica Deutschland Holding AG and the consolidated financial statements with the management reports for Telefónica Deutschland Holding AG and the group as presented by the Management Board were audited by the auditing company Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its seat in Stuttgart, branch Munich. Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft had been appointed auditor and group auditor for the financial year 2014 by resolution of the Annual General Meeting on 20 May 2014.

Telefónica Deutschland Holding AG's financial statements and the management report were prepared in accordance with the legal requirements of the German Commercial Code (HGB). The consolidated financial statements and the corresponding group management report were prepared in accordance with section 315a of the German Commercial Code (HGB) and Regulation (EC) no. 1606/2002 on the basis of the International Financial Reporting Standards (IFRS) as applicable in the European Union.

The auditor performed its audit on the basis of German generally accepted auditing principles as promulgated by the Institut der Wirtschaftsprüfer (IDW). The auditor issued an unqualified opinion (uneingeschränkter Bestätigungsvermerk) for the 2014 annual financial statements of Telefónica Deutschland Holding AG with management report and the consolidated financial statements and the group management report.

The financial statements of the corporation and the group and all related documents thereto as well as the Management Board's proposal for the distribution of profit and the respective auditor's reports were submitted to the Supervisory Board in due time prior to the meeting on 23 March 2015 ("Bilanzsitzung"). The Audit Committee and the Supervisory Board in its entirety thoroughly examined the reports and discussed them in detail together with the auditor on 23 March 2015. The Supervisory Board acknowledged and approved the auditor's findings in the audit reports and had no objections. At its meeting on 23 March 2015, the Supervisory Board approved the annual financial statements of Telefónica Deutschland Holding AG and the consolidated financial statements together with their respective management reports for the 2014 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Relations to affiliated companies

The report on relations to affiliated companies (dependency report) as prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act was also audited by the auditor. With respect thereto, the auditor issued the following unqualified opinion (uneingeschränkter Bestätigungsvermerk):

"Based on our audit and assessment, which were carried out in accordance with professional standards, we confirm that

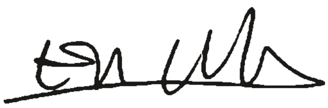
1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,
3. there are no circumstances that would require a materially different assessment of the measures listed in the report than that of the Management Board."

The dependency report as prepared by the management board and audited by the auditor as well as the audit report on the dependency report were submitted to the Supervisory Board in due time. Having examined the dependency report and the corresponding audit report in accordance with section 314 of the German Stock Corporation Act, the Supervisory Board had no objections against the dependency report and the Management Board's declaration on the relations to affiliated companies contained therein and agrees with the auditor's findings.

The Supervisory Board thanks the members of the Management Board and all employees for their dedication and excellent work in the past year. With their commitment, which in the reporting period was demanded in particular by the successful closing of the E-Plus transaction, they have contributed considerably to the success of the company.

Munich, 23 March 2015

On behalf of the Supervisory Board



Eva Castillo Sanz
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG

Corporate Governance Report_

The German Corporate Governance Code establishes a standard for transparent control and management of companies. In accordance with 3.10 of the German Corporate Governance Code, the Management Board and the Supervisory Board of Telefónica Deutschland Holding AG inform about Corporate Governance as follows. This Corporate Governance Report is also published together with the Management Declaration in accordance with § 289a German Commercial Code (HGB) on our website at **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT.**

Declaration of compliance

The Management Board and Supervisory Board of Telefónica Deutschland Holding AG feel committed to the principles of transparent corporate governance and regularly consider the principles of the German Corporate Governance Code. On 3/4 October 2014 they last stated a declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG) and resolved an update thereof on 19 December 2014. The full text of the compliance declaration and its update may also be viewed on the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE.**

The company's governing bodies

As a German stock corporation, Telefónica Deutschland Holding AG has three governing bodies: the general shareholders' meeting, the Supervisory Board and the Management Board. Their duties and powers are substantially determined by the German Stock Corporation Act, the Articles of Association and the by-laws of both the Management Board and the Supervisory Board.

German corporate law provides for a clear separation of personnel between management and controlling bodies.

The managing body is the Management Board. It manages the company in its own responsibility in the interest of the company with the object of sustainable value creation.

The Management Board is monitored and advised by the Supervisory Board. Management Board and Supervisory Board work together closely in the interest of the welfare of the company. All transactions and decisions that are of fundamental or material importance to the company are carried out in close coordination between the Management Board and the Supervisory Board.

The Management Board informs the Supervisory Board regularly, promptly and comprehensively on all material questions regarding the company, especially on planning, business development, strategy, risk situation and risk management as well as on compliance. Furthermore, the Management Board provides the Supervisory Board with information in case deviations of plans or objectives may occur in course of conducting of business and of the reasons thereof.

Details regarding the composition and the working procedures of the Management Board, the Supervisory Board and the Supervisory Board's committees can be found in the management declaration in accordance with section 289a of the German Commercial Code (HGB) (Erklärung zur Unternehmensführung) in the Annual Report or on the Telefónica Deutschland website under **WWW.TELEFONICA.DE/ERKLAERUNG-ZUR-UNTERNEHMENSFUEHRUNG.**

The Supervisory Board has specified concrete objectives regarding its composition (5.4.1, 2nd paragraph of the German Corporate Governance Code) considering the specifics of the company, its shareholders' structure and the company's international activities and taking into account that half of the members of the Supervisory Board are elected by the employees pursuant to German Co-Determination law. In this context, the Supervisory Board has set the following objectives regarding its composition:

— The Supervisory Board has at least one independent member within the meaning of section 100 paragraph 5 of German Stock Corporation Act (AktG) and 5.4.2 sentence 2 German Corporate Governance Code and should not include any persons who hold an office (e.g. at a significant competitor) which may create a material and not only temporary conflict of interest.

— One third of the members of the Supervisory Board, however in any event at least one third of the Supervisory Board members to be elected by the General Meeting, should be female.
— At least one third of the Supervisory Board members to be elected by the General Meeting should have international working experience, knowledge of the English language as well as an understanding of global economic contexts ("internationality").

The Supervisory Board considers these concrete objectives as currently fulfilled.

The Supervisory Board has refrained from implementing a concrete objective regarding an age limit and has in this regard made a declaration of deviation in the Declaration of Compliance.

Relationship to shareholders and the General Meeting

The shareholders are generally informed four times a year about the financial and earnings situation and business development (quarterly financial reports). The company provides for further information on its website (**WWW.TELEFONICA.DE/INVESTOR-RELATIONS**), especially the financial calendar. Furthermore, analyst conferences and meetings take place.

The shareholders exercise their rights according to the law and the Articles of Association before and during the General Meeting, especially by exercising their voting rights.

The General Meeting resolves amongst others about profit distribution, discharge of the Supervisory and Management Board and the election of the auditor.

Compliance

Telefónica Deutschland is committed to comply with the applicable laws, regulations, processes, rules and enactments for all its business activity. Therefore, the company has a group-wide compliance organisation that is continuously improved.

The compliance program focuses on antitrust, anti-corruption and ethically appropriate behavior. These topics are covered by mandatory online trainings, as are the areas of data protection, anti-discrimination and information security. Each employee is regularly required to complete certain mandatory training sessions based on his or her job responsibilities. At the end of each year, a Compliance Certificate in respect of the success of training and compliance activities is produced and processed as part of the Corporate Responsibility Report.

The company has a compliance team. Since 1 October 2014, the team is part of the Directorate Corporate Security, Data Protection and Compliance. The compliance team deals with the maintenance and enhancement of the compliance organization in the company and regularly reports on compliance topics to the management. To ensure constant monitoring, awareness, prevention and detection of potential issues the major units responsible for executing controls such as compliance, internal audit (incl. risk management), fraud, physical and information security, SOX compliance, intervention and data protection meet on a regular basis as compliance forum (an inter-departmental, operational supervisory committee) and are in constant exchange concerning potential failures or risk factors.

In this overall context, the company of course also maintains insider lists wherein any persons who act for the company and have authorised access to insider information are registered (following respective instructions regarding their duties by insider law).

The Management Board – as well as the Supervisory Board – regularly deals with the topic "compliance".

Transparency and communication

Telefónica Deutschland shareholders can receive information on the company on its website. This includes press releases, corporate news and ad-hoc news. The company's Articles of Association are also published on the website.

Relevant shareholdings of Management and Supervisory Board

The members of the Management Board hold shares of Telefónica Deutschland Holding AG. No member holds options on shares of Telefónica Deutschland Holding AG.

As per 31 December 2014, the Management Board held approximately 0.0015% of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed – if applicable – as directors' dealings.

As per 31 December 2014, the Supervisory Board held approximately 0.0014% of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed as directors' dealings.

Directors' Dealings

According to section 15a of the German Securities Trading Act (WpHG), members of the Management and Supervisory Boards and related parties are obliged to disclose directors' dealings in Telefónica Deutschland shares if the value of these transactions reaches EUR 5,000 within a calendar year.

Further information can be found on the Telefónica Deutschland website at **WWW.TELEFONICA.DE/DIRECTORSDEALINGS**.

Accounting and auditing

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with seat in Stuttgart, branch Munich, has been appointed auditor and group auditor for the financial year 2014 by resolution of the annual General Meeting on 20 May 2014.

Management Declaration_

in accordance with section 289a of the German Commercial Code (HGB)

1. Declaration of compliance in accordance with section 161 of the German Stock Corporation Act (AktG)

Under section 161 of the German Stock Corporation Act (AktG), the management board and the supervisory board of a listed stock corporation are required to declare annually that the company has complied and is complying with the recommendations of the "Government Commission for the German Corporate Governance Code", as published in the official part of the Federal Gazette by the Federal Ministry of Justice, or, alternatively, are to declare which recommendations the company has not followed or does not follow and why not. The declaration shall be published permanently on the company's website.

On 13/14 October 2014, the Management Board and Supervisory Board issued a declaration of compliance pursuant to section 161 German Stock Corporation Act (AktG):

Management Board and Supervisory Board of the Company hereby declare pursuant to sec. 161 para. 1 of the German Stock Corporation Act that since the issuance of the last compliance declaration the Company has complied, and will in the future comply, with the recommendations of the GCGC with the following exceptions:

1. While determining the total compensation, the Supervisory Board shall, according to 4.2.2, 2nd paragraph, sentence 3 GCGC, consider the relationship between the compensation of the Management Board and that of the senior management and the staff over-all, particularly in terms of its development over time whereupon the Supervisory Board shall determine how senior managers and the relevant staff are to be differ-enti-ated. With regard to the board member service agreements which have been signed in July 2014 and have become effective in October following closing of the acquisition of E-Plus, the Supervisory Board has deviated from this recommendation. Since the Company did not have, prior to closing of the acquisition of E-Plus, sufficient information regarding the remuneration structure at E-Plus, it could not consider the relationship between the compensation of the Management Board and that of the senior management and the relevant staff because this also would have required information on the remuneration structure at E-Plus.

2. The recommendation in 4.2.3, 2nd paragraph, sentence 4 GCGC that both positive and negative developments shall be taken into account with respect to the structure of the variable remuneration components has not been and will not be followed. The Management Board and the Supervisory Board are of the opinion that the remuneration of the Management Board is nevertheless oriented towards a sustainable company development. The remuneration consists of fixed as well as of short- and long-term variable components. The relevant parameters for the determination of the variable remuneration are overall oriented towards sustainable development and structured in a way that they, as a whole, do not provide incentives for business decisions which are opposed to the interests of the Company.

3. In 4.2.3, 2nd paragraph, sentence 7 the GCGC recommends that the variable remuneration components shall relate to rigorous and relevant comparison parameters. A partial deviation from such recommendation has been and will be made. The amount of the 2 annual bonus depends to a small extent also on parameters regarding Telefónica S.A. In addition, a part of the long-term remuneration components is dependent on the Total Shareholder Return of the Telefónica S.A. shares (measured against relevant competitors of Telefónica S.A.). Furthermore, one Management Board member receives a share award under a restricted share plan which also comprises shares of Telefónica S.A. The Management Board and the Supervisory Board are of the opinion that no misdirected incentives are created thereby.

4. The GCGC recommends in 4.2.3, 2nd paragraph, sentence 6 that the amount of compensation shall be capped, both overall and for individual compensation components. This recommendation has been and will be partially deviated from as neither for the stock option program nor for the Deferred Bonus caps have been determined. By doing to, the Supervisory Board shall be granted the necessary room for manoeuvre to ensure the balance between short-term and long-term variable remuneration elements at any time. Furthermore, one of the board member service agreements does not provide for the exact amount of the Company's pension expenses. The Company has assumed the respective pension commitments from the Management Board member's former employer and continues them unchanged.

5. The recommendation in 4.2.3, 2nd paragraph, sentence 8 GCGC that forbids a retroactive change of performance objectives or comparison parameters has not been and will not be followed. The service contracts partially allow a retroactive change of the criteria for the variable remuneration. From the Management Board's and the Supervisory Board's view, this is necessary because the Company is active in an extremely volatile and innovative market environment, and a change of corporate strategy in the interest of a sustainable company development must also be possible within the calculation period for the variable remuneration components. Such changes of corporate strategy necessary with a view to reasonable company interests shall not be hindered or delayed as a result of monetary interests of the members of the Management Board. Thus, in particular the Supervisory Board is of the opinion that flexibility is required as to performance objectives and comparison parameters.

6. The GCGC recommends in 4.2.3, 3rd paragraph that, for pension schemes, the Supervisory Board shall establish the level of provision aimed for in each case – also considering the length of time for which the individual has been a Management Board member – and take into account the resulting annual and long-term expense for the company. This recommendation is deviated from. There are defined contribution commitments in place for the Management Board members of the Company which do not aim at a specific pension level, or the Company pays fixed amounts in order to build up private pension benefits. Therefore, with regard to the form of the pension commitments, the Supervisory Board does not refer to an aimed level of provision.

7. The recommendation in 4.2.5, 2nd paragraph GCGC that the compensation report shall also include information on the nature of fringe benefits provided by the Company has been and will only be followed partially. Furthermore the recommendation in 4.2.5 sentence 5 and 6 GCGC regarding the presentation of the remuneration of the management board, especially in accordance with the model schedule, is not followed. The general meeting on 5 October 2012 resolved pursuant to sec. 286 para. 5 German Commercial Code, to dispense with disclosure of the compensation of individual Management Board members for the period of 5 years.
As long as such so-called "opt-out" resolution of the general meeting is in place, is not foreseen to comply with the presentation as recommended in 4.2.5 sentence 5 and 6 GCGC. Furthermore the fringe benefits provided by the Company are only disclosed to the extent they are provided to all Management Board members. Where fringe benefits are only provided to individual Management Board members, these are not shown. The Management Board and Supervisory Board take the view that the individualization involved in the disclosure of these individual benefits would contradict the resolution of the general meeting and anyway would represent too large an intrusion on the private sphere of the relevant Management Board members.

8. Pursuant to 5.4.1, 2nd paragraph GCGC the Supervisory Board shall specify concrete objectives regarding its composition, considering an age limit. Supervisory Board has resolved on concrete objectives regarding its composition, however without specifying a concrete objective regarding an age limit for Supervisory Board members. In the view of the Company, a fixed age limit for Supervisory Board members is not appropriate, since the ability to control and supervise the Management Board is not necessarily restricted by reaching a certain age. Rather it may be necessary where appropriate in the interest of the Company to appoint persons of advanced age with extensive experience even after they reach a particular age limit.

9. Notwithstanding the recommendation in 5.4.6, 1st paragraph, sentence 2 GCGC that the chair and membership in committees is also to be taken into account in the compensation of the Supervisory Board members, only the chair of the audit committee receives an additional compensation. The Company takes the view that this reasonably takes into account the current composition of the Supervisory Board.

10. The consolidated financial statements and the interim reports are made publicly accessible within the periods defined by law, yet possibly not within 90 days of the end of the financial year or 45 days of the end of the period under review (7.1.2 sentence 4 GCGC). Given the time required for a diligent preparation of financial statements and business reports, it is for the period after the closing of the acquisition of the E-Plus Group, for the time being, impossible to enter into commitments concerning earlier dates of publication.

There was an update of the declaration of compliance on 19 December 2014:

Management Board and Supervisory Board of Telefónica Deutschland Holding AG (the "Company") have last issued a Compliance Declaration according to § 161 (1) of the German Stock Corporation Act on 13/14 October 2014. Subsequent to a change made to the Management Board pensions, Management Board and Supervisory Board of the Company update No. 4 and No. 6 of this Compliance Declaration as follows:

4. The GCGC recommends in 4.2.3, 2nd paragraph, sentence 6 that the amount of compensation shall be capped, both overall and for individual compensation components. This recommendation has been and will be partially deviated from as neither for the stock option program nor for the Deferred Bonus caps have been determined. By doing so, the Supervisory Board shall be granted the necessary room for manoeuvre to ensure the balance between short-term and long-term variable remuneration elements at any time. Furthermore, two of the board member service agreements do not provide for the exact amount of the Company's pension expenses. The Company has assumed the corresponding pension commitments from the respective Management Board member's former employer and continues them unchanged.

6. The GCGC recommends in 4.2.3, 3rd paragraph that, for pension schemes, the Supervisory Board shall establish the level of provision aimed for in each case – also considering the length of time for which the individual has been a Management Board member – and take into account the resulting annual and long-term expense for the company. This recommendation is deviated from. There are defined contribution commitments in place for two Management Board members of the Company which do not aim at a specific pension level, or the Company pays fixed amounts in order to build up private pension benefits. Therefore, with regard to the form of the pension commitments, the Supervisory Board does not refer to an aimed level of provision. For another Management Board member a pension commitment has been assumed from the Management Board member's former employer so that the Supervisory Board did not newly establish the level of provision aimed for. Apart from the above, the Compliance Declaration dated 13/14 October 2014 remains unchanged.

The Compliance Declaration as of 13/14 October 2014 remains in the rest unchanged.

This and previous declarations of compliance are available on the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**

2. Relevant disclosures of management practices

Telefónica Deutschland Holding AG and its administrative bodies are committed to efficient, sustainable and transparent corporate management as well as to values that form the basis of common business principles described in the company's code of ethics called "Our business principles". This code includes various fundamental principles and guidelines aimed to direct both management and employees in their daily work. It provides valuable help, particularly with respect to business situations in which legal and/or ethical conflicts of interest arise so that decisions can be taken with integrity and professionalism, both in the design and implementation of work processes and in the manner in which the company interacts with customers, shareholders, employees, suppliers and other stakeholders.

The company's business principles are available on the company's web site at **WWW.TELEFONICA.DE/GESCHAEFTSGRUNDSAETZE**

Compliance with the business principles is of eminent significance since Telefónica's reputation is built on and affected by decisions and actions taken by its administrative bodies and employees. It is therefore carefully monitored by means of close cooperation between the compliance team, human resources management and the departments internal audit, fraud and legal affairs.

The company's compliance program includes the main areas of anti-corruption with clear guidelines and procedures and an external whistle-blower system (**WWW.TELEFONICA.DE/OMBUDSMANN**), competition law and ethically appropriate behavior. The company's data protection officer ensures compliance with data protection legislation. This is a top priority for the company. The functions group compliance, data protection and corporate security – as does the legal department – reported until 1 October 2014 directly to the Management Board and since then to the General Counsel.

Further details regarding the compliance organization of the company are explained in the Corporate Governance Report which forms part of the Annual Report **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-BERICHT**

3. Composition and working procedures of the Management Board, Supervisory Board and the Supervisory Board's Committees

In the beginning of the reporting period, there were three members on the Telefónica Deutschland Holding AG Management Board (René Schuster, Rachel Empey and Markus Haas). Since February 2014 until the formal appointment of Thorsten Dirks on 9 October 2014, the Management Board consisted of two members (Rachel Empey and Markus Haas). Since 9 October 2014 the Management Board comprises of three members again.

The Management Board has sole responsibility for managing the company's business with the objective of creating sustainable value in the company's interest, taking into consideration the interests of its shareholders, employees and other stakeholders of the company. The work of the Management Board is governed in particular by the by-laws of the Management Board enacted with Supervisory Board approval and by the company's Articles of Association. The Management Board is responsible for corporate strategy, coordinating this regularly with the Supervisory Board, and also ensures its implementation.

Each Management Board member is responsible for managing the area of business assigned to it, but without prejudice to their joint responsibility for managing the company as a whole. All matters of fundamental or material importance for the company and/or its affiliates, in particular matters regarding organization, company policy, investment and financial planning as well as all investments significantly exceeding the annual budget approved by the Supervisory Board are decided by the entire Management Board. Furthermore, every Management Board member can submit matters to the full board for decision. Transactions and measures of particular significance are also subject to the prior approval by the Supervisory Board.

Management Board meetings are held regularly, generally once per week. Meetings may also be held by phone or video conference, and resolutions of the Management Board may also be passed outside of meetings, in particular in writing, by fax or e-mail.

The Management Board reports regularly to the Supervisory Board on the company's course of business, inter alia by providing the Supervisory Board with written reports each month covering key performance indicators for the company's business. Moreover, the Management Board must report to the Supervisory Board any transactions of possible material significance to the company's profitability or liquidity. Finally, the Management Board must report to the Supervisory Board any important events or affairs subject to section 90 para. 1 sentence 3 of the German Stock Corporation Act (AktG). The Management Board performs these measures as required by law.

In the beginning of the reporting period, the company's Supervisory Board consisted of twelve members (six shareholder and six employee representatives). Currently the Supervisory Board consists of sixteen members (eight shareholder and eight employee representatives). The Annual General Meeting of 20 May 2014 had resolved on the increase of the Supervisory Board from twelve to sixteen members and elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as further members of the Supervisory Board of Telefónica Deutschland Holding AG. Their office started with the registration of the change of the Articles of Association regarding the increase of the Supervisory Board on 18 September 2014.

With resolution of the Local Court of Munich of 31 October 2014 Joachim Rieger and Jürgen Thierfelder were appointed as further employee representatives of the Supervisory Board.

The current members of Supervisory Board are Chairperson Eva Castillo Sanz, Deputy Chairperson Imke Blumenthal and the Supervisory Board Members María Pilar López Álvarez, Angel Vilá Boix, Patricia Cobián González, Enrique Medina Malo, Michael Hoffmann, Sally Anne Ashford, Antonio Manuel Ledesma Santiago, Marcus Thurand, Thomas Pfeil, Christoph Heil, Claudia Weber, Dr. Jan-Erik Walter, Joachim Rieger and Jürgen Thierfelder.

The Supervisory Board advises and monitors the Management Board in the management of the company on an ongoing basis and must be consulted in all matters outside the ordinary course of business which are of particular importance to the company. The Supervisory Board appoints and dismisses the members of the Management Board and determines the remuneration of the Management Board. The Supervisory Board Chairperson coordinates the activities of the Supervisory Board and cooperation with the Management Board. The principles governing the work of the Supervisory Board and its cooperation with the Management Board are essentially described in the by-laws for the Supervisory Board and in the company's Articles of Association.

The Supervisory Board holds at least two meetings in a calendar half-year. Meetings of the Supervisory Board may also be held by phone or video conference, and resolutions of the Supervisory Board may also be passed outside of meetings, in particular in writing, by fax or e-mail.

Composition and work of the committees of the Supervisory Board
In order for the Supervisory Board to carry out its tasks in an optimal manner, the by-laws for the Supervisory Board provide for three fixed committees. The Supervisory Board receives regular reports on the work of the committees.

The Audit Committee is responsible for preparing the decision of the Supervisory Board regarding the approval of the financial statements, discussing the quarterly reports with the Management Board, monitoring the accounting processes and internal control systems (including compliance, risk management and internal audit systems) and the auditor's review. It furthermore is responsible for the coordination with the auditor for the audit of the financial statements.

The following members are currently in the audit committee:
- Michael Hoffmann (Chairperson)
- María Pilar López Álvarez
- Thomas Pfeil and
- Christoph Heil

The Nomination Committee is responsible for proposing suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González was elected chairperson of the nomination committee. The other members are María Pilar López Álvarez and Enrique Medina Malo.

The Mediation Committee with the responsibilities as defined in section 31 Co-Determination Act (MitbestG) consists of the following members:
- Eva Castillo Sanz (Chairperson)
- Imke Blumenthal
- Angel Vilá Boix and
- Marcus Thurand

Futhermore, in the context of the acquisition of E-Plus, a further committee was implemented, the so-called Capital Increase Committee. This consist of the following members:
- Patricia Cobian González (Chairperson)
- María Pilar López Álvarez
- Marcus Thurand and
- Thomas Pfeil

24 February 2015

Group Management Report_

for the financial year ending 31 December 2014

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Group Management Report_

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1. Fundamentals of the Group_

1.1 Business Model of the Group

1.1.1 Structure of the Telefónica Deutschland Group

Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland") is a corporation (AG) incorporated under German law.

The company's name is "Telefónica Deutschland Holding AG". The company's registered office is located in Munich, Germany. Telefónica Deutschland Holding AG is registered in the Commercial Register of the local court in Munich under registration number HRB 201055. The company's business address is Georg-Brauchle-Ring 23–25, 80992 Munich, Germany (telephone number: +49 (0) 89 2442-0; **WWW.TELEFONICA.DE**). Telefónica Deutschland Holding AG was established for an indefinite period.

The financial year of the company corresponds to the calendar year (1 January to 31 December).

The company is listed in the regulated market of the Frankfurt Stock Exchange. The security identification number (WKN – Wertpapierkennnummer) is A1J5RX, the ISIN (International Securities Identification Number) is DE000A1J5RX9.

Share capital

Following the registration of the capital increase against cash and the capital increase against contribution in kind in connection with the acquisition of E-Plus (section 7 Acquisition of E-Plus), the share capital amounts to EUR 2,974,554,993 and is divided into the same number of no-par value registered shares. Each share in general grants one vote at the Annual General Meeting.

Authorised capital

Telefónica Deutschland Holding AG had authorised capital 2012/I in the amount of EUR 292,808,507 as of 31 December 2014.

The original authorised capital of Telefónica Deutschland Holding AG allowed the Management Board of the company, with the approval of the Supervisory Board, to increase the share capital in the period up until 17 September 2017, once or repeatedly up to a total of EUR 558,472,700 by issuing new no-par value registered shares against cash and/or contribution in kind (authorised capital 2012/I) and to carry out a capital increase against contribution in kind of up to EUR 475,000,000 (authorised capital 2014/I).

For the capital increase against contribution in kind in connection with the acquisition of E-Plus (section 7 Acquisition of E-Plus), the Management Board decided by resolution on 24 September 2014, with approval from the Supervisory Board on the same day, to use all of the authorised capital 2014/I and a partial amount of EUR 265,664,193 of the authorised capital 2012/I (section 7 Acquisition of E-Plus). This capital increase for contributions in kind was entered into the commercial register on 7 October 2014, deleting the authorised capital 2014/I and adjusting the authorised capital 2012/I.

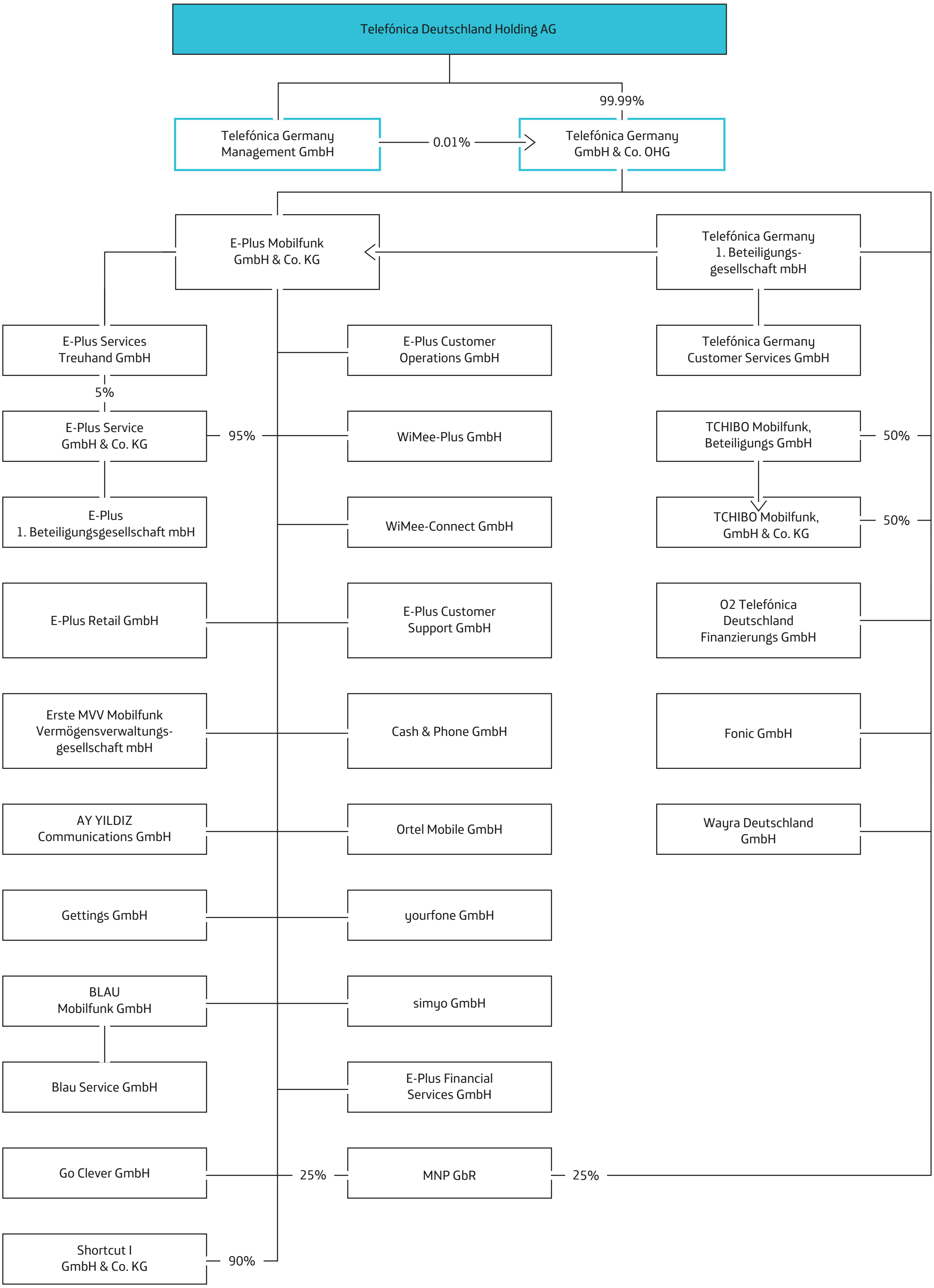
Conditional capital

The share capital of Telefónica Deutschland Holding AG is conditionally increased by up to EUR 558,472,700 by issuing up to 558,472,700 registered shares (conditional capital 2014/I).

Group structure of the Telefónica Deutschland Group

Telefónica Deutschland Holding AG is the parent company of the Telefónica Deutschland Group. It is included in the Consolidated Financial Statements of the ultimate holding company, Telefónica, S.A., Madrid, Spain (Telefónica, S.A.; whose group is: Telefónica, S.A. Group). The direct parent company of Telefónica Deutschland Group is Telefónica Germany Holdings Limited, a wholly owned subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited) and an indirect subsidiary of Telefónica, S.A.

As of 31 December 2014, the companies included in the Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart:


Telefónica Deutschland Holding AG
99.99%
Telefónica Germany Management GmbH
0.01%
Telefónica Germany GmbH & Co. OHG
E-Plus Mobilfunk GmbH & Co. KG
Telefónica Germany 1. Beteiligungs-gesellschaft mbH
E-Plus Services Treuhand GmbH
E-Plus Customer Operations GmbH
Telefónica Germany Customer Services GmbH
5%
E-Plus Service GmbH & Co. KG
95%
WiMee-Plus GmbH
TCHIBO Mobilfunk, Beteiligungs GmbH
50%
E-Plus 1. Beteiligungsgesellschaft mbH
WiMee-Connect GmbH
TCHIBO Mobilfunk, GmbH & Co. KG
50%
E-Plus Retail GmbH
E-Plus Customer Support GmbH
O2 Telefónica Deutschland Finanzierungs GmbH
Erste MVV Mobilfunk Vermögensverwaltungs-gesellschaft mbH
Cash & Phone GmbH
Fonic GmbH
AY YILDIZ Communications GmbH
Ortel Mobile GmbH
Wayra Deutschland GmbH
Gettings GmbH
yourfone GmbH
BLAU Mobilfunk GmbH
simyo GmbH
Blau Service GmbH
E-Plus Financial Services GmbH
Go Clever GmbH
25%
MNP GbR
25%
Shortcut I GmbH & Co. KG
90%

On 23 July 2013, Telefónica Deutschland, Telefónica, S.A. and Koninklijke KPN N.V., The Hague, Niederlande (KPN) concluded an agreement regarding the acquisition of KPN's German mobile business E-Plus by Telefónica Deutschland. This acquisition was completed with effect from 1 October 2014, following approval by the antitrust authorities and implementation measures such as carrying out a capital increase against cash and a capital increase against contribution in kind (section 7 Acquistion of E-Plus).

Since this date, Telefónica Deutschland Group has contained not only the companies that already belonged to it but also E-Plus Mobilfunk GmbH & Co. KG (E-Plus Mobilfunk) and its direct and indirect subsidiaries.

Management and governing bodies

The company's governing bodies are the Management Board, the Supervisory Board and the Annual General Meeting. The powers of these organs are established by the German Stock Corporation Act (Aktiengesetz – AktG), the articles of association of the company and the by-laws of the Management Board and the Supervisory Board.

Management Board

The members of the Management Board are appointed by the Supervisory Board for a period of no more than five years and can be re-appointed without limitation, in each case for no more than five years. The Supervisory Board may recall a Management Board member before expiry of his period in office in the event of an important reason such as the gross breach of duties or if the Annual General Meeting adopts a no-confidence resolution in relation to the Management Board member in question. Further reason for termination such as a mutual termination agreement can also be taken into consideration. The Supervisory Board can nominate one Management Board member as Chair or spokesperson for the Management Board and another Management Board member as vice-chair or vice-spokesperson. As of 31 December 2014, the Management Board of the company consisted of three members:

- Thorsten Dirks, CEO (Chief Executive Officer)
- Rachel Empey, CFO (Chief Financial Officer)
- Markus Haas, COO (Chief Operating Officer)

Between 1 February 2014, and the completion of the acquisition of E-Plus with effect from 1 October 2014, Rachel Empey und Markus Haas took over the responsibilities of the CEO jointly in addition to their existing responsibilities (Rachel Empey as CFO/Chief Financial Officer and Markus Haas as CSO/Chief Strategy Officer) (section 2.2 Overview of the 2014 Financial Year – Significant Events). Since the completion of the acquisition of E-Plus, Markus Haas has been responsible for operating business as COO, and Rachel Empey has been responsible for finance and strategy as CFO (section 2.2 Overview of the 2014 Financial Year – Significant Events).

Thorsten Dirks was formally appointed as a member of the Management Board and as CEO in the context of the completion of the acquisition of the E-Plus Group by Telefónica Deutschland – specifically, by way of the Supervisory Board resolution of 9 October 2014.

Supervisory Board

Pursuant to section 11 (1) of the articles of association of the company, sections 95 and 96 of the German Stock Corporation Act and section 7 of the German Co-Determination Act (MitbesG), the Supervisory Board comprises sixteen members, of whom eight are shareholder representatives and eight are employee representatives.

The Annual General Meeting on 20 May 2014 had elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as additional members of the Supervisory Board of Telefónica Deutschland Holding AG representing the shareholders. Their term of office began when the expansion of the Supervisory Board from twelve to sixteen members was registered on 18 September 2014, in the context of the completion of the acquisition of E-Plus.

Joachim Rieger and Jürgen Thierfelder were appointed as additional employee representatives on the Supervisory Board by order of the Munich Local Court on 31 October 2014.

All current shareholder representatives on the Supervisory Board were appointed for the period up to the end of the Annual General Meeting that resolves on the discharge for the financial year ending 31 December 2016.

1.1.2 Business activity

With almost 48 million customer accesses as of 31 December 2014, the Telefónica Deutschland Group, also including the E-Plus Group since 1 October 2014, is one of the three leading integrated network operators in Germany. We are also leading the German mobile telecommunications market with a total of over 42 million mobile customer accesses as of 31 December 2014. Telefónica Deutschland Group offers consumers and business customers voice, data and value added services in mobile communications and fixed networks. In addition, Telefónica Deutschland Group is among the leading wholesale providers in Germany. We offer our wholesale partners access to our infrastructure and to our services. We are a part of Telefónica, S.A. Group, one of the biggest telecommunications companies in the world.

Since the merger with the E-Plus Group, we are operating two nation-wide mobile communications networks reaching over 99% of the German population with GSM and more than 76% with UMTS as of 31 December 2014. We plan to combine the two existing networks to an even more powerful joint mobile network, particular with regard to UMTS network coverage. The expansion of our LTE network is being accelerated and at the end of 2014 outdoor population coverage with the new high-speed mobile communications technology already reached 62%.

In addition, we operate a nation-wide fixed network. Our strategic partnership with Telekom Deutschland GmbH, Bonn, expands our fixed network coverage to 98% and in addition enables us to serve 16.5 million households with high-speed DSL internet access and data transmission rates of up to 50Mbit/s. On 20 December 2013, we signed a contract for the expansion of the fixed network cooperation with Telekom Deutschland GmbH. It grants us access to the high-speed network of Deutsche Telekom and the possibility to offer our customers products with transmission rates of currently up to 100Mbit/s via the new vectoring technology. The cooperation was approved by the German Federal Network Agency (BNetzA) on 18 March 2014 as such the contracts came into effect.

Our sales and marketing approach follows a consequent multi-brand strategy in order to address a broad range of customer segments with our products and services. We offer the majority of our mobile communications products in the postpaid customer segment via our brands O_2 and BASE. Fixed communication products and bundles are offered via our premium brand O_2. We continually strive for an improvement of the market positioning of our premium brands, particularly in order to gain high value customers in the consumer and the business customer segment. For several years already, our strategic focus has been the sale of data-centric mobile telecommunications contracts to smartphone users. As of 31 December 2014, smartphone users already accounted for more than 75% of the customer base of the postpaid customer brands O_2 and BASE. On the back of their use of mobile data services together with an increasing interest in the new mobile communications standard LTE these customers generate above-average revenue numbers in comparison to users without a smartphone. We also see growing interest in smartphones and the use of mobile data in the prepaid area. As such, we also offer special prepaid tariffs for smartphone users.

Under the O_2 brand we have been selling mobile phones and other hardware at fixed prices, independently of mobile communications contracts, for example via our successful "O_2 My Handy" model. Here the customer can choose whether to pay the entire price upfront or to make a down-payment and pay the remaining purchase price in twelve or 24 monthly instalments. For the customer, this approach provides price transparency with regards to the cost of both the mobile phone and the telecommunications services contract. Customers can choose from a large variety of mobile phones including the latest premium devices and benefit from attractive payment conditions. Also to customers of the former E-Plus brands, we offer bundled services with hardware next to mobile only service. Customers have the choice between buying or renting a device at attractive conditions. Our main suppliers of mobile phones are the manufacturers Samsung, Apple, Nokia, HTC, Sony and Huawei. We focus on the sale of smartphones with internet capability, which represent the majority of mobile phones sold to our postpaid customers in the fourth quarter of 2014. In the same period, the share of LTE-enabled smartphones in relation to all smartphones sold is continuously on the rise. We are serving the growing demand for mobile data services among customers of our secondary brands and wholesale partners via a large range of cheap entry-level smartphones.

With our secondary and partner brands and via our wholesale channels, we reach further groups of customers that we do not target with our O_2 and BASE brands. Our secondary brands include blau.de, Fonic, simyo, Ay Yildiz, Ortel Mobile and netzclub, which are fully controlled by us, as well as brands from joint ventures and strategic partnerships such as TCHIBO mobil. Our multi-brand approach enables us to address a broad spectrum of customers and to maximise and also efficiently control our sales reach through customised product offers, sales and marketing.

As part of the wholesale business, we offer mobile services for customers such as MedionMobile (AldiTalk), ADAC, MTV, mobilcom/debitel and cable providers.

In addition, as part of the antitrust approval process in connection with the merger with the E-Plus Group we have committed to selling at least 20% of our future mobile network capacity via mobile bitstream access ("MBA") to MS Mobile Service GmbH ("Drillisch") before completing the merger. Drillisch also has the option to acquire up to 10% of additional network capacity.

In the fixed business, we offer our wholesale partners a range of "unbundled local loop" (ULL) services, including wireline telephony and high-speed internet. Furthermore, we offer added value services such as billing services or the management of telephone numbers and SIP accounts. This comprehensive portfolio enables our wholesale partners to independently serve their end-customers and at the same time gives us the opportunity to increase our reach and to achieve economies of scale.

In the business customer segment, small offices/home offices (SoHos) as well as small and medium-sized enterprises (SMEs) are addressed via our core brand O_2, while large international businesses are addressed via the Telefónica brand. We market our products via a diversified sales platform. This includes direct sales channels like our nation-wide network of independently operated franchise and premium partner shops, online and tele-sales as well as indirect sales channels like partnerships in retail/online retail and retailers/cooperations.

1.2 Goals and Strategies

Following the merger of Telefónica Deutschland Group and the E-Plus Group with effect from 1 October 2014, we are now one of the leading telecommunications providers in the German market.

As of 31 December 2014, Telefónica Deutschland Group is the market leader in the German mobile telecommunications market with a total of over 42 million mobile customer accesses. The company's aim is to focus on both customer retention by means of an improved network, service and customer experience and also the consequent monetisation of increasing data usage and future technologies such as LTE. We also intend to significantly expand our market position in small office/home office (SoHo) as well as small and medium-sized enterprises (SMEs) and take advantage of new opportunities in the wholesale and partner business. Overall, the goals and strategies of the extended company follow the clear vision of **building the leading digital telecommunications company** in Germany.

Building ...

Telefónica Deutschland Group considers the merger of the two companies not only as a possibility to achieve economies of scale, but rather as a unique opportunity to create a new company that radically changes its business model and actively shapes the market. In this transformation process, the company is guided by two overarching principles for action: **simplification and digitalisation**. In the context of the merger, the Telefónica Deutschland Group is striving to fundamentally simplify processes, structures and platforms. Simple and flexible structures help to enable the company to offer its customers simple and customised solutions, to react quickly and to stay ahead of the competition. Telefónica Deutschland Group also wishes to offer its customers a clearly structured product portfolio and user-friendly, easily accessible services.

With the challenger mentality inherited from both companies, we also aim to be a pacemaker in the industry, continuously surprising the market. Both companies were already known for innovations setting new trends in the market. These included establishing multi-brand strategies and new types of tariff models, as well as introducing and operating brands for partners from other industries. This challenger mentality will continue to be a key success factor for us after the merger.

... the leading ...

Our development into the leading digital telecommunications company is to be based on **three core strategic elements**. Firstly, we endeavour to offer our customers the best network experience where they need it most. Secondly, we aim to convince them with the best customer experience in all areas – from services, tariffs and devices all way to customer service. And thirdly, the extended Telefónica Deutschland Group is aiming for cost leadership amongst its competitors so that it can make attractive offers with excellent value for money.

The company aims to provide the **best network experience** by consistently aligning the network infrastructure to customer needs. The network quality from the customer's perspective must at least match or even exceed that of the competition. This applies especially to urban areas where customers with particularly intensive data usage are concentrated. Telefónica Deutschland Group will achieve this primarily through synergies resulting from the merger and smart investments in further network development. If the data usage patterns of customers change – e.g. if they consume higher data volumes – the company quickly reacts with a network capacity increase.

Attractive data services and the highest degree of transparency and responsibility in implementing processes are key for offering the **best customer experience**. The Telefónica Deutschland Group aims to consistently gear its tariffs, hardware and services towards its customers' requirements. In addition to the network experience, state-of-the-art devices and simple, comprehensible tariff structures also make a significant contribution to a positive customer experience and long-term customer satisfaction. Customers should also experience excellent service that is consistently geared towards their requirements throughout the entire customer relationship starting from their first contact and at each individual interface with the Telefónica Deutschland Group.

Sustained **cost leadership** is the third core element of the Telefónica Deutschland Group's strategy. With the merger with E-Plus, the company aims at achieving synergies across-the-board and substantial economies of scale in its business operations. This applies to the network infrastructure as well as to the sales organisation, customer service and administration. Furthermore, because customer acquisition and customer service are increasingly shifting to digital channels, a reduction in customer service costs over time is expected. Looking to the future, the company intends to manage the majority of customer contacts via digital channels in a few years' time. The organisation of the company is to remain lean overall, thus maintaining the learned culture of cost discipline. Cost leadership will enable Telefónica Deutschland Group to offer customers consistently excellent value for money.

… digital …
The extended company is using the combination of two strong partners as a unique opportunity to advance digitalisation faster and more decisively than its competitors and thus optimally meet evolving customer needs of future mobile communication. We expect to gain two major benefits from digitalisation:

Firstly, digitalisation brings the Telefónica Deutschland Group closer to its customers and their requirements. Because many people use their smartphone as the hub of their mobile life, mobile communications companies can get closer to their customers than companies in almost any other sector. This supports the development of innovative new offers that set Telefónica Deutschland Group apart from the competition. Both partners have already successfully proven their capacity for innovation in the past, for example with mobile music and video streaming offers and the world's first mobile communications partnership with the mobile communication service WhatsApp. Experience shows that customers who experience the tangible benefits of these applications in their everyday life use them more and more intensively over time. This leads to increasing data consumption, which benefits Telefónica Deutschland Group on a sustainable basis.

Secondly, digitalisation makes it possible to establish lean, efficient platforms along the entire process chain within the company. These are to be based on simple, standardised structures and processes, ranging from providing the service at the "back end" to the customer interface at the "front end". In this way, we aim to maintain cost leadership on the market and offer our customers an excellent, reliable and individual customer experience at attractive conditions. In the area of information systems, for example, we intend to establish state-of-the-art, flexible IT platforms. These platforms will be used as a shared "factory" with the highest level of operational stability by the three customer segments B2C (consumers), B2B (business customers) and B2P (partners) and can lead to significant cost benefits. They will also make it possible to develop and launch new offers within a short space of time. Simple and efficient integration of partner brands will be another competitive advantage of the new IT infrastructure. In addition, internal digitalisation will allow for better knowledge of customers' requirements. Part of the systematic digital business model of the extended Telefónica Deutschland Group will be effective customer relationship management. The knowledge gained from this will firstly be used by the company to closely tailor its offers to customers' requirements and to control marketing measures in a targeted way. Secondly, it will add to the information base for important business decisions such as investing in the network infrastructure and planning locations for fixed points of sale.

… telco
We see a **high-performing network infrastructure** as a key future success factor. Following the merger of the Telefónica Deutschland Group with the E-Plus Group, the network will be developed over the coming years so that it combines the best quality from customers' perspective with high efficiency. Because the Telefónica Deutschland Group, in line with many market studies, is firmly convinced that mobile use of data will see further dynamic growth, this means that a high-performing and optimally sized mobile network is at the heart of the network infrastructure. In addition, the company offers customers additional added value in the form of high-speed fixed services if needed.

The company invests smartly in network expansion and flexibly gears the network performance to the future requirements of the mass market, for example with the ongoing nation-wide roll-out of the LTE network. Telefónica Deutschland Group will continue to use outsourcing partnerships to an appropriate extent for the operation and expansion of the network, so as to keep its own organisation lean and underpin its cost leadership. The company always maintains exactly the network structure required to meet current customer needs while offering the best network experience. In this way, the company achieves its goal of ensuring the best customer experience together with attractive profitability.

In **brand management and sales**, the company focuses on a clear brand architecture and a multi-channel sales approach that is consistently geared towards customers' requirements. The brands are intended to address their respective target groups with clear, differentiated selling propositions. They acquire and retain customers in the competitive environment with new type of products, innovative partnerships and convincing value for money. In marketing and sales, we strive for an optimal mix of digital and stationary channels. Depending on their preferences, customers can gather information on products and tariffs, purchase devices, book tariffs or make service requests either online or in-store. All channels shall be closely interconnected, meaning that customers can, for example, choose a smartphone or tablet online and then have it set up and pick it up from a store. New types of concept stores will increase customer loyalty to the brands. In marketing, the company intends to use all cross-media formats and channels, including innovative content platforms. Customers will also be able to access all service functions via online channels. These will be supplemented with an appropriate physical presence.

Implementing the vision
In order to implement the strategic vision successfully and rapidly, the company will focus on the three strategic priorities of momentum, integration and transformation (**"MIT"**) in the coming months.

Momentum: The top priority is a continued systematic focus on actively shaping market developments and interacting with customers in order to compete successfully on the market, stabilise revenues from mobile services and improve profits. One key factor here is the monetisation of increasing data usage and higher demand for LTE, supported by the improved network quality. In the consumer segment, the focus is shifting away from acquiring new customers towards retaining existing customers and an increased focus on valuable customers. By contrast, the focus in the business customer segment is rather on acquiring new customers.

Integration: In order to take advantage from the synergies of the merger and economies of scale of the two companies as quickly as possible, the internal integration already began in the fourth quarter of 2014. The goal is to incorporate the best of both worlds (the Telefónica Deutschland Group and the E-Plus Group) in the extended company.

With regard to the network, this means selecting the best locations from the two networks so as to offer optimal coverage. Once the integration is complete, the new, joint network will have approximately 25,000 mobile network sites in Germany. Investments in the nation-wide LTE roll-out will be increased and the expansion will therefore progress at a faster pace. The mobile spectrum assets and the network sites are combined in such a way that customers can be offered the best network experience in the future. This applies especially to urban areas where customers with particularly intensive data usage are concentrated. However, there will not be any dramatic changes in network coverage in the short term; rather, the combination of the networks will progress step by step.

Sales capability is one of the biggest strengths of the new Telefónica Deutschland Group for maintaining momentum, defending market share and achieving the strategic goals. The merger enables the group to offer customers throughout Germany the best experience with one of the largest and best-performing shop networks in the industry. In addition, the sales units of E-Plus Group and Telefónica Deutschland Group, which are currently still separate, are being combined. The longer-term consolidation process will begin in 2015. The shop network has been analysed based on the criteria of location and performance. We intend to reduce the current distribution network by about one-third of the currently about 1,800 stores.

Transformation: simplification and digitalisation initiatives as well as an evolution of the business model accompany integration and daily business, thus continously moving forward the evolution towards a digital telco.

1.3 Management System

The Telefónica Deutschland Group is centrally managed by the members of the Management Board and the management at the level of Telefónica Germany Management GmbH respectively Telefónica Germany 1. Beteiligungsgesellschaft mbH. The goal is the generation of profitable corporate growth.

The encouragement of entrepreneurial behaviour is one of the most important fundamentals of the corporation. That is why the corporation has anchored a clear responsibility for results in the individual organisational units.

The corporate leadership strives to provide its shareholders with growth in value. In addition, it is firmly convinced that the satisfaction of customers is the key to realising this goal.

The management of the Telefónica Deutschland Group has introduced a comprehensive internal management system for the control of the group, which primarily comprises the following components:

- Process for strategic goal-setting
- Integrated budgeting and planning system
- Finance-related and operative performance indicators
- Monthly reporting to Management Board and Supervisory Board
- Continual opportunity and risk management
- Leadership by agreements on goals at all levels of the organisation

1.3.1 Process for strategic goal-setting

As part of the annual planning process, the corporate strategy is reviewed by the Management Board of Telefónica Deutschland. Here, long-term strategic goals for the positioning of the corporation on the German market as well as a business plan typically for the next three years are developed. The decisions are based on current market and competition analysis as well as market forecasts, which are compared with the corporate vision and the long-term strategic goals.

Within this systematic approach, chances and opportunities for growth are determined and investment decisions are made.

In close cooperation with the individual business units, the corporate strategy as well as the ascertained opportunities and potential for growth of the corporation are translated into concrete strategies for each organisational unit. For the practical implementation of the strategies at the level of the organisational units, in each case the relevant opportunities are prioritised, and concrete financial objectives are defined in the form of key performance indicators (KPIs) to measure the strategic implementation as well as the most important measures necessary for the realisation of the goals. The detailed budget planning for the next financial year is then prepared on the basis of the agreed multi-annual goals. At the same time the short-term strategic priorities are set.

1.3.2 Description of the management system

For the management of our strategic and operative goals, we have established key performance indicators (KPIs). The following finance-related and non-finance-related performance indicators are a component of the management system and value management of the Telefónica Deutschland Group and reflect the interests of our various stakeholders.

The following finance-related monitoring parameters have a particular significance for the value-oriented monitoring and evaluation of growth and profitability in our corporation:

Revenue and operating result before extraordinary effects

The development of the mobile service revenue is a key indicator of the success of our corporation. The mobile service revenue is largely generated by base fees and the fees levied for voice, short message and mobile data services as well as the revenue from services contracts. Alongside roaming revenues, mobile service revenue includes access and interconnection fees that were paid for by other service providers for calls and SMS delivered via our network. A central revenue driver for sustainable development is the mobile data business and the monetisation of data usage.

We measure the profitability of our operative business on the basis of OIBDA before extraordinary effects, i.e. the operating result before depreciation of property, plant and equipment and amortisation of intangible assets and before extraordinary effects. OIBDA before extraordinary effects as a fundamental monitoring parameter enables a comparison of the operative performance that was achieved in the individual reporting periods and businesses. The use of OIBDA before extraordinary effects as a basic parameter is advantageous, as this variable eliminates potential differences that can be caused by variations in the tax positions (for example on a change of the effective tax rates or deferred taxes and their effect on individual periods or businesses), depreciation and other positions. Thus, OIBDA is often used to compare the business activity of telecommunications corporations. However, as other corporations possibly use a different basis of calculation for OIBDA, it is possible that our representation is not comparable with other corporations.

Investment activity

Capital expenditure (CapEx) is comprised of the additions to property, plant and equipment and intangible assets. The investments in property, plant and equipment are primarily for the expansion of the coverage and capacity of our network (particularly for LTE and 3G) as well as product development. Intangible assets primarily include licences for mobile communications frequencies and software for office and IT applications. CapEx is a fundamental factor for the security of our future business activity.

Alongside our fundamental finance-related key performance indicators such as the mobile service revenue, OIBDA before extraordinary effects and CapEx, we have also provided other finance-related and non-finance-related figures in the Annual Report.

Free cash flow

The internal monitoring parameter free cash flow before the payment of dividends from continuing business operations is defined as the sum of the cash flows from the operating activity and the investment activity. The free cash flow implicitly provides information about the change in working capital. Working capital management is thus an essential part of the managing of the free cash flow in the relevant reporting period.

The figure free cash flow describes the change in financial liquidity from operational inflows and outflows of funds as well as all investment-related inflows and outflows that were made for the maintenance or expansion of the business. The figure provides information about the change in the corporation's available financial funds, which enable management, for example, to make investments in growth or to pay dividends or to service debt.

Net leverage ratio

Net leverage ratio[1] is defined as the quotient of the net financial debt and the operating result before depreciation and amortisation (OIBDA) for the last twelve months before extraordinary effects. Net financial debts include short and long-term interest-bearing assets and interest-bearing financial liabilities, cash and cash equivalents.

The net leverage ratio relates the net debt level to an operative success figure (OIBDA before extraordinary effects) and thus provides management with information about the

1 Leverage ratio is defined as the net financial debt divided by LTM (Last twelve months) OIBDA before extraordinary effects. Solely for purposes of calculating the leverage for any twelve month period which includes historical periods prior to the closing of the Transaction, a combined[2] OIBDA will be applied. This combined OIBDA includes the OIBDA of the E-Plus Group under Telefónica Deutschland Group accounting policies for the entire twelve month period as if the closing of the Transaction had occurred at the beginning of such twelve.

2 Combined figures for 2013 and 2014 are approximate and the result of the aggregation and then consolidation of Telefónica Deutschland Group and E-Plus Group financials according to Telefónica Deutschland Group accounting policies. The combined figures are further adjusted by material extraordinary effects if any, such as capital gains or restructuring costs based on estimates made by the management and resulting in combined figures we believe are more meaningful as a comparable basis. The combined financials are not necessarily indicative of results that would have occurred if the business had been a separate standalone entity during the year presented or of future results of the business. The presentation of the combined consolidated financial information is based on certain assumptions and is intended for illustrative purposes only. The combined information describes a hypothetical situation and thus, due to its nature, the presentation does not reflect the actual results of operations. The assumed acquisition date had been the beginning of the annual period 2014.

corporation's debt reduction ability. We are actively monitoring the capital structure, with the objective of keeping the net leverage ratio below 1.0x over the medium term ("target level").

As part of its dividend policy, Telefónica Deutschland has also decided to refrain from paying dividends distributing capital or capital reserves in cash or buying back shares if the net leverage ratio materially and consistently exceeds the target leverage of less than 1.0x.

Net adds in mobile communications business
New customers for the period less those customers leaving are designated as net additional customers (net adds). A continually positive number of net adds leads to a growing customer base. We differentiate here between contractual customers (postpaid) and customers without a contractual commitment (prepaid). The number of net adds is influenced by many factors. More new customers can be won with a highly attractive product portfolio and a high level of customer satisfaction among existing customers leads to a lower churn rate. One of the main goals of this KPI is to evaluate customer acquisition and customer retention measures.

Customer satisfaction
Customer satisfaction is among the most important priorities of our business. Thus, we continually strive for a better positioning of our brands in order to gain premium, consumer and business customers for mobile telecommunications products, wireline products and convergent services. We claim to serve the most satisfied customers on the German telecommunications market with the most popular brands. This means that we always strive to create customer-oriented offers and provide outstanding services on all our customer interfaces. We are convinced that high customer satisfaction values reduce termination rates and increase recommendation rates.

Employee satisfaction
A business is always only as successful as its employees. Our employees have made an important contribution to our success. Their dedication, their commitment and their engagement have made us the corporation that we are today.

We regularly review the satisfaction of our employees by means of external reviews and we take their feedback seriously in order to further improve our corporation.

1.3.3 Budgeting and planning system

The integrated planning system is based on strategic and operative goals. The Telefónica Deutschland Group sets internal objectives for the group with regards to the most important performance indicators, which are presented in section 1.3.2 Description of the management system. To develop a three-year plan, the anticipated market development as well as internal expectations with regards to progress in the areas of growth and efficiency evolution are discussed once a year. The first plan year is depicted on a monthly basis in order to establish a detailed budgeting. For reasons of control the budget is updated twice a year. Alongside the results that have already been achieved and which will be analysed as part of the monthly reporting, the current market development and the additional opportunities or risks that are known at the relevant point in time are taken into account in the updating. This prognosis is then used in order to introduce operative improvements or in order to seize new opportunities that offer themselves to the group.

1.4 Product Development and Innovation Management

Product development
Innovative and customer-oriented products form the basis of sustainable growth in revenues and results. For this reason we are continually expanding and improving our product portfolio. With a comprehensive analysis of our customer groups we have gained important knowledge in the past year, in order to exactly tailor our product and services offering as part of our multi-brand strategy to the needs of the relevant target group.

Our O_2 Unite tariff for business customers has been available since the beginning of April 2014. With this tariff, companies no longer select individual tariffs for each employee but instead are offered a pooling arrangement whereby they purchase quotas of call minutes, SMS messages and data that are used jointly by all employees. The companies are given full cost control in that all units that have not been used by the end of the month can be carried over to the following months and a practical monitoring tool provides a precise overview of the company's consumption at all times.

With machine-to-machine (M2M) complete solutions, the Telefónica Deutschland Group together with Software AG offers a joint product portfolio known as Smart Business Solutions. This comprises all necessary components from a single source: connectivity, hardware, applications and hosting. Companies from all sectors can thus individually develop their own M2M solutions that are perfectly tailored to their business models. Smart Business Solutions can be implemented without a great deal of IT expenditure and are particularly flexible and scalable. With their cloud-based application platform, new M2M solutions can be developed rapidly and integrated in existing business processes or ERP systems. Companies do not need to develop any specialist M2M knowledge in order to use them. They thereby gain competitive advantages that contribute to optimising work processes and increasing profitability.

Since October 2014, Telefónica has been offering a new service for drivers with O_2 Car Connection. We are one of the first providers in Germany to offer a comprehensive package that ensures greater safety, efficiency and a straightforward driving experience.

Drivers can connect their vehicle with the smartphone, and important diagnostic information is thus sent directly to the phone. Error codes, problem notifications and prompts to take the vehicle to a garage are sent to the driver quickly and simply by app, thus increasing safety on the roads. Information on the condition of the engine or the battery voltage allows the vehicle owner to better assess possible damage – and avoid surprises when the vehicle is being serviced at the garage. If the car is stolen or the driver cannot remember where it is parked, assistance is provided by the practical vehicle locator, which shows the car's location simply on a map on the smartphone. With "geofencing", the vehicle owner can be informed immediately if the car moves beyond certain boundaries, for example if the owner has lent the car to another driver.

With regard to environmental protection, O_2 Car Connection is also a step ahead: The integrated GPS module keeps a log of journeys made and also assesses the driving style. The associated app thus encourages the driver to adopt a more economic, low-wear driving style. This not only helps protect the environment and save money; it also invites drivers to engage in playful competition, as different users of O_2 Car Connection can connect with one another and compare their driving style using the app.

Innovation management

For our future growth it is critical that we recognise trends and new technological developments early and transform these into customer-oriented products and bring them onto the market quickly. For this we use the worldwide innovation network of the Telefónica, S.A. Group and optimise the relevant global products. In addition we develop targeted products and services that are of strategic significance for the German market.

One focus of our technical development in the previous year was Voice over LTE (VoLTE). Since November 2013, a smooth handover of telephone calls from LTE networks (4G) to UMTS (3G) or GSM (2G) has been possible in the O_2 Live network. The Telefónica Deutschland Group is thus one of the first providers in the world to establish this handover in the live network, too. This is particularly important when driving so that conversations do not break off. Further advantages are shorter call connection times and longer battery life. VoLTE use for end-customers is scheduled to begin in 2015.

The basis for these developments is our innovation management, which follows the principle of "Open Innovation". Thus we include employees as well as customers, start-up enterprises, business partners and other innovation assistants in our innovation activities.

Since 2011 we have been operating the "O_2 Ideas Laboratory". Here we introduce new concepts and products to our customers at an early stage of development and receive their direct feedback. By implementing selected ideas from the "O_2 Ideas Laboratory" we not only improve our products but rather we also deliver credible proof of our excellent customer orientation.

Through the start-up initiative, Wayra, the Telefónica Deutschland Group supports young technology businesses and thus secures access to new business models. In addition, since 2012 we have been operating the Wayra Academy in Munich, where start-ups further develop their business models and bring them to market maturity.

Our venture capital company Shortcut that we acquired as part of the merger with the E-Plus Group has the goal of supporting young entrepreneurs who have promising new ideas with a vision for tomorrow's market. They are provided with risk capital as well as direct personal access to the business know-how and experience of a team of experts right from the start.

In addition, we are in close contact with leading research institutes and actively involve ourselves in the exchange of innovative ideas. Thus, we regularly attend technical conferences and panel discussions like the DLD conference (Digital-Life-Design) and represent re:publica, which brings together pioneers from the IT and telecommunications branches.

2.
Economic Report_

2.1 Overall Economic and Branch-Related Conditions

2.1.1 Economic environment

Overall economic environment in Germany

The German economy saw stronger growth again for the first time in 2014 after two weak years in a row. After an energetic start to the year followed by a weak phase in the summer, the economic situation stabilised towards the end of 2014 and thus achieved a turnaround. As reported by the German Federal Statistical Office, gross domestic product (GDP) rose by 1.5% year-on-year in 2014, representing the German economy's strongest growth since 2011. According to economic research institutes, the German economy held its ground in a difficult global economic environment and particularly benefited from strong domestic demand.
(Source: Deutsche Bundesbank (German Central Bank), German Federal Statistical Office, January 2015)

1 — GDP development 2012–2014 for Germany and the Euro area

In %	2012	2013	**2014**
Germany	0.7	0.4	**1.5**
Euro area	(0.7)	(0.4)	**0.8**

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.

The strong demand for mobile data usage and the increasing smartphone and tablet penetration open up further opportunities for growth for mobile telecommunications network operators, 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 monetisation of the mobile data business will continue to gain strongly in significance for mobile telecommunications providers. According to the industry association BITKOM, the increasing availability of cloud services is responsible for a profound change in information technology.

With Cloud Computing the use of IT services occurs according to demand via decentralised 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 German mobile telecommunications market

With more than 112.6 million customers (SIM cards) at the end of December 2014, the German mobile telecommunications market is the largest in the EU. The notional mobile penetration rate was 140%, meaning that each German citizen has an average of 1.4 mobile SIM cards. Customer growth in 2014 was primarily attributable to the postpaid sector. Overall, postpaid customers made up 51% of the total connections as at the end of December 2014. At the end of December 2013, the proportion was still 49%.

The mobile telecommunications market was very dynamic in 2014 and was characterised by intense competition, primarily driven by the strong demand for smartphones and the increasing number of smartphone tariffs. Mobile media use is leading to further increases in sales volumes and revenues, particularly for smartphones and tablet PCs. According to the German Association for Consumer and Communication Electronics (Gesellschaft für Unterhaltung- und Kommunikationselektronik – gfu), around 7.8 million tablet PCs (an increase of 10.3%) and around 25 million smartphones (an increase of 4.8%) were sold in 2014.

The increasing penetration of mobile end-devices with internet capability such as smartphones or tablets and the increasing use of mobile data services also showed itself in the strong growth of revenues from mobile data on the German market: In 2014, according to estimates by Analysys Mason, mobile data revenue increased by over 20% in comparison to the previous year. By contrast, revenue from mobile telephony and SMS declined, driven by price decline, regulatory effects and changed customer behaviour.

The German mobile telecommunications market is an established market. Following the merger of the Telefónica Deutschland Group with the E-Plus Group, it consists of

three network operators and several service providers. As of the end of December 2014, the Telefónica Deutschland Group had a market share of 37.4% with over 42 million connections, making it the largest German mobile telecommunications network operator in terms of customers.
(Source: company data, German Association for Consumer and Communication Electronics (gfu))

The German fixed broadband market
Intense competition prevails on the German market for fixed broadband services as well. The number of subscriber lines increased by approximately 3% in comparison to the previous year and the customer base grew to approximately 29.2 million by the end of September 2014. The proportion of DSL connections here is 80%.
(Source: Analysys Mason: Telecoms Market Matrix Western Europe Q3 2014, January 2015)

The largest DSL provider in Germany is Deutsche Telekom AG, Bonn. The Telefónica Deutschland Group and other significant players on the broadband internet market rent the unbundled subscriber lines (Unbundled Local Loop, ULL) from Deutsche Telekom AG.

2.1.2 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 22 June 2004, in the version from 25 July 2014, and certain complementary regulations to the Telecommunications Act.

The Telecommunications Act implements the European legal framework for electronic communications networks and services, which was adopted in November 2009 (in the following: Legal Framework). The Legal Framework comprises, among other things, the provisions of the Framework Directive (2002/21/EC), the Authorisation Directive (2002/20/EC), the Access Directive (2002/19/EC), the Universal Service Directive (2002/22/EC) and the Directive about the Protection of Privacy in Electronic Communications (2002/58/EC).

The Telecommunications Act contains provisions that affect the following, among other things: (i) the organisation 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.

In November 2009 the European Parliament followed a suggestion of the European Commission and adopted legal provisions to amend certain Directives within the Legal Framework in order to strengthen the competitiveness and the rights of consumers on the European telecommunications markets and in order to promote access to fast broadband internet connections. The changes to the existing Legal Framework came into force on 19 December 2009, and had to be implemented in national law.

While the majority of the new provisions came into force in May 2012, for some of them there were transition deadlines. Worthy of mention in this connection are the provisions regarding the free queue, the regulations regarding a change of service provider and standards regarding the transparency of end-customer contracts.

The future development of the GSM licences
The GSM licences, which authorise the use of the frequency spectrum in the frequency sectors 900MHz and 1,800MHz, expire generally at the end of 2016. The Federal Network Agency is currently preparing the future allocation of these frequencies. In November 2012 the Federal Network Agency released an information paper in which four possible scenarios with regard to the future of the spectrum were illustrated. The possibilities extend from an extension to an isolated allocation of the GSM licenses through to scenarios in which the allocation of the GSM spectrum is made together with additional spectra, which are expected to be available in the coming years. The Federal Network Agency has released a draft decision on the basis of the submissions on the information paper. Opinions regarding the draft could be submitted up to 4 October 2013. Telefónica Germany GmbH & Co. OHG also made use of this opportunity. The opinions were published on the internet site of the Federal Network Agency.

On 25 July 2014, the Federal Network Agency gave all interested groups the opportunity to state their frequency requirements, including in view of the changed market structure, as part of a consultation, and called on them to update or announce their forecast requirements from 1 January 2017, onwards in the frequency ranges 700MHz, 900MHz, 1,800MHz and 1.5GHz by no later than 20 August 2014. The Telefónica Deutschland Group did so on schedule. On 22 October 2014, the Federal Network Agency then submitted drafts of the necessary presidential chamber decisions in accordance with section 55 (10) and section 61 of the German Telecommunications Act (Telekommunikationsgesetz – TKG) on the arrangement and selection of the frequency allocation procedure and on the allocation conditions and auction regulations to a public consultation. Opinions could be submitted up until 26 November 2014, and Telefónica Germany GmbH & Co. OHG did so. The opinions were published on the internet site of the Federal Network Agency.

After the national consensus on the inclusion of the 700 MHz frequencies had been decided between the federal government and the states at the Conference of Minister-Presidents on 11 December 2014, the Federal Network Agency consulted with its advisory committee and on 28 January 2015, the presidential chamber's decision on the arrangement and selection of the allocation procedure and on the allocation conditions and auction regulations for the allocation of frequencies in the ranges 700MHz, 900MHz, 1,800MHz and 1.5GHz was finally made and published. With the publication of the decision, the admission procedure for the auction was opened. Telefónica Deutschland Group submitted the applications for admission to the auction to the Federal Network Agency as of 5 March 2015. The auction is scheduled to be held in the second quarter of 2015. Telefónica Deutschland Group has filed an action against the decision of the President's Chamber in the first instance purely in a timely manner, on which has not yet been decided.

Telekom Deutschland GmbH's VDSL contingent model and expansion of the fixed network cooperation

In July 2012, the Federal Network Agency approved Telekom Deutschland GmbH's so-called VDSL contingent model. With this model Telekom Deutschland GmbH grants its competitors VDSL bit stream access on the basis of agreed access quotas. In December 2012 Telefónica Germany GmbH & Co. OHG executed a fee model of this kind with Telekom Deutschland GmbH and offers VDSL to its customers on this basis. With the offer of VDSL the Telefónica Deutschland Group receives access to almost 16.5 million households and thus promotes a further form of competitive wireline structures. Telefónica Germany GmbH & Co. OHG concluded a contract with Telekom Deutschland GmbH on 20 December 2013, to expand the fixed network cooperation. It comprises on the one hand a further development of the contingent model ("Migration contract") by Telekom Deutschland, which will be offered by Telekom Deutschland identically to all service providers, and a bilateral agreement ("Transformation contract"). The cooperation comprises the intensified use of Telekom's high-speed infrastructure by the Telefónica Deutschland Group for its wireline products. Within the scope of this cooperation, the Telefónica Deutschland Group will be able to implement the transition from the independent ADSL infrastructure through to a sustainable NGA platform. The transition should be fully completed in 2019. The Telefónica Deutschland Group will continue to use Telekom's VDSL and vectoring wholesale products. The Federal Network Agency confirmed that the cooperation complies with the Telecommunications Act in its draft decision of 17 December 2013. The draft decision was submitted to public consultation and reported to the European Commission. The European Commission responded on 13 March 2014, and did not express any serious doubts. The Federal Network Agency subsequently published its final decision on 18 March 2014, confirming its draft decision from December 2013. The cooperation entered into force with the Federal Network Agency's final decision on 18 March 2014. The Federal Cartel Office had opened investigations into the cooperation with regard to general competition law aspects. A ruling was issued on 5 November 2014. As expected, the 7th Ruling Chamber of the Federal Cartel Office determined that, according to current information, the cooperation does not give rise to any grounds for the Ruling Chamber to take action.

Decisions regarding the termination fees for mobile and fixed networks (MTR/FTR)

MTR

The rates that were definitively approved by the Federal Network Agency on 19 July 2013, for termination of calls in the mobile network of the Telefónica Deutschland Group and other mobile network operators expired at the end of November 2014. For the period starting from 1 December 2014, Telefónica Germany GmbH & Co. OHG and E-Plus Mobilfunk each submitted an application for the approval of new mobile termination rates (MTR) to the Federal Network Agency on 28 April 2014. In a provisional decision on 26 November 2014, the Federal Network Agency approved the rates in the amount of 1.72 Euro cents per minute for the period from 1 December 2014, to 30 November 2015, and 1.66 Euro cents per minute for the period from 1 December 2015, to 30 November 2016. The rates are symmetrical for all German mobile network operators. The draft of this decision was reviewed by the European Commission. As part of this notification process, the European Commission expressed serious doubts about the rate method and the rate level. A final decision by the Federal Network Agency is not to be expected before the second quarter of 2015.

FTR

On 19 February 2014, the Federal Network Agency issued a provisional decision for alternative local exchange carriers and thus also for the Telefónica Deutschland Group with regard to the local fixed line termination rates (FTR) of 0.36 Euro cents per minute (peak) and 0.25 Euro cents per minute (off-peak) that applied from 20 November 2013, until 30 November 2014. The European Commission was notified of these decisions on rates for alternative local exchange carriers on 11 August 2014. As part of this notification process, the European Commission expressed serious doubts about the rate method and the rate level. The preliminary rates were confirmed by the final decision of the Federal Network Agency on 15 January 2015.

On 11 September 2014, Telefónica Germany GmbH & Co. OHG submitted an application to the Federal Network Agency for approval of new FTRs for the period starting from 1 December 2014. On 26 November 2014, the Federal Network Agency issued the provisional decision regarding the local FTRs for Telekom Deutschland GmbH, which were reduced by 20% with effect from 1 December 2014, for a limited period up until 31 December 2016. By reason of the regulatory standards, Telekom Deutschland GmbH's FTRs also have an effect on the FTRs of alternative network operators. On 28 November 2014, the Federal Network Agency therefore issued a provisional decision for alternative local exchange carriers and thus also for the Telefónica Deutschland Group with regard to the local FTR of 0.24 Euro cents per minute (peak and off-peak) that applies from 1 December 2014, until 31 December 2016. In the meantime the decisions on the rates for alternative local exchange carriers were submitted to national consultation and notified to the European Commission on 18 January 2015. A final decision by the Federal Network Agency is expected not before second quarter 2015.

Transparency regulation of the Federal Network Agency

On the basis of Article 20 of the Universal Service Directive, in 2012 changes were made to section 43a of the Telecommunications Act (Telekommunikationsgesetz – TKG) regarding the transparent description of services in telecommunications contracts. The Federal Network Agency is empowered under section 43a (3) TKG to set corresponding standards. In May 2013 the Federal Network Agency set out key points to that effect and at the same time suggested that businesses self-regulate. Leading associations from the telecommunications industry and their members – among them the Telefónica Deutschland Group – have developed a voluntary agreement and submitted it to the Federal Network Agency, which has as its object the information that must be provided to the consumer in future before, during and after conclusion of the contract. In February 2014, the proposal was considered by the Federal Network Agency to be insufficient; a public authority draft regulation that is now based on the authorisation conferred by section 45n TKG has since been drawn up and submitted to an oral hearing. The Telefónica Deutschland Group and leading associations from the telecommunications industry submitted their opinions on this in late March 2014. The Federal Network Agency has since revised its draft regulation and is still engaged in dialogue with the industry in this regard. Before being issued, the regulation requires the consent of several federal ministries and of the German Federal Parliament (Bundestag). The regulation is expected to enter into force in the first half of 2015. However, owing to extended transition deadlines, parts of the regulation will not come into force until during the second half of 2015.

Roaming III

On 30 May 2012, the Council of the European Union adopted a new, revised roaming regulation ("Roaming III"), which replaces the previous Roaming II Regulation from 2009. This new Roaming Regulation came into force on 1 July 2012, and applies until 30 June 2022. The Roaming III Regulation will further reduce the current price caps for voice calls and SMS messages and introduce a new price cap for data services in the end-customer area. The price caps were also reduced in steps for wholesale, and new structuring measures were introduced in order to promote competition between the operators. Since 1 July 2014, customers have had the option to acquire inland and roaming services separately with different operators while retaining the same telephone number. In addition, since 1 July 2012, mobile virtual network operators (MVNOs) have had the right to use the networks of other operators at wholesale prices in order to offer roaming services.

The Regulation also contains provisions for transparent prices and for the improvement of information about the end-customer roaming fees.

With regards to the end-customer prices, some of the new provisions of the Roaming III Regulation that came into force on 1 July 2012, have been as follows since 1 July 2014:

— 22 cents per minute for a call;
— 5 cents per minute for receiving a call;
— 7 cents per SMS sent and
— 23 cents per megabyte (MB) for data transmission or surfing the internet in foreign countries (billing in kilobytes).

"Digital Single Market" initiative of the European Commission

Under the catchphrase "digital single market", on 11 September 2013, the European Commission adopted a package containing various measures intended to improve the framework conditions for investments in modern broadband networks and to create more favorable framework conditions for a strong European telecommunications sector. The draft regulations contain, in part, positive elements that could improve the competitiveness of the sector in the long-term, such as, in particular, the suggestions for a stronger coordination of frequency allocations and the rules for frequency auctions. At the same time however, the package contains measures that have a direct negative effect on the revenue of network operators, for example regarding roaming and international long-distance conversations, or that result in additional costs and further regulation and limitation on the freedom to contract, such as stricter provisions for customer protection. The package was commented upon by member states as well as businesses. It was also discussed in European Parliamentary committees, and those committees viewed the measures for the regulation of roaming, among other things, critically. The European Parliament has since coordinated its positioning and communicated the results of this coordination to the European Council and the European Commission. On 23 September 2014, the Italian Council Presidency put forward a compromise proposal with reduced regulatory content and more detailled standards. In light of the fact that the European Commission has been newly constituted and then still has to deal with the opinions received, the legislative procedure can be expected to be completed in 2015.

2.2 Overview of the 2014 Financial Year

The financial year 2014 was on the one hand characterised by the acquisition of the E-Plus Group and on the other hand by an ongoing dynamic competition in the market:

With effect as of 1 October 2014, the E-Plus Group belongs to Telefónica Deutschland Group. Since then we are one of three leading integrated network operators in Germany with about 48 million customer accesses as of 31 December 2014. Additionally we are market leader in the German mobile market with more than 42 million mobile customer accesses as of 31 December 2014.

Combining the two businesses, it is our ambition to build the leading digital telecommunications company in the german market, keep the commercial momentum and strengthen our position as the largest german mobile service provider according to customer accesses.

Furthermore Telefónica Deutschland Group continued to execute its data monetisation strategy in a market that has not seen significant changes of dynamics throughout the year. There is still a high level of competition around bundles of smartphone tariffs and devices with a clear focus on value maximisation leveraging increased customers' demand for LTE.

Operating and financial performance of Telefónica Deutschland Group follows the execution of its strategy in these market dynamics, and also the ongoing shift in communications' behaviour from customers, adopting a more digital lifestyle, and the current regulatory framework.

Mobile service revenue amounted to EUR 4,375 million in the financial year 2014. The increase by EUR 702 million or 19.1% compared to the previous period is mainly due to the the integration with E-Plus Group in the fourth quarter.

OIBDA before extraordinary effects amounted to EUR 1,088 million in the financial year 2014 in comparison to EUR 1,161 million in the previous year. OIBDA margin before extraordinary effects evolved on a lower level, reaching 19.7% for the financial year 2014 in comparison to 23.6% in the previous year and contained the OIBDA of E-Plus Group from 1 October 2014 until 31 December 2014. The ongoing competitive market environment required increased commercial spend for customer acquisition and retention measures, which is not yet offset by higher contribution of the mobile data business and the continuous focus on efficient processes. Furthermore, additional costs related with the acquisition and integration of the E-Plus Group are reflected in the OIBDA.

CapEx increased from EUR 666 million in the previous year to EUR 849 million in the financial year 2014, thereof 52% (EUR 438 million) were recognized in the fourth quarter 2014. The fourth quarter of 2014 was the starting point of a new investment cycle for the new company, maintaining a clear focus on the accelerated deployment of the LTE network.

Comparison of the actual development with the predicted business development

At the time of preparing the management report as of 31 December, 2013, we knew that the closing of the acquisition of E-Plus Group would change the scope of operations of Telefónica Deutschland Group significantly. Due to a number of uncertainties, including the exact point in time for the change of control, our ability to provide a precise outlook for the whole year 2014 was very limited. As such, in the management report as of 31 December 2013, we gave an outlook for the first half of the year 2014 only.

As described in the management report as of 31 December 2013, we expected a continuation of trends in mobile 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.

Mobile service revenue reached EUR 1,435 million in the first six months, declining 3.0% year-on-year excluding the impact from mobile termination rate cuts and 3.1% in reported terms. In the second quarter the company saw an improvement of trends for mobile service revenues with a year-on-year decline of 2.5% excluding the impact from mobile termination rate cuts compared with a decline of 3.4% year-on-year in each of the two prior quarters. This year-on-year performance is better than expected.

On the back of the acquisition of the E-Plus Group and as described in the management report as of 30 September 2014, we expected consolidated mobile service revenue in the fourth quarter to show a moderate quarter-on-quarter decline over the combined[2] mobile service revenue of EUR 1,424 million in the third quarter of 2014.

In the fourth quarter mobile service revenue totaled EUR 1,391 million and showed a moderate decline over the previous quarter on a combined[2] basis. This is in line with the given outlook, leveraging a strong contribution from premium brands. The increased adoption of mobile data bundles already outweighed ongoing declines from traditional voice and messaging services and thus confirmed the improved year-on-year trends already seen in previous quarters.

In the management report as of 31 December 2013 we expected that OIBDA margin before extraordinary effects in the first half of 2014 will show a limited year-on-year erosion from 2013 level (23.4%), similar to the year-on-year OIBDA margin before extraordinary effects performance seen in previous quarters.

Telefónica Deutschland Group is taking advantage from its value-for-money approach to premium LTE services and continued commercial investments to gain trading momentum in the market. In line with our expectations, the resulting OIBDA margin in the first half of 2014 showed a moderate year-on-year decline of 2.1 roll-outage points to reach 21.3%, which is in line with expectations.

From a combined[2] OIBDA of EUR 350 million in the third quarter of 2014 (17.5% combined[2] margin on revenues), we expected in our management report as of 30 September 2014 for the fourth quarter consolidated OIBDA before extraordinary effects to be slightly lower quarter-on-quarter, with a similar margin before extraordinary effects.

OIBDA before extraordinary effects totaled EUR 354 million and OIBDA before extraordinary effects margin of 17.6% meeting the given quarter-on-quarter outlook on the back of a higher contribution from the mobile data business. Commercial expenses reflected ongoing activities that resulted in a sustained trading momentum, while the accrual of additional expenses related to integration activities were not yet compensated by synergies.

In our management report as of 31 December 2013, we expected that in the first half of 2014, Telefónica Deutschland Group's Capital Expenditures show a moderate decline compared to the same period of the prior year (EUR 296 million).

As expected Capital Expenditures were lower year-on year due to a different investment planning, and also taking into account the envisaged integration with E-Plus. CapEx totaled EUR 266 million, a decline of 10.1% year-on-year compared with the first six months of 2013.

Taking a combined[2] CapEx of EUR 286 million in the third quarter of 2014 as a basis for comparison, we expected in the management report as of 30 September 2014, combined[2] CapEx in the fourth quarter of 2014 to be 1.5 times higher.

CapEx amounted to EUR 438 million, a significant 53% increase over the combined third quarter, as anticipated. This marks the starting point of a new investment cycle for the new Telefónica Deutschland Group, maintaining a clear focus on the accelerated deployment of the LTE network whilst integrating the two existing networks.

The business development is further detailed in the following sections.

Significant events

Agreement on the acquisition of E-Plus and implementation of the acquisition

On 23 July 2013, Telefónica Deutschland, Telefónica, S.A. and KPN concluded an agreement for the acquisition of KPN's German mobile business, E-Plus, by Telefónica Deutschland. As consideration, KPN received new shares and approximately EUR 3.6 billion in cash ("cash purchase price"), which will be subsequently adjusted in a final purchase price reduction.

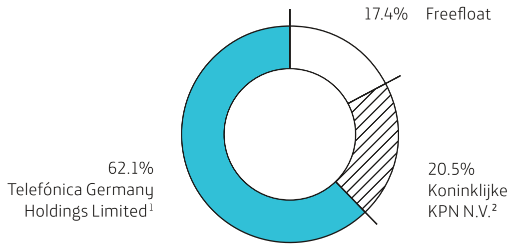
The cash component to be paid to KPN was financed via a cash capital increase of Telefónica Deutschland (section 7 Acquisition of E-Plus).

The shares issued as further consideration to KPN were generated via a capital increase against contribution in kind, initially giving KPN a 24.9% stake in Telefónica Deutschland after the completion of the cash capital increase and the capital increase against contribution in kind. KPN held a stake of 4.4% of the 24.9% only in trust for Telefónica S.A. (section 7 Acquisition of E-Plus).

Telefónica, S.A. then acquired the 4.4% share in Telefónica Deutschland indirectly from KPN for EUR 1.3 billion (section 7 Acquisition of E-Plus).

This resulted in a 62.1% stake in Telefónica Deutschland held by Telefónica, S.A. and a 20.5% stake held by KPN:

2 — Shareholder structure



1 Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.

2 According to the voting rights notification dated 20 October 2014, Koninklijke KPN N.V. now holds these shares directly

Furthermore, Telefónica, S.A. concluded a call option agreement with KPN on 30 September 2014. This agreement grants Telefónica, S.A. the right to acquire from KPN a further share of up to 2.9% of Telefónica Deutschland. This right can be exercised one year after the conclusion of the call option agreement at an exercise price of up to EUR 0.51 billion.

The acquisition of E-Plus was completed with effect from 1 October 2014. Since this date, the Telefónica Deutschland

Group also comprises E-Plus Mobilfunk together with its direct and indirect subsidiaries in addition to the existing companies.

Agreement for network access with regard to the E-Plus acquisition

On 25 June 2014, the Telefónica Deutschland Group concluded an agreement with MS Mobile Services GmbH ("Drillisch"), a group company of Drillisch AG, in which Drillisch undertakes to purchase 20% of the mobile network capacity under the control of the Telefónica Deutschland Group after the completion of the acquisition of the E-Plus Group in addition to the requirements for its existing customers already activated in the networks of the Telefónica Deutschland Group or E-Plus. This level of 20% will be reached by way of a five-year glide path. In addition, Drillisch acquires the right to purchase another up to 10% of the capacity of these networks.

The Telefónica Deutschland Group grants Drillisch access by way of a mobile bitstream model to the future joint network of Telefónica Deutschland and E-Plus and to current and future technical developments in this network, which Drillisch can offer to its customers.

The agreement was concluded in view of the European Commission's decision in the merger control procedure for the acquisition of E-Plus by Telefónica Deutschland (section 7 Acquisition of E-Plus). It is intended to ensure the implementation of individual commitments made by Telefónica Deutschland as part of the merger control procedure in order to dispel competition law concerns on the part of the European Commission.

The agreement with Drillisch entered into force after the European Commission confirmed on 29 August 2014, that this agreement fulfilled the conditions associated with the decision on approval to the extent that these conditions were required to be fulfilled before completing the transaction.

Changes in the Management Board of Telefónica Deutschland

As of 31 December 2014, the Management Board consisted of Thorsten Dirks, Rachel Empey and Markus Haas.

At the beginning of the 2014 financial year, the Management Board consisted of René Schuster, Rachel Empey and Markus Haas.

On 31 January 2014, René Schuster left in mutual agreement as CEO and member of the Management Board. The Supervisory Board of Telefónica Deutschland had approved a corresponding termination agreement on 29 January 2014.

From 1 February 2014, the responsibilities of the CEO were taken over jointly by Rachel Empey and Markus Haas, in addition to their previous responsibilities. Rachel Empey focused on the operative business and Markus Haas on the preparation for the E-Plus integration.

Since the completion of the acquisition of E-Plus, Markus Haas has been responsible for operating business as COO and Rachel Empey has been responsible for finance and strategy as CFO.

On 2 July 2014, the Supervisory Board of Telefónica Deutschland Holding AG resolved to appoint Thorsten Dirks as future Chief Executive Officer (CEO).

Thorsten Dirks was formally appointed as a member of the Management Board and as CEO in the context of the completion of the acquisition of the E-Plus Group by Telefónica Deutschland – specifically, by way of the Supervisory Board resolution of 9 October 2014.

By way of another resolution on the same date, the Supervisory Board extended the term of office of Rachel Empey and Markus Haas.

All current members of the Management Board are appointed for the period up until 30 September 2017.

Changes in the Supervisory Board of Telefónica Deutschland

The Annual General Meeting on 20 May 2014, elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as additional members of the Supervisory Board of Telefónica Deutschland Holding AG representing the shareholders. Their term of office began when the amendment to the articles of association regarding the expansion of the Supervisory Board from twelve to 16 members was registered on 18 September 2014.

Joachim Rieger and Jürgen Thierfelder were appointed as additional employee representatives on the Supervisory Board by order of the Munich Local Court on 31 October.

Therefore, at full strength the Supervisory Board consists of 16 members with eight shareholder representatives and eight employee representatives as of 31 December 2014.

Decision by the Federal Network Agency on the return of frequencies in the ranges of 900MHz and 1,800MHz

In the telecommunication law ruling on the planned merger of Telefónica Deutschland and E-Plus on 4 July 2014, the presidential chamber of the Federal Network Agency ruled that, in the event of the transaction taking place, the Telefónica Deutschland Group and E-Plus Mobilfunk are required to return those frequencies in the ranges of 900MHz and 1,800MHz for which they do not have any allocation beyond 2016 at that time by 31 December 2015 (early return of 900/1,800MHz spectrum), and that the Federal Network Agency will carry out an overall examination, taking account of the future frequency spectra in the ranges of 900MHz and 1,800MHz, to determine whether measures are required with regard to the frequency spectrum resulting from the merger, particularly in the 2GHz range (frequency allocation review). On 4 August 2014, the Telefónica Deutschland Group filed a suit against the Federal Network Agency's ruling of 4 July 2014, with the Cologne Administrative Court. No ruling has been issued yet with regard to this suit. In addition, an application for temporary legal protection was submitted on 9 December 2014, for which likewise no ruling has been issued yet.

Extraordinary General Meeting

On 11 February 2014, an extraordinary General Meeting was held at which the following capital measures for the E-Plus transaction were approved:

- increase in the share capital by up to EUR 3.7 billion against cash with a subscription right of the shareholders, as well as a related amendment of the articles of association
- authorisation of the Management Board, with the approval of the Supervisory Board, to execute a capital increase against contribution in kind up to EUR 475 million and the related amendment of the articles of association (authorised capital 2014/I).

The resolution passed by the Annual General Meeting on the authorisation to increase share capital by up to EUR 3.7 billion applied to any implementation of the cash capital increase up until the end of 10 August 2014. It was replaced by the corresponding resolution on the cash capital increase by the Annual General Meeting on 20 May 2014 with an implementation deadline of 19 November 2014 (section 1.1.1 Structure of the Telefónica Deutschland Group and section 7 Acquisition of E-Plus).

Furthermore, the extraordinary General Meeting resolved a new conditional capital 2014/I whilst suspending the former conditional capital 2012/I. The new conditional capital 2014/I was registered in the commercial register on 25 February 2014, whilst suspending the former conditional capital 2012/I (section 1.1.1 Structure of the Telefónica Deutschland Group).

Annual General Meeting and dividend distribution

On 20 May 2014, the second Annual General Meeting of Telefónica Deutschland took place. Next to the discharge of the Supervisory Board and Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the 2014 Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG, the Annual General Meeting resolved to distribute a dividend of EUR 0.47 per dividend-entitled share, a total EUR 524,964,338.

In addition, an increase in the share capital of up to EUR 3.7 billion against cash contributions with a subscription right of the shareholders in connection with the acquisition of E-Plus (also referred to hereinafter as the “cash capital increase”) and a corresponding amendment to the articles of association were resolved (section 1.1.1 Structure of Telefónica Deutschland and section 7 Acquisition of E-Plus). This also established the possibility to use the cash capital increase beyond the term of validity of the corresponding resolution adopted under agenda item 1 of the extraordinary General Meeting on 11 February 2014, i.e. after 10 August 2014.

In addition, it was resolved to increase the number of Supervisory Board members from twelve to 16 and to amend the articles of association accordingly. The amendment to the articles of association was entered in the Commercial Register on 18 September.

The Annual General Meeting had elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as members of the Supervisory Board of Telefónica Deutschland subject to the registration of this amendment to the articles of association.

Issue of a 7-year bond (Bond II)

On 10 February 2014, Telefónica Deutschland Group issued a senior unsecured 7-year bond with a nominal value of EUR 500 million. The bond matures on 10 February 2021. It was issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the seven-year Euro Midswap Rate, resulting in a yield of 2.434%. The bond has a denomination of EUR 1 thousand and was issued on the basis of a bond security prospectus. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general corporate purposes.

In this context, an interest rate swap was concluded for a partial amount of EUR 150 million of the bond’s nominal value. On the basis of this interest swap contract, Telefónica Deutschland Group pays a variable interest rate in the amount of the three-month Euribor on a nominal amount and receives a fixed interest rate of 1.268% on the same amount in return.

Conclusion of contract to expand the wireline cooperation

In May 2013, the Telefónica Deutschland Group concluded a Memorandum of Understanding with Telekom Deutschland GmbH via Telefónica Germany GmbH & Co. OHG to expand their wireline cooperation. This comprises the future intensified usage of the high-speed infrastructure of Telekom Deutschland GmbH by the Telefónica Deutschland Group for its fixed products. Within the scope of this cooperation, the Telefónica Deutschland Group will be able to implement the transition from the independent ADSL infrastructure through to a sustainable NGA platform. In future, the Telefónica Deutschland Group intends to increasingly use VDS Land vectoring wholesale products provided by Telekom Deutschland GmbH. The transition should be fully completed in 2019. A binding agreement for the wireline cooperation with Telekom Deutschland GmbH was concluded on 20 December 2013.

The cooperation includes regulating aspects which are subject to an inspection by the Federal Network Agency (Bundesnetzagentur – BNetzA) and the Federal Cartel Office (Bundeskartellamt – BKartA). The Federal Network

Agency approved the cooperation in its draft decision from December 2013. The draft decision was subsequently discussed publicly at national level and with the European Commission. In its statement on 13 March 2014, the European Commission did not express any significant misgivings. The Federal Network Agency published its final decision on 18 March 2014, positively confirming its draft decision from December 2013. With this decision, the binding agreement with Telekom Deutschland GmbH that had been signed in December 2013 entered into force on 18 March 2014.

The cooperation is not subject to antitrust approval but it was examined by the Federal Cartel Office with regard to general competition law aspects. A ruling was issued on 5 November 2014. As expected, the 7th Ruling Chamber of the Federal Cartel Office determined that, according to current information, the cooperation does not give rise to any grounds for the Ruling Chamber to take action.

With effect from 1 May 2014, the Telefónica Deutschland Group thus already uses the high-speed infrastructure to an increased extent for fixed products under the agreement concluded.

Dividend proposal for the 2014 financial year

On 8 September 2014, the Management Board of Telefónica Deutschland resolved and announced its intention to propose a cash dividend of at least EUR 700 million, to be paid in 2015, to the next Annual General Meeting for the 2014 financial year.

Cash capital increase

To generate the cash purchase price in the context of the E-Plus acquisition (section 7 Acquisition of E-Plus), a cash capital increase on the basis of the authorisation granted by the Annual General Meeting of 20 May 2014, and the resolutions of the Management Board and the Supervisory Board of 8 September 2014, was resolved, under which the share capital of the company was to be increased by EUR 1,116,945,400 from its previous level of EUR 1,116,945,400, divided into 1,116,945,400 no-par value registered shares, to EUR 2,233,890,800 by issuing 1,116,945,400 new shares. The cash capital increase was entered in the Commercial Register on 18 September 2014.

Capital increase against contribution in kind/new share capital

In connection with the acquisition of E-Plus, the Management Board resolved on 24 September 2014, with the approval of the Supervisory Board, to increase the share capital of the company by EUR 740,664,193 from EUR 2,233,890,800 to EUR 2,974,554,993 by issuing 740,664,193 new no-par value registered shares (capital increase against contribution in kind) (section 7 Acquisition of E-Plus).

The new shares were subscribed for by KPN Mobile Germany GmbH & Co. KG (KPN Mobile Germany) in return for a contribution in kind in the form of the limited partner's interest in E-Plus Mobilfunk. According to the voting rights notification, KPN now holds these directly.

The capital increase against contribution in kind was entered in the Commercial Register on 7 October 2014. Since this date, the share capital of the company has amounted to EUR 2,974,554,993, divided into the same number of no-par value registered shares.

In connection with the implementation of the capital increase against contribution in kind, the authorised capital 2014/I, which had been used in full, was removed. The authorised capital 2012/I is still in place in the amount of EUR 292,808,507 after partial use.

In the course of the above shown capital increase against cash and contribution in kind, an increase in capital reserves resulted to an amount of EUR 4.799.744.944 as of 31 December 2014.

The increase in capital reserves results from the total subscription price of the shares from the capital increase in cash and contribution in kind reduced by the cost of the capital increase as well as the contribution in share capital.

Integration of E-Plus

Following the completion of the E-Plus acquisition, the Management Board of Telefónica Deutschland published the planned key points for the integration of E-Plus on 17 October 2014. The merger with E-Plus offers Telefónica Deutschland a unique opportunity to actively shape the revolution in the telecommunications sector and become the leading digital telecommunications provider.

With the goal of digital transformation of the business model and of leveraging the announced synergies with a net present value of over EUR 5 billion, next to other actions, a restructuring programme was initiated in the course of which 1,600 of the total of around 9,100 full-time positions are to be cut by 2018. This will particularly be a case of eliminating duplicated functions. Telefónica Deutschland Group has set up a redundancy programme for employees leaving the company. Terminations of employment for operational reasons are to be avoided as far as possible (section 5 Report on Events after the Reporting Period).

In addition, the limited partner's interest in E-Plus Mobilfunk was contributed to Telefónica Germany GmbH & Co. OHG in the fourth quarter 2014 in accordance with the corresponding resolutions by the Management Board and the Supervisory Board. The Management Board and the Supervisory Board also resolved to convert E-Plus Mobilfunk into a limited liability company (GmbH) and conclude a profit and loss transfer agreement with Telefónica Germany GmbH & Co. OHG in the first quarter of 2015 (section 5 Report on Events after the Reporting Period).

In the fourth quarter 2014, the Telefónica Deutschland Group agreed to sell yourfone GmbH, including its trademark rights, customers and employees, to Drillisch AG (section 5

Report on Events after the Reporting Period). Further sales of customer bases from the shared portfolio of Telefónica Deutschland and E-Plus are not currently planned.

The integration of the E-Plus Group in operating business is also progressing rapidly. Since mid-November 2014, our sales employees have been serving business customers with a uniform product portfolio. At the same time, new O_2 products have been launched and LTE has been activiated without any extra charge for all contractual customers of O_2. Existing customers of E-Plus were given easy access to O_2 DSL tariffs a few weeks after the merger took place.

2.2.1 Results of operations

By the acquisition of the E-Plus Group as of 1 October 2014, results of operations of Telefónica Deutschland Group have changed significantly. Since the integration of E-Plus Group is progressing rapidly, a separate statement of earnings of the former E-Plus Group is not appropriate in our view.

To allow a better comparison, a presentation of selected indicators on a combined[2] basis take place in the following:

Revenue for the financial year 2014 totalled EUR 5,522 million, consolidating E-Plus Group with effect of 1 October 2014. On a combined[2] basis, 2014 revenues would have been EUR 7,793 million. Mobile service revenues for 2014 were EUR 3,580 million or EUR 5,528 million on a combined[2] basis.

Operating Income before Depreciation and Amortisation (OIBDA) for 2014 amounted to EUR 679 million or EUR 1,461 million on a combined[2] basis before extraordinary effects[3]. OIBDA margin was 12.3% for the full year 2014. For the illustration of the business development in comparison to the previous year see **Tab. 3, p. 47.**

2.2.1.1 Revenues

In the 2014 financial year, total revenues of EUR 5,522 million were generated. This corresponds to an increase of EUR 608 million or 12.4% in comparison to the previous year. The increase in revenues is primarily attributable to growth in mobile service revenues as a result of the merger with the E-Plus Group as of 1 October 2014. Due to a reduced DSL customer base, lower fixed service revenues were realised from fixed/DSL. Revenues continued to be positively influenced by strong growth in the mobile data business. — **Tab. 4, p. 48**

Mobile service revenues

Mobile service revenues, comprising revenues from mobile communications services and handset revenues, amounted to EUR 4,375 million in the 2014 financial year. This corresponds to an increase of EUR 702 million or 19.1% in comparison to the previous year.

In the 2014 financial year, mobile service revenues (for more detailed definition, see section 1.3.2 Description of the management system) amounted to EUR 3,580 million. This corresponds to a year-on-year increase of EUR 591 million or 19.8% and is due in particular to the increased customer base as a result of the merger with the E-Plus Group. Net adds in mobile communications business amounted to 172 thousand in the 2014 financial year (2013: 101 thousand). On the back of the integration with E-Plus Group, the customer base in the valuable postpaid segment was up 82.5% year-on-year as of the end of the 2014 financial year, while the customer base in the prepaid segment increased by 156.2% year-on-year, in particular because of the merger with the E-Plus Group. The increased share of prepaid customers (54% as of 31 December 2014) in our mobile access base (54%) resulted in a decline of average revenue per user (ARPU) to EUR 11.8 in comparison to the previous year (2013: EUR 12.7). The market and competitive environment remained demanding in the 2014 financial year. Changes in user behaviour with regard to mobile telephony services resulted in reduced importance of voice telephony and a lower number of text messages sent. This was countered by strong demand for data services (e.g. mobile internet, service applications and other data content), which had a positive impact on mobile service revenues. The monetisation of the data business was continued successfully, as reflected in the growth of data revenues. The growth driver here is non-SMS data business, its share over total data revenues reached 71.2% (2013: 66.5%). In accordance with this development, in the 2014 financial year the portfolio of integrated mobile communications products was renewed in order to further stimulate the increasing use of data – both with the postpaid tariffs "O_2 Blue All-in", "O_2 Blue Basic" and the "Young People" specials, and in the prepaid area with the "O_2 Loop Smart" tariff, as well as with the "BASE All-in" tariffs.

Handset revenues are subject to fluctuations, particularly due to their dependence on the market launch of new mobile devices. In the 2014 financial year, handset revenues of EUR 795 million were generated. Alongside the additional revenues resulting from the merger with the E-Plus Group, increased sales figures for mobile devices, especially the iPhone 6, also contributed to the year-on-year increase of EUR 111 million or 16.2%.

Handset revenues include the income from the sale of mobile phones as part of the "O_2 My Handy" model, those from the previous E-Plus brands and the hardware portion of bundled products (hardware bundle offers), and cash sales. In addition, handset revenues include further components from the mobile business such as activation fees and accessories.

3 Excluding extraordinary effects from restructuring costs of EUR 414 million for the full year 2014 on a combined basis.

Fixed business

In the 2014 financial year, revenues of EUR 1,138 million were generated in fixed and DSL business. This corresponds to a decline of EUR 97 million or 7.8% in comparison to the previous year. Good demand for our new "O_2 DSL All-in" tariffs as well as the continuing positive customer development in the VDSL business partially offset the contraction in the customer base and the overall intensely competitive market conditions. Fixed and DSL revenues comprise mainly revenues from the DSL service business, revenues from the fixed business, activation fees from the DSL business as well as the sale of DSL hardware. Furthermore, they contain revenues from the DSL service business with large customers, from termination rates paid by other telecommunications companies and, in 2013, from hosting services.

Other revenues

Other revenues relate to new business such as advertising and financial services, e.g. the mobile offer service "O_2 More Local" or the mobile payment system "mpass". This item increased by 41.4% year-on-year to revenue of EUR 8 million in the 2014 financial year, particularly due to the increase in mobile marketing activities.

2.2.1.2 Total profit for the year

Operating expenses, comprising supplies, personnel expenses and other expenses, increased by EUR 1,102 million or 28.7% to EUR 4,948 million in the 2014 financial year. The rise in operating expenses is mainly attributable to the merger with the E-Plus Group as of 1 October 2014, and expenses for restructuring the context of the integration in an amount of EUR 409 million, which were recognised in personnel expenses with EUR 322 million and in other expenses with EUR 87 million.

Supplies mainly include interconnection costs, which arise when our customers are connected with other mobile communications networks. Furthermore, this position reflects the costs for sold devices, in particular the sales as part of the "O_2 My Handy" model, for example. In addition, this line item contains the expenses for leased lines and the unbundled local loops (ULL) access charges as well as the costs for the leasing of space for network installations. In the 2014 financial year, supplies amounted to EUR 2,144 million. This corresponds to a year-on-year increase of EUR 186 million or 9.5%, due in particular to the acquisition of the E-Plus Group and higher expenses for end-devices sold.

Personnel expenses rose by EUR 409 million or 97.7% to EUR 828 million in the 2014 financial year. Adjusted for provisions for restructuring, the increase would have come to 20.9%, particularly due to the increased expense resulting from the merger with the E-Plus Group.

Other expenses include primarily commission paid to retailers, marketing costs, expenses for customer service and the outsourcing of administrative tasks, expenses for hardware and the maintenance of the IT infrastructure, leasing expenses for facilities and space as well as energy costs. In the 2014 financial year, other expenses amounted to EUR 1,976 million, which corresponds to an increase of EUR 507 million or 34.5% in comparison to the 2013 financial year. This increase arises in particular from the increased expense resulting from the merger with the E-Plus Group, the provisions recognised for restructuring as well as increased commercial expenses to gain new customers in the market. Adjusted for provisions for restructuring, the increase would

3 — Consolidated Income Statement

	1 January to 31 December			
(Euros in millions)	2014	2013	Change	% Change.
Revenues	**5,522**	**4,914**	**608**	**12.4**
Other income	106	169	(63)	(37.4)
Operating expenses	(4,948)	(3,846)	(1,102)	28.7
Supplies	(2,144)	(1,958)	(186)	9.5
Personnel expenses	(828)	(419)	(409)	97.7
Other expenses	(1,976)	(1,469)	(507)	34.5
Operating income before depreciation and amortisation (OIBDA)	**679**	**1,237**	**(558)**	**(45.1)**
OIBDA margin	**12.3%**	**25.2%**		**(12.9%-p.)**
Depreciation and amortisation	(1,325)	(1,132)	(194)	17.1
Operating income	**(646)**	**105**	**(751)**	**>(100)**
Net financial income (expense)	(41)	(27)	(14)	51.9
Profit (loss) before tax for the period	**(687)**	**78**	**(765)**	**>(100)**
Income tax	(34)	(1)	(33)	>(100)
Total profit (loss) for the period	**(721)**	**78**	**(799)**	**>(100)**

have come to 28.6%. Increased costs for customer acquisition and retention measures combined with higher advertising expenditure to increase the brand presence resulted in a rise in customer numbers, particularly in the contractual customer segment.

In the 2014 financial year, OIBDA after extraordinary effects amounted to EUR 679 million EUR, equivalent to a decline of EUR 558 million or 45.1% compared to the same period of the previous year.

Adjusted for extraordinary effects, OIBDA of EUR 1,088 million was generated in the 2014 financial year (2013: EUR 1,161 million). The extraordinary effects include expenses of EUR 409 million for restructuring in the context of the integration of the E-Plus Group. The previous year's OIBDA included one-off gains from the sale of assets in the amount of EUR 76 million. Adjusted for the specified extraordinary effects in the 2013 and 2014 financial years, the year-on-year decrease would have come to 6.3%. The adjusted OIBDA margin would have been 19.7% (2013: 23.6% adjusted). The still highly competitive market environment required increased expenditure for acquiring and retaining customers, which could not be offset by the higher value added from mobile data business and the continued focus on efficient work processes.

At EUR 1,325 million, depreciation and amortisation rose by 17.1% in the reporting period in comparison to the previous year (2013: EUR 1,132 million). This increase is particularly due to the inclusion of E-Plus for the first time in the fourth quarter of 2014 and initial effects from the consolidation of the networks as a result of the merger. These factors were partly offset by assets that were already fully written off and no longer used (mainly within the category of software) (For further information see details regarding the intangible assets and property, plant and equipment in section 2.2.3 Asset position).

The operating result declined by EUR 751 million or 713.3% to EUR –646 million in comparison to the previous year (2013: EUR 105 million).

The financial result for 2014 amounted to EUR –41 million (2013: EUR –27 million). This was primarily due to the company's higher level of indebtedness as a result of the bonds issued in November 2013 and in February 2014. It also includes interest expenses from finance lease obligation.

The Telefónica Deutschland Group did not record any positive taxable income in 2014 and as a result will once again not pay any current income tax. The tax expenses in the financial year 2014 in an amount of EUR 34 million relates predominantly to changes in the deferred taxes in an amount of EUR 33 million. In the previous period, an expense of EUR 1 million resulted from deferred taxes.

The above-mentioned effects led to a result of EUR –721 million for the current financial year in comparison to the value for the previous year of EUR 78 million.

2.2.2 Financial position

2.2.2.1 Principles and goals of financial management

Risk control and a central management are the fundamental principles of the financial management of the Telefónica Deutschland Group. The goal of financial management is to continually ensure financial liquidity and stability. Risk controls are used in order to anticipate potential risks and to mitigate them with appropriate security measures. An important parameter here is the net leverage ratio[1]. The Telefónica Deutschland Group intends to maintain a net leverage ratio of below 1.0x ("target leverage"). The net leverage ratio[1] corresponds to the net financial liabilities divided by LTM (last twelve months) OIBDA before extraordinary effects. The company aims to protect solvency by (a) refraining from paying dividends, distributing capital or capital reserves in cash or buying back shares, if the ratio of net financial debt/OIBDA materially and consistently exceeds the target leverage, and (b) restricting the use of new debt to pay dividends, allowing it only if the ratio of net financial debt/OIBDA before extraordinary effects complies with the target leverage.

4 — Revenue breakdown

			1 January to 31 December	
(Euros in millions)	2014	2013	Change	% Change
Mobile business	**4,375**	**3,673**	**702**	**19.1**
Mobile service revenues	3,580	2,989	591	19.8
Handset revenues	795	684	111	16.2
Wireline business	**1,138**	**1,235**	**(97)**	**(7.8)**
Other revenues	**8**	**6**	**2**	**41.4**
Revenues	**5,522**	**4,914**	**608**	**12.4**

2.2.2.2 Finance

Long-term finance agreements

On 12 September 2012, our subsidiary Telefónica Germany GmbH & Co. OHG signed a loan agreement with the finance company of the Telefónica, S.A. Group, Telfisa Global B.V., as a lender. Under the agreement, Telfisa Global B.V. grants a credit facility (in the following: the credit facility) with an initial amount of EUR 1.25 billion, with an interest rate equal to the three-month Euribor, plus a margin of initially 120 basis points, increasing by 40 basis points each year. The repayment schedule provides for annual repayments until 2017, each being 20% of the original total loan amount of EUR 1.25 billion.

Telefónica Germany GmbH & Co. OHG is entitled to repay the credit facility early in whole or in part with payment installments of at least EUR 100 thousand on an interest payment date – or at any point in time subject to a market standard breakage fee. If Telefónica Germany GmbH & Co. OHG cannot comply with its payment obligations under the loan contract, a default interest is payable, which is 2 roll-outage points above the agreed interest rate.

Taking into account the loan granted by Telfisa Global B.V. on 12 September 2012, of EUR 1.25 billion and the annual repayment of EUR 0.25 billion in September 2013 as well as the early repayment of EUR 0.15 billion in December 2013 and EUR 0.125 billion in February 2014, our future repayment obligations from financial agreements are configured as illustrated in table 5 (as of: 31 December 2014). **— Tab. 5, p. 50**

Revolving credit facility

In August and September 2012, Telefónica Germany GmbH & Co. OHG concluded revolving credit facility agreements with several banks. Thus, Telefónica Germany GmbH & Co. OHG has a total of EUR 710 million in banking liquidity lines with a term of over one year. The facilities have not been drawn. The interest rate for drawings under the individual agreements is calculated as Euribor plus a margin and is applied to the amount drawn down.

Bonds

In November 2013, O2 Telefónica Deutschland Finanzierungs GmbH issued a bond with a nominal value of EUR 600 million and a term of five years. The bond pays an annual coupon of 1.875%. The bond was issued at a price of 99.162% resulting in a total yield of 2.053% p.a. The bond has been approved for trading on the Luxembourg Stock Exchange by the Commission de Surveillance du Secteur Financier of the Grand Duchy of Luxembourg (CSSF). Telefónica Deutschland Holding AG guarantees the punctual payment of interest, capital and any other amounts payable under the bond. The issuer transferred the net issuing proceeds of the bond to its shareholder Telefónica Germany GmbH & Co. OHG as part of a loan contract. Telefónica Germany GmbH & Co. OHG will use the net proceeds for general business financing.

In February 2014, O2 Telefónica Deutschland Finanzierungs GmbH issued another bond with a nominal value of EUR 500 million and a term of seven years. The bond pays an annual coupon of 2.375%. The bond was issued at a price of 99.624% resulting in a total yield of 2.434% p.a. The bond has been approved for trading on the Luxembourg Stock Exchange by the Commission de Surveillance du Secteur Financier of the Grand Duchy of Luxembourg (CSSF). Telefónica Deutschland Holding AG guarantees the punctual payment of interest, capital and any other amounts payable under the bond. The issuer transferred the net issuing proceeds of the bond to its shareholder Telefónica Germany GmbH & Co. OHG as part of a loan contract. Telefónica Germany GmbH & Co. OHG will use the net proceeds for general business financing.

Cash pooling

The Telefónica Deutschland Group will continue to participate in the liquidity management system of the Telefónica, S.A. Group. Agreements have been made with Telfisa Global B.V. for deposits and liquidity management. The liquid funds of the entire Telefónica, S.A. Group are centralised by means of these agreements. In this way we can benefit from the economies of scale of the entire Telefónica, S.A. Group as well as from the internal set-off of receivables and liabilities that exist between us and the participants within the Telefónica, S.A. Group. In accordance with the cash pooling agreements, the total liquidity surplus, which is recorded in our accounts within the cash pool, is automatically transferred to main accounts that are maintained by Telfisa Global B.V. on a daily basis. In addition, we can use other methods in order to pay the cash in to the cash pool account and in order to balance out receivables and liabilities via the cash pool that are to be allocated to companies in the Telefónica, S.A. Group and third parties. We can draw from the cash pool account in an amount that exceeds our cash deposits up to EUR 69 million. The level of funds held in the cash pool may not exceed our free cash flow for the last 18 months. Further, we are entitled to make cash deposits in separate accounts with a term from one to a maximum of twelve months. We receive interest payments for credit in the cash pool account, based on a reference interest rate (Libor or Euribor, depending on the currency), plus/minus a margin on the basis of market prices. For deposits that are made in separate accounts for a term of between one and a maximum of twelve months, an agreement is reached in each case with the Telefónica Group regarding the applicable interest rate. Similarly, we are obliged to make interest payments if we take money from the cash pool in excess of our cash deposits. The average interest rate for borrowed capital is calculated based on a reference interest rate (Libor or Euribor, depending on the currency), plus a margin.

The agreements regarding deposits and liquidity management are automatically extended each calendar year unless terminated by one of the contracting parties before expiry of the contractual year within a 30 business days' notice. Under certain circumstances the agreements can also be terminated immediately – for example, if the contractually agreed payments are not made or if we have reason to assume that our contractual right to repayment cannot be fully met. In accordance with the deposit and liquidity management agreement and subject to compliance with the legal framework conditions that apply to the set-off of receivables, rights to repayment with respect to the deposits can be set off against liabilities from loans granted to us by Telfisa Global B.V. In the case of Telefónica Germany GmbH & Co. OHG, this also includes the outstanding amount of EUR 0.725 billion as of 31 December 2014, from the existing credit facility that was granted by Telfisa Global B.V. on 12 September 2012, with an initial amount of EUR 1.25 billion. In addition, as part of the agreements about deposits and liquidity management, we are granted comprehensive rights to information with regards to the financial position of the Telefónica, S.A. Group and Telfisa Global B.V.

In this way, we can weigh on whether we want to continue to participate in the cash pooling or whether termination rights should be exercised. Telefónica, S.A. has guaranteed the performance of Telfisa Global B.V.'s obligations under the cash pooling agreements.

On 1 October 2014, E-Plus Mobilfunk also concluded an investment agreement with Telfisa Global B.V. with the same conditions.

Silent factoring

In connection with the monthly payments for the "O_2 My Handy" model, we have concluded factoring agreements with certain credit institutions regarding the sale of receivables in order to strengthen our working capital. That means that the payments for the "O_2 My Handy" models are made to us without delay if we have concluded a factoring agreement with the credit institutions for these receivables. In the 2014 financial year, three factoring transactions with a net cash effect of EUR 31 million, EUR 71 million and EUR 101 million were concluded. The assigned receivables were derecognised from our balance sheet other than a small proportion due to a continuing involvement. Further information regarding the silent factoring can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2014.

Handset leases

The Telefónica Deutschland Group leases mobile phones to its end-customers under lease agreements. End-devices relating to this business model are leased as part of a sale and lease-back agreement with the aim of a balanced cash flow. Because these leases are classified as finance leases, we recognise liabilities to the leasing company and receivables from the customer. The leases mostly have the same terms and payment arrangements. Further information can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2014.

2.2.2.3 Finance analysis

Net financial debt

Table 7 shows the composition of net financial debt – i.e. the net amount of interest-bearing financial liabilities less cash and cash-equivalents and interest-bearing financial assets and receivables. Compared to 31 December 2013, net debt decreased by EUR 465 million to EUR 3 million as of 31 December 2014, resulting in a leverage ratio[1] of 0.0x.

The decrease in net financial debt is mainly attributable to a year-on-year rise in cash and cash equivalents of EUR 994 million. This increase is chiefly due to the net cash inflow from the cash capital increase (less transaction costs paid in the reporting period) in the amount of EUR 3,595 million and the purchase price payment made (net of cash acquired) in the amount of EUR 3,239 million, to the bond issued in February 2014 with a nominal value of EUR 500 million and to the free cash flow before dividends (and before purchase price payment for the E-Plus acquisition) in the amount of EUR 719 million. The cash inflows described were partly offset by the payment of dividends in the amount of EUR 525 million and the early repayment of EUR 125 million under a loan agreement with the financing company Telfisa Global B.V.

The non-cash increase in financial assets and financial liabilities is primarily attributable to the merger with E-Plus.

5 — Financing arrangements

	Payment due by period				
(Euros in millions)	2015	2016	2017	2018	> 2019
Loans	225	250	250	–	–
Debt relating to finance leases	374	168	14	15	–
Bonds	–	–	–	600	500
Total (nominal value)	**599**	**418**	**264**	**615**	**500**

Chart 8 shows the evolution of net financial debt in the 2014 financial year.

Off balance sheet obligations

In table 6, our contractual obligations as of 31 December 2014, are shown. The information in this table is based on corporate management estimates with regards to the contractual maturity of our obligations. These may vary significantly from the actual maturity dates.

2.2.2.4 Liquidity analysis

Table: Consolidated Statement of Cash Flows **— Tab. 9, p. 54**
Chart: Reconciliation of cash flow **— Chart 10, p. 54**

Consolidated Statement of Cash Flows

The following is an analysis of the cash flow development of Telefónica Deutschland Group in the 2014 and 2013 financial years. The cash flows from operating activities, investing activities and financing activities include the cash inflows/outflows for the fourth quarter of 2014 of E-Plus Group that has been acquired on 1 October 2014, by Telefónica Deutschland Group.

Cash flow from operating activities

Cash flow from operating activities was EUR 1,403 million in the 2014 financial year and thus EUR 133 million higher than the amount of the previous year (2013: EUR 1,270 million). This increase mainly results from an improvement of working capital which is mainly due to the increase of deferred income caused by an increase in an amount of EUR 269 million for other advanced payments for future services to be received as well as for a restructuring provision and liability amounting to EUR 409 million partly offset by a decrease in other working capital lines. This increase in working capital effect is partly offset by a decrease in OIBDA in the amount of EUR 558 million in comparison to the prior year (2013: EUR 1,237 million).

Cash flow from investing activities

Cash flow from investing activities amounted to EUR –3,924 million in the 2014 financial year. Compared to the previous year, the cash outflow increased by EUR 3.351 million (2013: EUR –572 million). The significant cash outflows in this area are mainly due to the acquisition of E-Plus Group amounting to EUR 3.239 million net of cash acquired. Payments on investments in property, plant and equipment and intangible assets[4] in 2014 totalled EUR 849 million (2013: EUR 666 million). These are mainly related to investments for the roll-out of the 4G network (LTE), the expansion of the 3G technology capacities, improvement of performance as well as improved coverage of the mobile networks.

Cash flow from financing activities

Cash flow from financing activities amounted to EUR 3,530 million in the reporting year. The cash inflows thus increased in comparison to the previous year by EUR 3.843 million (2013: EUR –314 million). The cash inflow from financing activities is mainly due to the cash capital increase (less transaction costs of the period) in September 2014 in the amount of EUR 3.595 million as well as the bond issued in February 2014 amounting to EUR 498 million. This was partly offset by cash outflows from dividend payments of EUR 525 million and from the partial repayment of EUR 125 million for the loan with an initial volume of EUR 1.250 million, which Telefónica Germany GmbH & Co. OHG concluded with Telfisa Global B.V. as lender.

Cash and cash equivalents

Due to the cash inflows/outflows described above, cash and cash equivalents increased in comparison to the reporting date of the previous year by EUR 994 million, of which EUR 396 million was attributable to the cash assumed as a result of the merger with the E-Plus Group as of 1 October 2014. Cash and cash equivalents amounted to EUR 1,702 million as of 31 December 2014 (2013: EUR 709 million).

Free cash flow pre dividend

The free cash flow pre dividend decreased by EUR 3,219 million and came to EUR –2,521 million in the 2014 financial year.

4 Investment expenditures respectively Capex (EUR 849 million; 2013: EUR 666 million), plus the change in liabilities for investments made (EUR –211 million; 2013: EUR 23 million), plus the change in reserves for outstanding invoices for investments (EUR 51 million; 2013: EUR –31 million) and plus other changes (EUR 0 million; 2013: EUR 6 million) result in payments on investments for property, plant and equipment and intangible assets of EUR 689 million (2013: EUR 664 million).

6 — Operating lease obligations, purchase obligations and other contractual obligations

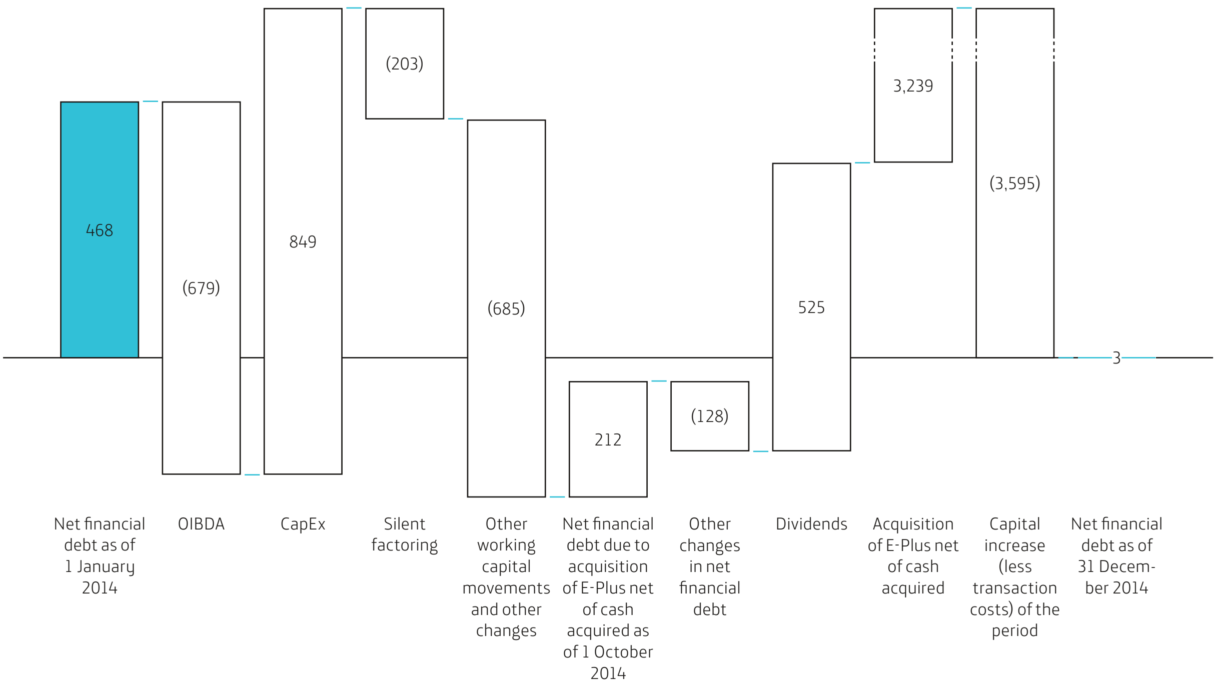
	Payment due by period			
(Euros in millions)	Less than 1 year	1 to 5 year	Over 5 years	Total
Operating lease obligations	549	1,396	1,031	2,976
Purchase obligations and other contractual obligations	710	265	710	1,685
Total	**1,259**	**1,660**	**1,742**	**4,661**

7 — Consolidated net financial debt evolution

(Euros in millions)		As of 31 December 2014	2013	Change	% Change	As of 1 October 2014: thereof contribution from opening balance E-Plus	As of 1 October 2014: % change minus the effect "contribution from opening balance E-Plus"
A	Liquidity	**1,702**	709	994	>100	396	84.3
B	Current financial assets	**456**	188	268	>100	192	40.4
C	Current financial debt	**612**	104	508	>100	350	>100
D=C–A–B	Current net financial debt	**(1,547)**	(793)	(753)	95	(237)	65.1
E	Non-current financial assets	**250**	83	167	>100	98	83.1
F	Non-current financial debt	**1,800**	1,344	456	34	151	22.7
G=F–E	Non-current net financial debt	**1,550**	1,261	289	22.9	54	18.7
H=D+G	Net financial debt [1]	**3**	468	(465)	(99.3)	(184)	(60.0)

1 Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents. B + E Current and non-current financial assets include handset receivables (current: EUR 454 million in 2014 and EUR 188 million in 2013; non-current: EUR 236 million in 2014 and EUR 83 million in 2013), positive fair value hedge for fixed interest financial liabilities (current: EUR 2 million in 2014 and EUR 0 million in 2013; non-current: EUR 12 million in 2014 and EUR 0 million in 2013) as well as loans to third parties (current: EUR 1 million in 2014 and EUR 0 million in 2013; non-current: EUR 1 million in 2014 and EUR 0 million in 2013) C + F Current and non-current net financial debt include bonds issued (EUR 1.115 million in 2014 and EUR 594 million in 2013), other loans (EUR 726 million in 2014 und EUR 851 million in 2013) as well as finance lease payables (current: EUR 374 million in 2014 und EUR 2 million in 2013; non-current: EUR 197 million in 2014 und EUR 1 million in 2013)
Note: Handset receivables are shown under trade and other receivables in the Consolidated Statement of Financial Position.

8 — **Net financial debt evolution** (Euros in millions)



Adjusted for the purchase price payment made for the acquisition of E-Plus in the amount of EUR 3,239 million (purchase price net of cash acquired), the free cash flow pre dividend of EUR 719 million was roughly at the previous year's level (EUR 699 million).

This development is due firstly to the year-on-year decrease of EUR 741 million in the operating cash flow (OpCF) and secondly to an increase in working capital of EUR 788 million.

The decline in operating cash flow (OpCF) from EUR 571 million in the 2013 financial year to EUR –169 million in the 2014 financial year results from considerably lower OIBDA compared to the previous year (2014: EUR 679 million EUR; 2013: EUR 1,237 million) and higher capital expenditure (2014: EUR 849 million; 2013: EUR 666 million).

The positive development of the change in working capital, which increased from EUR 132 million in the 2013 financial year to EUR 920 million in the 2014 financial year, chiefly resulted from the increase in deferred income due to advance payments for future services to be received and the recognition of a restructuring provision.

2.2.3 Asset position

The analysis of the asset and capital structure compares the assets and liabilities as of 31 December 2014, with the balances as of 31 December 2013. — **Tab. 12, p. 56**

As of 31 December 2014, the group had assets of EUR 17,887 million (2013: EUR 9,021 million), corresponding to an increase of 98.3%.

Changes in assets and capital structure, due to the opening balance of the merger with E-Plus on 1 October 2014, are presented separately. More information can be found in the Notes to the Consolidated Financial Statements for the financial year ended 31 December 2014, Note No. 7 Business Combinations. — **Tab. 12, p. 56**

Intangible assets

Intangible assets including goodwill amounted to EUR 8,355 million as of 31 December 2014 (2013: EUR 3,590 million). This corresponded to a year-on-year increase of EUR 4,765 million or 132.7% and was chiefly attributable to the merger with E-Plus. Current additions in the reporting period amounted to EUR 192 million (2013: EUR 142 million), of which EUR 187 million related to investments in software (mainly licences for office and IT applications). These were offset by amortisation of intangible assets in the amount of EUR 629 million in the 2014 financial year (2013: EUR 528 million).

Property, plant and equipment

Property, plant and equipment amounted to EUR 5,029 million as of 31 December 2014 (2013: EUR 2,896 million). A year-on-year increase of EUR 2,134 million or 73.7% was therefore reported, which was chiefly attributable to the merger with E-Plus. Current additions to property, plant and equipment amounted to EUR 656 million (2013: EUR 524 million) and mainly related to investments in connection with an accelerated network expansion including the optimisation of UMTS (3G), the further enhanced LTE roll-out, the expansion of IP technologies as well as the expansion of mobile data services with even faster download times. The data network inceased its quality considerably by expansion and installation, which is essential considering increasing real-time communication in "high-speed".

Furthermore, an additional requirement for provisions in connection with decommissioning, dismantling and shutdown obligations was capitalised in the amount of EUR 243 million. Depreciation of EUR 696 million (2013: EUR 604 million) offsets the effect from the additions.

With the acquisition of the E-Plus Group as of 1 October 2014, the business model of Telefónica Deutschland Group has changed significantly. As the integration of E-Plus Group is progressing rapidly, a separate disclosure of investments (CapEx) of the former E-Plus Group is not appropriate in our view. To allow a better comparison, CapEx is also disclosed on a combined[2] basis in the following paragraph.

CapEx in 2014 amounted to EUR 849 million (EUR 1,161 million on a combined[2] basis). In the fourth quarter, we saw with 53% a significant increase to EUR 438 million quarter-on-quarter on a combined basis. The fourth quarter of 2014 saw the starting point of a new investment cycle for the new company, maintaining a clear focus on the accelerated deployment of the LTE network.

Trade and other receivables

Trade and other receivables were significantly above the previous year's level at EUR 1,750 million as of 31 December 2014 (2013: EUR 960 million). The increase of EUR 789 million or 82.2% was primarily due to the merger with E-Plus and the rise in sales figures for handsets in the fourth quarter.

Deferred tax assets

Deferred tax assets amounted to EUR 581 million, down slightly compared to the previous year's level (EUR 584 million).

Other financial assets

Other financial assets amounted to EUR 68 million as of 31 December 2014 (2013: EUR 36 million). This increase was primarily the result of the merger with E-Plus and the positive development in the fair value of the two interest rate swaps. This item also chiefly comprised equity investments in start-up enterprises, a deposit for silent factoring and reimbursement rights from insurance contracts.

Other non-financial assets
Other non-financial assets amounted to EUR 213 million as of 31 December 2014 (2013: EUR 158 million), and particularly included advance payments for rents for antenna sites and leased lines.

Inventories
Inventories amounted to EUR 104 million as of 31 December 2014 (2013: EUR 89 million).

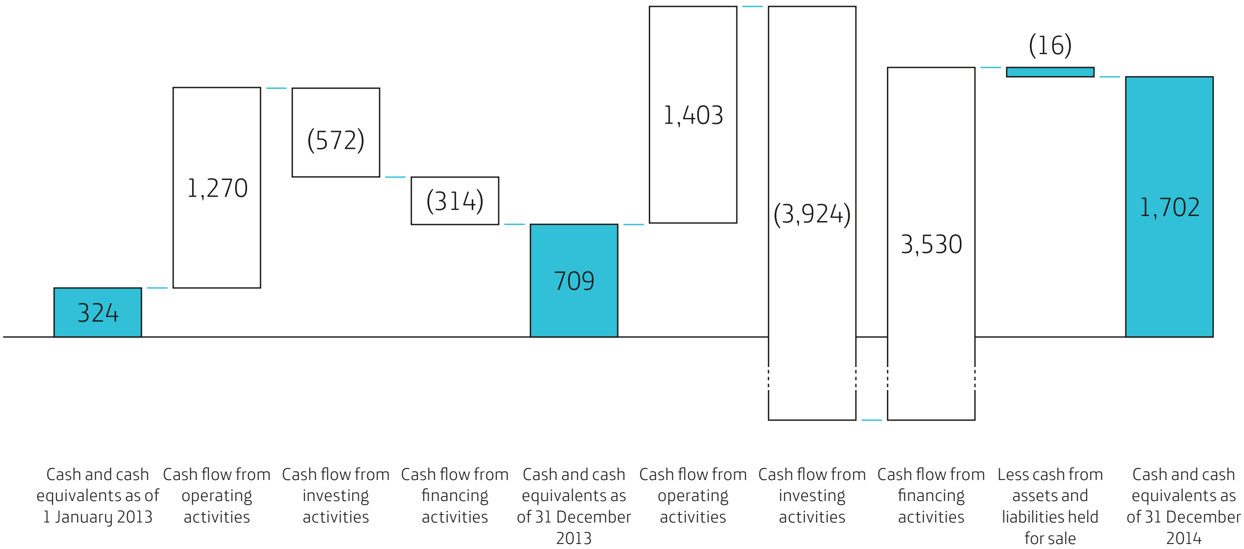
Cash and cash equivalents
Cash and cash equivalents amounted to EUR 1,702 million in total as of 31 December 2014 (2013: EUR 709 million). The increase of EUR 994 million or 140.2% is attributable to several effects. (Further information can be found in section 2.2.2.4 Liquidity analysis).

Interest-bearing debt
Compared to 31 December 2013, interest-bearing debt rose by EUR 967 million from EUR 1,448 million to EUR 2,415 million as of 31 December 2014. Besides the merger with the E-Plus Group this increase resulted in particular from the bond issued by O2 Telefónica Deutschland Finanzierungs GmbH in February 2014 with a nominal value of EUR 500 million and from the increase in finance lease obligations in the amount of EUR 66 million. This was partly offset by the early repayment of EUR 125 million of the loan concluded on 12 September

9 — Consolidated Statement of Cash Flows

(Euros in millions)	1 January to 31 December 2014	2013
Cash and cash equivalents at the beginning of the period	**709**	**324**
Cash flow from operating activities	1,403	1,270
Cash flow from investing activities	(3,924)	(572)
Cash flow from financing activities	3,530	(314)
Net increase (decrease) in cash and cash equivalents	**994**	**385**
Less cash and cash equivalents attributable to assets and liabilities held for sale	**(16)**	**–**
Cash and cash equivalents at the end of the period	**1,702**	**709**

10 — Reconciliation of cash flow (Euros in millions)



2012, by Telefónica Germany GmbH & Co. OHG with the financing company Telfisa Global B.V. as lender.

Provisions

Provisions rose by EUR 920 million or 853.1% year-on-year to EUR 1,028 million. Besides the merger with E-Plus, this development is mainly attributable to a significant increase in provisions for the dismantling and removal of assets from valuation changes in the amount of EUR 243 million, the newly recognised provision for restructuring of EUR 399 million and an increase in pension provisions of EUR 84 million.

The provision for restructuring primarily includes measures resulting from the transformation of Telefónica Deutschland Group in connection with the integration of the E-Plus Group that aim to increase profitability through synergies. The amount of EUR 399 million as of 31 December 2014 (2013: EUR 0), is allocated to personnel adjustments, the suspension of contracts with sales representatives and other measures. The majority of the provision amount recognised as of 31 December 2014, is attributable to severance payments in connection with personnel adjustments. These relate to the planned reduction until 2018. An amount of EUR 409 million for restructuring is recognised in the financial year 2014 with EUR 87 million under "other expenses" and EUR 322 million in "personnel expenses".

Trade and other payables

Trade payables and other payables amounted to EUR 2,302 million as of the end of the year. This corresponded to an increase of EUR 1,028 million or 80.6% compared to the previous year (EUR 1,274 million). Trade payables increased by EUR 950 million to EUR 2,108 million. This increase is chiefly attributable to increased accruals for outstanding invoices for goods and services as well as for fixed assets. Other payables increased from EUR 116 million as of 31 December 2013, to EUR 194 million as of 31 December 2014.

Other non-financial liabilities

Other non-financial liabilities amounted to EUR 18 million as of 31 December 2014 (2013: EUR 23 million). They particularly included wage tax and social security.

Deferred income

Deferred income increased in comparison to the previous year by EUR 535 million or 315.3%, and amounted to EUR 704 million as of 31 December 2014. Besides the acquisition of the E-Plus Group, the increase results in particular from the increase of other advance payments for future services to be received amounting to EUR 269 million. Furthermore, the line item includes advance payments received for prepaid credit of EUR 282 million.

11 — Reconciliation of cash flow and OIBDA minus CapEx

	1 January to 31 December			
(Euros in millions)	**2014**	2013	Change	% Change
OIBDA	**679**	**1.237**	**(558)**	**(45.1)**
– CapEx	(849)	(666)	(183)	27.5
= Operating Cash flow (OpCF)	**(169)**	**571**	**(741)**	**>(100)**
+ Silent factoring[1]	203	219	(16)	(7.5)
+/– Other working capital movements	717	(87)	805	>(100)
Change in working capital	**920**	**132**	**788**	**>100**
+/– Gains (losses) from sale of companies, fixed assets and other effects	(0)	(76)	76	(99.6)
+/– Proceeds from sale of companies, fixed assets and other effects	1	107	(106)	(99.3)
+ Net interest payments	(30)	(21)	(9)	43.2
+ Taxes paid	(6)	0	(6)	(100)
+/– Proceeds/Payment on financial assets	4	(14)	18	>(100)
= Free cash flow pre dividends[2] and pre-acquisition of E-Plus net of cash acquired	**719**	**699**	**20**	**2.9**
+ Acquisition of E-Plus net of cash acquired	(3.239)	0	(3.239)	(100)
= Free cash flow pre dividends[2]	**(2.521)**	**699**	**(3.219)**	**>(100)**
+/– Dividends[3]	(525)	(503)	(22)	4.4
= Free cash flow post dividends	**(3.046)**	**196**	**(3.242)**	**>(100)**

1 Full impact (YTD) of silent factoring in the twelve month period in 2014 of EUR 203 million and EUR 219 million in the twelve month period 2013 (transactions have been executed in January, March and September 2014 respectively in March, June and September of the year 2013).
2 Free cash flow pre dividends is defined as the sum of cash flow from operating acitivities and cash flow from investing activities.
3 Dividend payment of EUR 525 million in May 2014. Dividend payment of EUR 503 million in May 2013.

Equity

Equity increased by EUR 5,381 million or 89.7% to EUR 11,380 million in the 2014 financial year (2013: EUR 5,999 million). This rise in equity is mainly due to the cash capital increase and the capital increase against contribution in kind (less costs of the capital increase) in the amount of EUR 6,657 million, which were entered in the Commercial Register on 18 September 2014 and on 7 October 2014. This increase was partly offset by the dividend payment of EUR 525 million on 21 May 2014, the result for the period of EUR –721 million and other effects totalling EUR –31 million.

12 — Consolidated Statement of Financial Position

	As of 31 December				As of 1 October 2014	
(Euros in millions)	**2014**	2013	Change	% Change	Thereof contribution from opening balance E-Plus	Change minus the effect "contribution from opening balance E-Plus"
Goodwill and other intangible assets	8,355	3,590	4,765	>100	5,257	(491)
Property, plant and equipment	5,029	2,896	2,134	73.7	1,931	203
Trade and other receivables	1,750	960	789	82.2	677	113
Deferred tax assets	581	584	(2)	(0.4)	–	(2)
Other financial assets	68	36	31	86.4	19	13
Other non-financial assets	213	158	55	35.1	93	(38)
Inventories	104	89	15	16.3	21	(7)
Cash and cash equivalents	1,702	709	994	>100	396	597
Assets held for sale	85	–	85	100	–	85
Total assets = Total equity and liabilities	**17,887**	**9,021**	**8,866**	**98.3**	**8,394**	**472**
Interest-bearing debt	2,415	1,448	967	66,8	505	462
Provisions	1,028	108	920	>100	254	666
Trade and other payables	2,302	1,274	1,028	80.6	703	325
Other non-financial liabilities	18	23	(5)	(23.3)	6	(12)
Deferred income	704	170	535	>100	220	315
Liabilities held for sale	40	–	40	100	–	40
Equity	**11,380**	**5,999**	**5,381**	**89.7**	**6,706**	**(1.325)**

3. Employees_

The telecommunications market finds itself in continuous transition, which again and again poses new challenges for our employees as well. For this reason we specifically promote measures to impart the required capabilities and skills to our employees and to regularly further educate them. We also give our employees the freedom to further develop their own capabilities. In this way we ensure that the skills of the business always correspond with the requirements of the market. We promote an open working environment based on equal opportunity. In addition, we are committed to ensuring that our employees can combine the requirements of career and family with one another. For this reason the Telefónica Deutschland Group is one of the most attractive employers in Germany, as documented and substantiated by many surveys and awards.

Important areas of personnel management

Business Transformation

The core task of Business Transformation is advice in relation to and the implementation of all HR relevant aspects as part of the planning and implementation of change processes in the business areas. These include reorganisation projects in order to continually realign our core business so that we as a business remain competitive.

For example, in 2014 we prepared and supported all organisational and personnel changes that have been or will be implemented as part of the merger of Telefónica Deutschland Group with the E-Plus Group.

Culture Change

Our employees contribute significantly to the sustainable success of our business.

With Culture Change, we support our employees in promoting a certain attitude in the business on completely different levels: to inspire employees, to give them freedom and responsibility, but also to stand by decisions and implement them consistently. To be open, to actively approach customers, to learn how and above all why people and businesses use technology. And also: to question processes, products and ways of thinking. At the end of the day this always involves creating an environment in which new ideas arise and impressing our customers.

Employee Proposition

We understand Employee Proposition to mean a promise to our employees of performance beyond the purely material side. Alongside salary and fringe benefits, this includes in particular intangible issues such as a good work-life balance and flexible working hours. A good Employee Proposition serves to create employee loyalty and promotes the company's appeal as an employer so that it is able to recruit the best employees in the future as well. It helps us to increase the awareness and recommendation rate of the Telefónica Deutschland Group as an employer. With our strong presence at innovative personnel trade fairs and recruitment events, we are also positioning ourselves as an attractive employer.

Operational Excellence

It is our goal to permanently optimise HR services and HR processes with standardised methods so that we achieve the highest possible quality at low cost. The systematic development of our operating model includes the introduction of a uniform HR management system throughout the entire Group.

Looking to the future, the integration will involve further harmonisation and standardisation of HR policies and processes across all company units. In order to map our global HR processes in a uniform and practical way, we have decided to introduce an integrated and innovative HR system. Our HR systems are intended to make our employees' lives easier and save time in the normal working day.

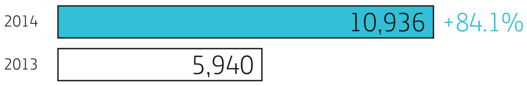
In 2014, we once again worked on optimising collaboration with the shared service centre European People Services Centre (EPSC) and achieved a qualitative development.

Number of employees and staff structure

At the end of 2014 the Telefónica Deutschland Group had 10,936 employees. The number of employees thus increased by 84.1% compared with the previous year (2013: 5,940 employees), mainly as a result of the merger with the E-Plus Group (increase of approximately 5,000 employees).

The basis for these calculations can be viewed in the notes to the Consolidated Financial Statements as of 31 December 2014 (Note No. 16 Information regarding employees). The fluctuation rate was 10.2% (2013: 8.6%).

13 — Employees on average



The business has a relatively young workforce. The average age of our employees in 2014 was around 38 years (2013: 37). A total of 2,230 employees, representing around 20.4% of the workforce, worked part time in 2014 (2013: 931 employees, 15.7%)

Diversity Management

In accordance with our corporate principles, we are expressly committed to diversity and equal opportunity in our business. By naming a diversity officer in 2010, we anchored this commitment solidly in our organisational structure. With the signing of the Memorandum for Women in Leadership (Memorandum für Frauen in Führung – MFF) in 2011, we undertook to specifically support women in positions of leadership.

Female employees accounted for 39.7% of our workforce in 2014. In the 2014 financial year, 14 women in leadership positions were represented in the business-leading Senior Management, corresponding to a proportion of 14.1% (2013: four women in leadership positions, 8.7%). In the Women-on-Board Index II 2014, we achieved second place out of 119 listed German corporations.

At the end of 2014, workers of 74 different nationalities were employed with the Telefónica Deutschland Group. People with disabilities are also welcome in our corporation. Because we take the obligation of inclusion very seriously we have opened a barrier-free career portal, which went online at the end of 2012. In this way we create direct access for and to qualified persons as part of our “Employer Branding”. In addition, since 2009 we have been working with the Stiftung Pfennigparade (Penny Parade Foundation) and providing a work-related perspective to people with disabilities. At the end of 2014, 261 employees with disabilities were employed at our company.

Employee satisfaction and employer appeal

We would like to be one of the most attractive employers in Germany. Because, at the end of the day, qualified and motivated employees are a fundamental pre-requisite for the realisation of our strategic goals. For this reason we offer our employees a whole series of additional benefits. These include flexible working hours, voluntary programs and countless opportunities to combine work and family in a healthy ratio to one another.

We regularly carry out internal surveys of employee satisfaction. In this questionnaire, employee satisfaction with managerial behaviour, working conditions and their opportunities for development at the Telefónica Deutschland Group were recorded, among other things. In the 2013 financial year, we achieved an index value of 76 out of a possible 100 roll-outage points. Especially during the integration of the E-Plus Group, we are in an close dialogue with our employees. To offer the opportunity to participate in the employee satisfaction survey to the newly joined employees of the E-Plus Group at an early stage of integration, we have adapted the concept to the special situation of the fiscal year 2014: The survey was conducted later, with a considerably more compact and more focused questionnaire and with a shorter survey period performed whereby the comparability with the previous year is limited. A further revision of the survey is planned for 2015. We use the qualitative and quantitative feedback from our staff to optimise our business management.

We participate in a “berufundfamilie” (work and family) audit in order to optimise the programmes that we offer as a family-aware employer. In the first quarter of 2012, we started the analysis process and received the corresponding certification at the end of 2012. Beginning with the results of the audit, we have started further developing and optimising our programmes and processes and aim to further develop these up to the end of 2015.

Our staff management has always focused on the compatibility of work and family. There are many programmes that support our employees before and during parental leave and subsequently ease their return to work. In addition, we offer a comprehensive range of services for families in cooperation with external partners. Thus, we support our employees in the search for the right childcare or for care opportunities for relatives and broker private tuition or household help. At regular intervals we offer our employees motivational talks on various topics as well as free workshops in the evening.

All these initiatives increase the satisfaction of our employees, promote their loyalty to our corporation and ensure that our employees are happy to work for us.

Training and further education

Continuous further development of our employees’s skills is one of the most important goals of staff management. In 2014, the Telefónica Deutschland Group invested a total of EUR 4.1 million in the training and further education of its employees. This represents a decrease of around 11% of the expenditure in this area compared with the previous year (2013: EUR 4.6 million), also resulting from a higher proportion of online trainings and webinars. In 2014, a total of 8,300 employees participated in one of our further education courses (2013: 5,100 employees). The number of course hours taken up amounted to 181 thousand hours in the reporting year (2013: 173 thousand). The cost saving is also attributable to our new training programme (EasT). With the EasT “Experts as Trainers” programme, we use the knowledge of our employees and managers, who act as experts as part of the programme and train their colleagues and fellow workers. In 2014, 50 employees were trained within this programme, meaning that we can now make use of over 120 "EasT" trainers. This has not only a great motivational effect but also reduces training costs without having to make any compromises in terms of quality. The increase in the number of participants in training courses and the level of perceived lessons result from the merger with the E-Plus Group on 1 October 2014.

Depending on the qualification and function, we offer our employees both internal and external further education opportunities. Our employees can also attend the "Telefónica University", which maintains a broadly diverse course programme with an international orientation.

Apprenticeship and integrated study

Through the training of young employees, we secure our future and at the same time do justice to the social responsibility that we have as an employer. For years, the Telefónica Deutschland Group and the E-Plus Group have been offering apprentices good career prospects and traineeships, primarily in commercial and technical areas (retail dealer, IT specialist, office management assistant, sales person for dialogue marketing, etc.).

In the 2014 financial year, we prepared 171 young people (apprentices and students; 73 of whom joined us from the E-Plus Group as of 1 October 2014) for their future professional life at our company. Our declared goal here is to take on the apprentices in a permanent employment relationship following their successful graduation. In 2014 we were able to offer permanent employment to 23 of the apprentices (72%) who had successfully completed their examinations (E-Plus: not included as they were taken on before October 2014). In 2013 19 young people successfully completed their apprenticeship and 15 of them (79%) were employed by us.

Furthermore, we offer those starting their studies the opportunity to complete studies with in-depth practical experience (integrated studies) at our company. These students can attend integrated courses at various universities of cooperative education or attend occupational practical studies in different locations. Subject areas include business administration, electrical engineering and information technology, computer science, business informatics and international management. In 2014, 57 students (including 17 from E-Plus) have taken up this opportunity (54 in the previous year, not yet including E-Plus).

4. Corporate Responsibility_

Digital communication not only brings the world closer together – it is also key for sustainable development. This is the vision we are pursuing with our Corporate Responsibility (CR) strategy. With digital applications we are helping to shape a development that is radically changing the world. We exercise our responsibility particularly in the areas where we as a telecommunications company can make the biggest impact. For this purpose, we have set ourselves three strategic priorities:

— Enabling better lives: We aim to make our customers' working and living world easier and more sustainable by providing smart digital solutions.
— Transforming society: We aim to initiate social and community innovations and use digital communication to contribute to inclusion. The focus here is on our youth programme Think Big.
— Caring for the planet: We aim to make a sustainable lifestyle possible for all of our customers with digital products and services, while consistently optimising resource conservation and efficiency in internal processes.

CR management

We have defined clear responsibilities for managing our CR strategy. The Corporate Responsibility department coordinates all CR activities across the different departments. The team transposes the strategy to the departments and reviews achievement of the goals. In addition, the CR department initiates new projects and manages existing activities in line with the three above-mentioned priorities of our CR strategy.

The CR targets formulated with the departments on an annual basis are reviewed and approved by the Management Board. We integrate the goals in our management processes by way of key figures that are defined throughout the company. To this end, the Telefónica Deutschland Group has introduced group-wide indicators for the areas of employees, customers, environment and energy, corporate management, health and safety at the workplace, society and suppliers.

Stakeholder dialogue

We align the development of our business and our contribution to society with the needs of our stakeholders. For this purpose, we engage in intensive dialogue with them through various channels:

— We make contact with our customers via shops and hotlines as well as with innovative formats such as the "O_2 Pop-up" shop. In addition, our customers can communicate with one another and with Telefónica Deutschland Group employees in one of our forums.
— We use various different formats to engage in dialogue with our employees, such as regular surveys of employee satisfaction or about the current development of the company.
— Our representative office in Berlin serves as an interface with politics, business and associations. In 2014, the Telefónica Deutschland Group organised a stakeholder dialogue on data protection in Berlin with the aim of intensifying social dialogue about this issue. Based on the question "Smart world – everything smart, everything better?", the Telefónica Deutschland Group discussed the opportunities and challenges of innovative data-based applications with representatives from politics, associations and start-ups.
— The "Telefónica Blue Hour" represents an opportunity for dialogue between the Telefónica Deutschland Group and members and employees of the German Federal Parliament (Bundestag) with regard to current ITC policy issues. For example, in 2014 Telefónica welcomed the Parliamentary State Secretary at the Federal Ministry for Economic Affairs and Technology and retired Federal Minister, Brigitte Zypries, as a guest speaker at a Blue Hour to hold a discussion about the German Federal Government's digital agenda.
— The "BASE_camp" is a platform for digital expertise at the heart of Berlin's government district, where the opportunities and challenges of digitalisation are discussed with entrepreneurs, companies, consumers, politicians, academics and digital multipliers. It is a place for communication that is open to all interested parties from Berlin's digital community as an event location, a network space and a place for trying things out. Telefónica uses various different formats such as the "UdL Digital Talk" and "Mobile Living" to call relevant stakeholders' attention to important digital issues.

— In addition, we engage in intensive dialogue with capital market participants.

New version of the Telefónica Global Millennial Study
The Telefónica Global Millennial Study is the largest study to date of young adults aged between 18 and 30. It gives an indication of how the generation of 18- to 30-year-olds will organise their future in an even more digital world. In 2014, a new version appeared with the key findings that young adults in Germany value freedom and a good job and welcome new technologies. But although they are more sceptical of digital technologies than young people in other countries, they protect their data less in comparison.

Social responsibility
Digital communication is one of the most effective forces for transforming society and for social innovation. Our social activities focus on the youth programme Think Big, which uses digital media to encourage creativity and initiative in young people.

Think Big
The youth programme Think Big is a joint initiative of the Telefónica Foundation, the German Children and Youth Foundation (DKJS) and the Telefónica Deutschland Group that was launched in 2010. Since then, more than 56,600 young people have participated, and over 2,650 projects have been implemented.

With workshops, coaching and financial project support, Think Big inspires and supports 14- to 25-year-olds in finding their bearings in the digital world, enhancing their technological skills, developing ideas and entrepreneurship, and starting their own social projects. The ideas range from a networking platform for young artists and associations, to an anti-racism channel on YouTube, to apps for private lessons. The young people document the results on the programme's website (www.think-big.org).

In 2014, we integrated the Think Big School programme in the overall concept of Think Big, and is now part of the first stage of the programme "Think Big Lab". In workshops at educational centres, at events or at Telefónica, young people enhance their digital expertise and develop project ideas.

In addition to Think Big Lab, there are three more successive advancement levels in which the young people develop and implement their social digital projects. Depending on the degree of development, we support these with between EUR 400 and EUR 5 thousand. They are also given individual advice by professional partner organisations and Telefónica employees, as well as access to digital technology. At the highest support stage, the project teams can take part in co-working spaces, a large social entrepreneur network and targeted training to establish their project entrepreneurially in the long-term. In the year under review, we also developed a new advisory module together with DKJS: the digital workshop. This allows young people to consult an expert team free of charge about new technologies such as developing an app and thereby acquire knowledge about digital technologies for their project.

Further commitment
Our commitment focuses on the opportunities and challenges of digital life for children and young people. In the "Zentrum für Kinderschutz im Internet" (Centre for the Protection of Children on the Internet), a think tank founded by the German Federal Ministry for Families, we are helping to develop a central advice and assistance system for young internet users. The Telefónica Deutschland Group is a member of the "Freiwillige Selbstkontrolle für Multimedia-Diensteanbieter", a self-regulatory body for multimedia service providers that is involved in a wide range of media education projects for children and young people. With our youth protection hotline, we also advise parents on selecting and configuring mobile communications products in a child-friendly way.

Ay Yildiz, a Telefónica Deutschland Group brand, supports students with an immigrant background: With the aim of turning an intercultural background into a professional advantage, in 2014 the company put together a network of 22 companies and organisations offering over 60 internships. Ay Yildiz is Germany's first mobile telecommunications brand for citizens with a Turkish background.

Environment and climate protection
Climate protection and saving resources are important principles of our environmental management. Since 2004,

14 — Society

	Unit	2013	2014
Donations and investments in non-profit projects	EUR	307,967	**218,933**[1]
Participants in Think Big (young people)	Number	14,000	**14,708**
Participants in the Corporate Volunteering Programme (employees)	Number	771	**839**
Hours worked in the Corporate Volunteering Programme	Number	9,758	**7,112**

1 In 2014, Fundacion Telefónica bore all expenses for the projects in the Think Big programme. Fundacion Telefónica's investment in the German Think Big programme was around EUR 2 million in 2014.

our environmental management system has been certified in accordance with ISO 14001. In 2014, compliance with the standard was confirmed again for Telefónica Deutschland Holding AG. In addition to energy efficiency measures, our activities also include saving resources, returning our used electric devices, encouraging mobile phone recycling among our private and business customers, transparency with regard to electromagnetic fields, and promoting health.

Eco-efficiency

At around 95%, the majority of the Telefónica Deutschland Group's electricity consumption is attributable to the network. Telefónica Germany GmbH & Co. OHG has therefore set itself the goal of reducing energy consumption in the network by 30% per customer accesses by 2015 in comparison to 2007. To this end, we replaced the existing rectifiers with more efficient ones at 233 locations in Telefónica Germany GmbH & Co. OHG's mobile network in 2014. With this implemented measure, we expect to make annual energy savings of 589 thousand kWh in the future, thus achieving our goal. In the context of completing the replacement of the refrigerant R22, we replaced another 59 air conditioners with more efficient ones. Over 90% of Telefónica Germany GmbH & Co. OHG's facilities at 23,942 locations are operated without air conditioning. We also perform tests on features of our mobile telephony system suppliers using energy efficiency software. Our goal is to reduce the average energy consumption of the components in future while maintaining the same network quality.

In order to further reduce our energy consumption, in 2014 we identified additional factors for energy efficiency measures that will be implemented step by step after the combination of the networks as part of the integration of the E-Plus Group in the Telefónica Deutschland Group. We intend to use an additional analysis to identify savings potential through more detailed recording of consumption levels. The results are expected in 2015 – we will then examine whether we can adapt the results from the test location to other fixed network locations.

Efficiency, savings and innovation are important components for dealing with energy in the E-Plus Group, too. With existing flagship projects at E-Plus such as energy-self-sufficient mobile telecommunication stations and climate-friendly logistics solutions, we intend to strengthen the Telefónica Deutschland Group's positioning as an exemplary, environmentally conscious company of the future.

Eco Index – rating system for purchasing decisions

To assist our customers in choosing the most socially compatible and environmentally friendly smartphones, we have been using the rating system Eco Index since 2011. This offers a simple option for assessing the mobile phones on offer with a scale from 0 to 5 points. We developed the Eco Index with Forum for the Future, a British non-government organisation (NGO) for sustainable development, and in collaboration with various different device manufacturers. In 2014, over 93% of the mobile phones in the O_2 portfolio were rated by the Eco Index. By means of direct dialogue with the manufacturers, we achieved an increase of almost 18% in 2014 in comparison to the previous year.

Resource efficiency

The increasing digitalisation within the company itself enables us to save valuable resources. In 2014, we reduced our paper consumption by another 85 tons compared to the previous year, meaning that we have made paper savings of over 72% since 2010. The changeover to recycled paper certified with the Blue Angel environmental label in all offices and call centres in 2014 and the digitalisation of customer invoices had a positive impact on our environmental record. In addition, the payslips of Telefónica Germany GmbH & Co. OHG employees have been sent digitally since May 2014. We ran a campaign to raise awareness among employees of environmentally friendly behaviour at home, in the office, when dealing with electric devices and by recommending green apps that help protect the environment and climate. The environmental campaign was underpinned with an employee mobile phone collecting campaign and an environmental ideas competition.

By passing on our used IT devices to the non-profit limited liability company AfB (Arbeit für Menschen mit Behinderung – Work for People with Disabilities), we help both the environment and society. In 2014, we expanded our partnership in a targeted way so that AfB is now the main recipient of hardware disposal. Over 32 tons of PCs, laptops and flat screens were disposed of with AfB in 2014, and 93% of this was recyclable. This represents an increase of almost 92% in comparison to the previous year, when there had been a disposal volume of 2.6 tons. We were thus able to create three jobs for people with disabilities at AfB. In principle, the Telefónica Deutschland Group's IT devices are kept in use for as long as possible. If this is no longer possible, AfB picks up the devices directly from our office locations, guarantees certified erasure of the hard drives, tests and cleans the devices and sells them on with a guarantee of at least twelve months. Devices that are no longer functional are disposed of by AfB after the erasure processes and documented in steps.

Telefónica mobile phone recycling and Happy Handy

Our mobile phone recycling initiatives were a key focus of our environmental commitment again this year: With 21,416[5] recycled mobile phones, we made an important contribution to resource efficiency and to our recycling targets in 2014.

5 In 2014, Telefónica Germany GmbH & Co. OHG collected 17,368 and the E-Plus Group 4,048 old cell phones for recycling.

The income from recycling mobile phones goes to non-profit environmental projects of our cooperation partners. For 2014, these partners were Naturefund e.V. and the Nature and Biodiversity Conservation Union of Germany (NABU). In our O_2 shops and partner shops, we optimise our system for returning old mobile phones by actively bringing our customers' attention to the possibility of returning their devices. We are currently developing additional concepts to increase the ratio of mobile phones returned. In addition, the Telefónica Deutschland Group is involved in the nationwide German campaign "Happy Handy" created by the Information Centre for Mobile Communications (IZMF). From October 2014 to April 2015, the IZMF is calling on associations and schools to collect old mobile phones so that they can be recycled in a professional and environmentally friendly way. The IZMF has high-profile support for this campaign from the German Federal Minister for the Environment, Dr. Barbara Hendricks.

M2M – added value from intelligent machines
With data communication between machines (M2M), we are creating applications that our customers can use to make processes more efficient, reduce costs and thus achieve their business goals better – often with added value for the environment, too. In the context of the energy transition in particular, M2M applications can reduce energy losses by up to 30% with intelligent electricity networks – this is an approach that we will continue to pursue intensively.

In this way we can, for example, enable our customers to reduce emissions with a safer and more efficient driving style by using O_2 Car Connection. Furthermore, using the product O_2 Fleet Store helps companies to reduce their emissions thanks to safer and more efficient driving.

15 — Environment

	Unit	2013	2014
CO_2 emissions through electricity consumption and vehicle fleet[1]	Tons	239,380	**288,382**
CO_2 emissions through business travel[2]	Tons	3,389	**3,990**
Total electricity consumption[3]	MWh	489,634	**589,682**
thereof network[4]	MWh	467,907	**560,615**
thereof offices, shops, call centres[5]	MWh	21,727	**29,066**
Proportion of electricity consumption from renewable energy	%	58	**60**
Water consumption[6]	Cubic metres	93,059	**111,787**
Paper consumption[7]	Tons	585	**858**
Number of old mobile phones collected[8]	Number	43,906	**53,868**
Proportion of mobile phones reviewed by Eco Index[9]	%	75.68	**93.48**

1 Calculation of CO_2 emissions in accordance with ISO 14064, Greenhouse Gas Protocol (Scope 1 + 2 direct and indirect emissions) and ITU-T L.1420; Energy and emissions in 2013 were audited in 2014, 2014 data are in verification process in context of the sustainability reporting of Telefónica S.A. The direct and indirect CO_2 emissions increased at Telefónica Germany GmbH & Co. OHG slightly from 239,380 to 240,711 tons.
2 CO_2 emissions from business travel at Telefónica Germany GmbH & Co. OHG increased from 3,389 to 3,749 tons.
3 Total power consumption of Telefónica Germany GmbH & Co. OHG increased slightly from 489,634MWh to 492,997MWh.
4 Power consumption of the network of Telefónica Germany GmbH & Co. OHG slightly increased from 467,907 to 473,356MWh.
5 Power consumption for offices, shops and call centers at Telefónica Germany GmbH & Co. OHG fell from 21,727 to 19,641MWh.
6 Water consumption of Telefónica Germany GmbH & Co. OHG fell from 93,059 to 92,014 cubic meters.
7 Paper consumption decreases steadily as result of the internal digitization and the further demand for transition to online accounts. Compared with the previous year paper consumption fell by 14.5% to 500 tonnes in the Telefónica Germany GmbH & Co. OHG.
8 The number of old cell phones includes mobile phones which are brought into recycling process, recycled in "Re-Use" process or accepted through our cell phone trade-in program. In 2014, Telefónica Germany GmbH & Co. OHG collected 17,368 and E-Plus Group 4,048 old cell phones for recycling. For "re-use" Telefónica Germany GmbH & Co. OHG received 1,263 phones (until April 2014) with the trade-in program and 20,417 used devices. The E-Plus Group gathered 10,772 mobile phones in Q4 2014 for "Re-Use". The number of mobile phones collected from Telefónica Germany GmbH & Co. OHG therefore increased compared to the previous year by almost 7%.
9 The increase of 17.8% could be achieved through direct dialogue with the manufacturers about relevant sustainability criteria. For 2015, a unified product portfolio is planned including the continuation of the Eco Index for the Telefónica Deutschland Group.

5. Report on Events after the Reporting Period_

Integration and transformation

The change in the legal form of E-Plus Mobilfunk into a limited liability company (GmbH) was entered in the Commercial Register on 26 January 2015. On 4 February 2015, a profit and loss transfer agreement was concluded with Telefónica Germany GmbH & Co. OHG with effect from 1 January 2015, so that, with effect from 1 January 2015, the E-Plus Mobilfunk GmbH including its income tax group subsidiary companies are integrated in the income tax group of Telefónica Deutschland Group.

Yourfone

The sale of yourfone GmbH to Drillisch AG was closed on 2 January 2015.

Framework redundancy plan

The Management Board and Works Councils of the Telefónica Deutschland Group have agreed in February 2015 on a framework redundancy plan that will apply until the end of 2018. Based on the regulations set out in this plan, the implementation of the redundancy programme announced in autumn 2014 could begin in the first quarter 2015 as planned. In this way, Telefónica Deutschland Group is ensuring clarity for the employees and pressing ahead at full steam with the integration in the context of the acquisition of the E-Plus Group completed at the beginning of October 2014.

Private Placement transaction

On 13 March 2015, Telefónica Deutschland Group closed its inaugural private placement transaction in the form of promissory notes (Schuldscheindarlehen) and registered bonds (Namensschuldverschreibung). The transaction was announced on 2 February 2015, with a target volume of EUR 250 million but closed with a volume of EUR 300 million due to the high oversubscription achieved.

In the promissory note format, unsecured tranches with tenors of 5, 8 and 10 years were issued with both fixed and floating interest rates. In the registered bond format, unsecured tranches with tenors of 12, 15 and 17 years with fixed interest rates were issued. All tranches were issued by Telefónica Germany GmbH & Co. OHG, Munich.

The EUR 52 million sized fixed rate tranche with a 5-year tenor yields 0.961%, the EUR 60.5 million sized floating rate tranche yields an interest of the 6-months Euribor + 65 bps margin.

The EUR 19.5 million sized fixed rate tranche with a 8-year tenor yields 1.416%, the EUR 1.5 million sized floating rate tranche yields an interest of the 6-months Euribor + 85 bps margin.

The EUR 29.5 million sized fixed rate tranche with a 10-year tenor yields 1.769%, the EUR 9 million sized floating rate tranche yields an interest of the 6-months Euribor + 105 bps margin.

The volume of the 12, 15 und 17 year tenor tranches amounts to EUR 3 million, EUR 33 million and EUR 92 million, with respective yields of 2.000%, 2.250% and 2.375%.

All tranches were issued at par.

The promissory notes and registered bonds can be transferred in a minimum amount of EUR 500 thousand.

The proceeds of the transaction will be used for general corporate purposes.

Changes in the Supervisory Board of Telefónica Deutschland

María Pilar López Álvarez resigns from her function as member of the Supervisory Board of Telefónica Deutschland with effect of the end of the Annual General Meeting in which her successor shall be elected.

Declaration of Telefónica Germany on authorisation application of Telefónica Germany GmbH & Co. OHG to award spectrum under "Project 2016" by the Federal Network Agency

As part of the allocation of frequencies under "Project 2016" by the Federal Network Agency in the fields at 700MHz, 900MHz, 1,800MHz and 1.5GHz for mobile access for the supply of telecommunications services, the Telefónica Germany is obligated as parent company of Telefónica Germany GmbH & Co. OHG to ensure unlimitedly that Telefónica Germany GmbH & Co. OHG is equipped in such a way that all funds necessary for the fulfillment of a submitted bid to acquire a frequency in the auction process and all resources needed for the planned investments in the development and expansion as well as the operation of the mobile network will be permanently available. These obligations are based on the specified supply obligations and their time frame.

Procedure on the allocation of frequencies in the ranges 700MHz, 900MHz, 1,800MHz and 1.5GHz
The Federal Network Agency published on 28 January 2015, the presidential chamber's decision on the arrangement and selection of the allocation procedure and on the allocation conditions and auction regulations for the allocation of frequencies in the ranges 700MHz, 900MHz, 1,800MHz and 1.5GHz was finally made and published. With the publication of the decision, the admission procedure for the auction was opened. Telefónica Deutschland Group submitted the applications for admission to the auction to the Federal Network Agency as of 5 March 2015. The auction is scheduled to be held in the second quarter of 2015. Telefónica Deutschland Group has filed an action against the decision of the presidential chamber in the first instance purely in a timely manner, on which has not yet been decided.

Dividend proposal for the 2014 financial year
Management Board of Telefónica Deutschland proposed to the supervisory to suggest to the Annual General Meeting (scheduled on 12 May 2015) the distribution of a dividend in the amount of approximately EUR 714 million respectively EUR 0.24 per share.

There were no material transactions that have an impact on the Consolidated Financial Statements as of 31 December 2014 beyond the above mentioned ones.

6.

Risk and Opportunity Management_

The Telefónica Deutschland Group anticipates and recognises new business opportunities in order to increase the long-term company value and to pursue growth in revenue. However, to maximise these opportunities and increase efficiency the corporation also has to take certain risks. Our risk management is designed to recognise these risks early and to actively manage them.

6.1 Risk Management and Financial Instruments

General financial market risks
The Telefónica Deutschland Group is exposed to various financial market risks as part of its business activity. Due to Telefónica Deutschland Group's regional focus of its activities, however, it is not significantly affected by e.g. foreign currency risks. The Telefónica Deutschland Group is exposed to the risk of default from operative business (trade receivables). Related parties receivables are mainly related to a subsidiary of Telefónica, S.A. Group.

In addition, there are liquidity risks for the Telefónica Deutschland Group that are connected with credit risks, market risks, a weakening of operative business or disruptions of the financial market.

If such financial risks occur, they may lead to negative impacts 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 solely 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 monitoring with regards to the use of financial derivatives.

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

Currency risk
The underlying currency of the financial reports of the Telefónica Deutschland Group is the Euro. All financial statements of all subsidiaries of Telefónica Deutschland Group are also prepared in Euro; thus, the Telefónica Deutschland Group is not subject to any translation risk. However, aside from the translation risks there is a transaction risk that primarily arises from the business relationship of the Telefónica Deutschland Group with its suppliers or business partners in countries with a different national currency than the Euro. Because the Telefónica Deutschland Group finances itself exclusively through self-generated cash in Euro as well as Euro-denominated equity and debt, there is no exchange rate risk through debts that are denominated in a different currency than the Euro. The net risk position from foreign currency risks in the statement of financial position is comprised of non-derivative and derivative financial instruments denominated in foreign currencies, as well as future positions in foreign currencies in the following year.

Derivatives are contracted with Telefónica, S.A. Group Treasury to hedge against identified key currency risks.

Interest rate 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. The Telefónica Deutschland Group deposits cash surpluses almost exclusively in cash pooling and deposit accounts with Telfisa Global B.V., Netherlands. These accounts and the bank accounts pay a variable interest rate. The loan agreements where the Telefónica Deutschland Group is the borrower carry a variable interest rate. In November 2013 and February 2014, interest rate swaps were signed in each case in connection with the issue of bonds for a partial amount of the bonds' nominal values. On the basis of these interest swaps 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. These interest rate swaps compensate, to the level of their nominal amounts, the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities from the bond issues (fair value hedge). Hedge accounting for these hedge relationships complies with IAS 39. At the start of each hedge relationship, both the relationship between the hedge instrument and the underlying transaction as well as the goal and strategy of the hedge were documented. A specific allocation of the hedging instrument to the corresponding liability took place and an estimate of the degree of effectiveness of the hedging relationship was made. The existing hedging relationship is continuously monitored for effectiveness.

Credit risk
Credit risk describes the risk of financial losses from the inability of contractual partners to repay or service debts in accordance with the contract. The Telefónica Deutschland Group's maximum credit risk corresponds with the carrying amount of the financial assets (without considering any guarantees or securities).

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. Suitable processes have been established for the management and the monitoring of the credit risk.

This approach for credit risk management is based on the ongoing monitoring of the expected risks and the level of default. Here, particular attention is paid to customers who can have a significant effect on the Consolidated Financial Statements of Telefónica Deutschland Group and for whom, depending on the business area and the type of relationship, appropriate credit management instruments are used such as credit insurance or security to limit the credit risk. To control the credit risk, the Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and only reports adjustments for doubtful receivables with a credit risk. The Telefónica Deutschland Group has concluded cash pooling and deposit agreements with Telfisa Global B.V. with regards to its cash surpluses in accordance with Telefónica corporate policy, and it deposits the majority of its cash surpluses there. The majority of cash surpluses of the Telefónica Deutschland Group are thus concentrated in Group companies of the Telefónica, S.A. Group. Telefónica, S.A. is rated by international rating agencies with an investment grade rating. The remaining cash surpluses are distributed across several German banks that have been rated by international rating agencies with investment grade.

Liquidity risk
Liquidity risk includes the risk that a business cannot comply with its financial obligations, which are processed either in cash or with other financial assets. To manage liquidity risk, the Telefónica Deutschland Group ensures that it has sufficient liquidity at all times to fulfil its obligations, both under normal and under demanding circumstances.
The Telefónica Deutschland Group works on its liquidity management closely with Telefónica, S.A. Group and, in accordance with the corporate policy, has concluded cash-pooling and deposit agreements with Telfisa Global B.V., Netherlands. It deposits the majority of its cash surpluses there. Liquidity risk is reduced by the inflowing funds generated by the operative business of the Telefónica Deutschland Group, by the opportunity to factor receivables and by maintaining (currently unused) credit facilities.

Capital management
The Telefónica Deutschland Group strives to guarantee the sustainability of its business and to maximise the business value. It monitors its capital costs with the goal of an optimal capital structure. In particular, the Telefónica Deutschland Group monitors its equity ratio and OIBDA. Further information regarding risk management and financial instruments can be found in the Notes to the Consolidated Financial Statements 31 December 2014 (Note No. 17 Financial Instruments and Risk Management).

6.2 Risk Management and Risk Reporting

Fundamental risk management principles
As part of our business activity, we are confronted with various business, legal, financial and other (global) risks. We perform our services on the basis of the organisational, strategic and financial decisions and provisions made by us.

Every business activity involves risks that can prejudice the process of goal-setting and goal fulfilment. 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 recognised and dealt with, they can endanger the successful development of the corporation. In order to react appropriately to this fact, the corporate management has introduced a risk management process. This is intended to guarantee immediate and complete transparency with regard to new 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 minimise and deal with the risks. As a result, the evaluation, communication and management of risks is the task of all managers of the corporation. A lower limit for the recognition of risks is generally not set. 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. In addition, the so-called bottom-up approach, i.e. the identification of risks through the operative units, is complemented by the top-down approach, in order to ensure a cross-business perspective of risk. The purpose of the top-down approach is to ensure that risks that can only be identified at the highest management level or on the basis of a group-wide consideration, are discussed with the operationally responsible units in order to enable a full classification as well as integrated management and to evaluate the relevance for future reporting. Here the role is continually in contact with all areas of the corporation and our risk coordinators in order to progressively pursue and evaluate risks and their management and development. Responsible employees are individually trained in order to ensure a uniform, structured process of risk identification and evaluation. In addition, fundamental training is available for participation by all employees in order to generally raise their awareness of the management of risks.

Risks are evaluated with regard to their effect on our business goals both from an operational and a 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.

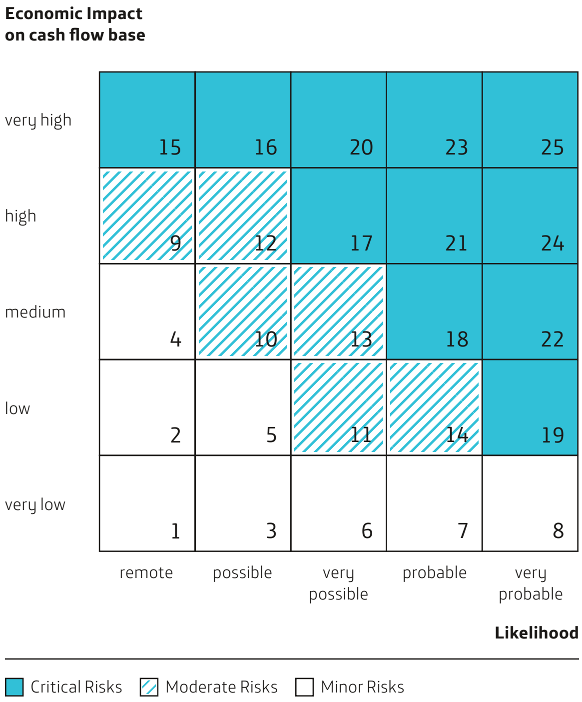
Opportunities are not recorded in the risk management system.

Risk evaluation

In the following section, the risks are illustrated that can significantly prejudice our financial situation, our competitiveness or our ability to implement the objectives. They are presented in line with the net principle, under which only the risks that remain after implementing risk limitation measures are presented and evaluated.

To ascertain the risks illustrated in the following with significant influence on the business development, we use a 5 × 5 matrix as a starting point, within which the potential level of damages and the relevant probability of occurrence are each divided into five categories:

16 — Risk profile



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.

Essentially, the lower threshold value for risk reporting to the Management Board and the Supervisory Board (Audit Committee) is currently EUR 6 million. In addition, risks with only a low potential impact are not described in detail to the Management Board and the Supervisory Board (Audit Committee), but rather are reported in summary. Such risks are identified, documented and administered by the relevant management levels as part of the risk management process.

For internal use and reporting within the Group, risks are divided into business risks, operational risks, financial risks and other (global) risks; this division also forms the basis of this section of the report. The relevant risks from the business risk, operational risk and financial risk areas are discussed in accordance with their ranking in the relevant category.

In addition, our corporation can be influenced by other or additional risks of which we are presently unaware or that we do not consider significant in accordance with the current state of knowledge. Moreover, it cannot be precluded that risks that are currently estimated as minor will change within the period of the prognosis in such a way that they can have a potentially greater effect than the risks currently estimated as critical.

6.3 Risks

Business risks

Competitive markets and changing customer demands

We operate in markets characterised by a high level of competition and continuous technological developments. Our corporation faces increasing competition with alternative telecommunications service providers – among them cable operators, MVNOs and corporations for entertainment electronics – and competes in addition with alternative telecommunications services like OTT (Over-The-Top). In order to prevail against these corporations, we have to success-fully market and make available our services and products. We have to react to the business activities of our competitors and anticipate technological changes, new customer needs and the general economic, political and social conditions. This implies a significant risk in achieving our growth and earnings targets.

Regulatory environment

We operate in a strongly regulated market environment and decisions made by the regulatory authorities can directly and critically influence services, products and prices.

Licences and frequencies

Our licences and frequency usage rights are limited in time and dependent on a preceding assignment, which represents a significant risk to the operation and development of the network. If we do not extend or cannot newly obtain the licences and frequency usage rights necessary for our business or if the financial conditions for the use of these licenses and rights change significantly, this can operate to the detriment of our business activity.

In this context, it is to be referenced to section 2.1.2 Regulatory influences on the Telefónica Deutschland Group and the future development of mobile service licenses as descibed therein. The frequencies allocated to the Telefónica Deutschland Group in May 2010 for providing services in line with the LTE standard are not affected by the described allocation. The procedure involves three main risk areas for the Telefónica Deutschland Group.

Firstly, there is a risk that after the auction it may no longer be possible to use all the currenly available spectrum, having the effect that capacity or bandwidths that are planned for the future cannot be fully realised. There is also a risk that during the auction an additional company could acquire a sufficient nationwide frequency spectrum to establish itself as another market participant (newcomer). Based on the conditions imposed by the European Commission for the acquisition of the E-Plus Group, the Telefónica Deutschland Group would be required to provide a newcomer of this kind with infrastructure and network capacity in return for payment. This could result in a further increase in competition on the German mobile telecommunications market.

In addition, the auction of mobile communications frequencies also entails a risk that considerable and possibly non-forecast financial expenses could be required in order to purchase the desired frequency bands by auction.

To evaluate and reduce the risks, an internal working group was already set up some time ago. This working group assesses different scenarios of the auction results, their effects and possible responses and maintains continuous contact with the Federal Network Agency.

There is also a moderate risk of a negative impact on the performance and expansion of our mobile telecommunications network in the event of delays in the approval of usage rights, particularly for radio relay frequencies, by the Federal Network Agency and of a change in the specifications for the maximum permitted transmission power due to new regulations regarding the electromagnetic fields.

Non-approval of planned business mergers, takeovers, sales or cooperations

The Telefónica Deutschland Group constantly evaluates opportunities to achieve increases in efficiency and operative profit also through cooperations, additional purchases and mergers, as well as through the sale or spin-off of business segments or parts of companies. Agreements between corporations who are active in the same or neighbouring substantive markets are subject to the supervision and by large to the requirement for approval from the responsible cartel authorities (European Commission, Federal Cartel Office, Federal Network Agency). Furthermore it is possible to issue approvals only on certain conditions. The withholding of approval or the stipulation of extensive remedies carries the significant risk that the profitability of the agreement is reduced, planned savings, synergies and growth expectations cannot be generated to the full extent or the possibility that contractual damages become due.

Termination fees in mobile communications

The termination fees in mobile communications have sunk in Europe in recent years, and there have also been considerable reductions in Germany of around 84.3% since 2006. Various reviews of these fees and court processes regarding regulatory measures have not yet concluded. The European Commission intends to make a further considerable reduction to fixed and mobile telecommunications termination fees and has issued a recommendation for the calculation of these tariffs by the relevant national regulatory authority. As a result, the provisional decision of the German Federal Network Agency from 26 November 2014, is subject to approval by the European Commission (notification process). Because the Federal Network Agency has not completely followed the recommendation to date, there is a moderate risk that the decisions of the Federal Network Agency could be changed. Moreover, it is possible for third parties to submit comments and to proceed contrary to the decisions. Any further reduction in the termination fees would have negative effects on the earnings of the Telefónica Deutschland Group.

Termination fees in fixed communications

Like all operators of their own networks, the Telefónica Deutschland Group is subject to a regulation with regard to the prices that can be charged to competitors for termination services to its own network.

At the end of February 2014, a provisional decision of the Federal Network Agency was issued to Telefónica Germany GmbH & Co. OHG regarding the local FTRs that applied from 20 November 2013, until 30 November 2014. This decision is currently going through the notification process in the European Commission. For the fees from 1 December 2014, onwards, a provisional approval with slightly reduced uniform FTRs was issued in November 2014.

As expected, the amount of the fee was again based on Telekom Deutschland AG's fee. The regulatory decision and the approved fees were broadly implemented on the market. Based on the affected chargeable traffic and the assumption that a further significant change in the termination fee is unlikely, we assess this risk as moderate.

Other regulatory influences on fees

Other price-regulated services include international roaming and SMS and data services for roaming customers. The European Parliament and the European Council have approved the Roaming III Regulation, which sets fee caps for voice and SMS services at the level of end-customers and large customers. In addition, Roaming III regulates the data roaming prices at the level of the end-customer and large customers and establishes rules to increase price transparency and to better explain fees to roaming customers. Since 1 July 2012, MVNOs have had the right to use the networks of other operators at large customer fees in order to offer roaming services. Since July 2014, mobile telecommunications network operators have been required to separate the sale of roaming services and domestic mobile telecommunications services. This gives customers the opportunity to choose another network operator for roaming calls. It is not yet clear whether there will be connections with alternative roaming providers. The regulatory authorities can take additional measures at any time in order to curtail roaming tariffs and fixed or mobile telecommunications termination fees. They could similarly oblige us to grant third parties access to our networks at reduced prices. There is a moderate risk that further reductions of these tariffs and fees could prejudicially affect our business activity, our financial situation and our earnings.

In order to guard against these regulatory risks, the Telefónica Deutschland Group maintains close communications with the decision makers on a national and international level in order to bring our interests and standpoint into the decision-making process in good time. Moreover, we review and use legal protective mechanisms against decisions of the regulatory authorities in order to actively foster positive changes for us.

Changes in the regulatory requirements for collecting and validating customer data

For some time already, there have been calls from politicians and the Ministry of the Interior for more stringent regulatory requirements in accordance with section 111 TKG for collecting and validating customer data, particularly for prepaid contracts. An increase in the requirements for the selling and registration process entails a risk that established sales channels could no longer be used, or not with the same degree of efficiency, which could result in additional costs for acquiring new customers. In order to guard against this regulatory risk, the Telefónica Deutschland Group maintains close communications with the decision makers on a national and international level in order to bring its interests and standpoint into the decision-making process in good time. In addition, the registration processes are continuously improved in close coordination with the regulatory authority so as to reduce the necessity for more stringent requirements. In view of the measures implemented to counter it, we consider this risk to be moderate.

Additional regulatory standards to improve customer protection

Legislative initiatives to improve customer protection have been discussed and adopted at national and European level in the past. In addition to the potential effects on roaming and termination fees in particular, as described in previous reporting periods, these initiatives also include increased requirements with regard to informing customers about the costs and conditions of telecommunications contracts. The requirements from the implementation of the Consumer Rights Directive in national law have been successfully implemented at the company. If we are unable to implement the new requirements in full or on schedule, particularly those arising from the planned transparency regulation, then individual sales channels could experience restrictions. In addition, there is a risk that the planned customer and revenue growth cannot be achieved or will be delayed. To counter this risk, the necessary technical changes have already been commissioned and manual processes have been prepared internally and at outsourcing partners. Taking these measures into account, the risk is considered low.

Insurances
Considering the existing opportunities and evaluating financial efficiency, the Telefónica Deutschland Group makes use of the opportunity to counter risks by taking out insurance policies. In particular, risks in connection with the operation of the technical infrastructure and breaches of copyright or patent rights are thereby significantly reduced, essentially to the selected excess.

Despite an existing risk management process, there is a moderate risk that unforeseen events will entail financial losses, should our accruals or our insurance cover turn out to be insufficient. As part of the management of our insurance protection, a regular review of our insurance cover takes place with the goal of achieving the best possible cover for all conceivable risks.

Macro-economic factors
Macro-economic factors can prejudice consumer spending and growth prospects for the German telecommunications market in general and have a negative influence on our market penetration of new added value services, the use of our networks for voice and data traffic, our customer numbers and thus our revenues.

Recessive general conditions could likewise lead to an increase in payment defaults and/or delays by our customers, greater customer migration and difficulties in gaining new customers. In consideration of the overall current economic climate, we see the low risk of a negative influence on the desired growth and earnings targets.

Acquisition and sale of parts of the business as well as joint activities
There is a low risk that we may make acquisitions or sales or enter into joint ventures which could generate lower-than-expected revenues, profit or liquidity. The risk could also mean that it will not be possible to fully generate synergies in the event of delays or issues with the integration.

Operational risks

Service quality
The success of our business activity is dependent on our ability to gain customers and to retain existing customers. A key factor for success here is anticipating technical requirements and the desires of customers and reacting to them in good time. False interpretations or incorrect decisions could imply the significant risk of negatively influencing the acceptance of our products by customers and could lead to us not reaching our growth and earnings targets.

There is a significant risk that lasting or repeated disturbances or damages in our mobile telecommunications or fixed networks and in our technical facilities could have a negative influence on customer satisfaction and result in a loss of customers or service revenue losses. In addition, there is a risk that costly repairs are required to restore operations.

Supplier defaults
As a mobile telecommunications and fixed operator and a provider of telecommunications services and products, we are (like other corporations in the branch as well) dependent on a few main suppliers (e.g. Deutsche Telekom AG, BT Germany, ZTE Services Deutschland GmbH, Atos Information Technology AG, arvato AG), which implies a significant risk. These suppliers make important products and services available that primarily relate to the IT and network infrastructure. If these suppliers do not make their products and services available when due, this could endanger the operation and expansion of the network, which in turn could prejudicially affect our corporation and its earnings. The same applies if service providers to whom we award projects for reasons of efficiency do not perform the services by the required deadline or to the required quality. As part of our supplier management, we continuously evaluate risks and the quality of the services made available in order to be able to identify weak points early on and take preventative action against them.

Termination of leases for technical sites by the lessor
The Telefónica Deutschland Group depends on leased sites for technical facilities, particularly antenna sites, for the expansion and operation of its mobile and fixed network. If there is an unexpected significant increase in the number of leases terminated by the lessors and the affected sites cannot be substituted by redundant sites of the Telefónica Deutschland Group, this would represent a significant risk to business activities, since new sites would have to be found and set up at considerable expense.

Dependence on services of the major shareholder Telefónica and of KPN
Even after its own IPO and the merger with the E-Plus Group, the Telefónica Deutschland Group still obtains services and inputs from the Telefónica, S.A. Group to a significant extent. There are a range of contracts, particularly in the areas of financial management and IT services. The use of the core brand O_2 in Germany is also subject of a licence agreement with O2 Holdings Ltd., a subsidiary of Telefónica S.A. There is a long-term agreement with KPN regarding the use of the BASE brand in Germany. There is a risk that the services provided by the Telefónica, S.A. Group to date can no longer be provided and cannot be purchased on the market or not at equally favourable conditions. Based on the considerable importance of trademark rights for our business activity, we consider this risk to be significant even though there are no indications of a future interruption of service relationships.

Legal risks

As part of its business activity, the Telefónica Deutschland Group is required to comply with a large number of laws. In the areas of competition law and data and customer protection in particular, the telecommunications market and the companies operating on it are subject to particular scrutiny by national and European authorities, organisations and associations. In the recent past, there have been repeated investigations and proceedings against companies on the European telecommunications market.

An infringement of legal provisions intrinsically poses a risk to the business activity, success and reputation of the company. Infringements of antitrust law represent a significant risk due to the possibility of significant fines and penalties being imposed.

In the course of our business activity, we also collect and process customer data and other personal data. Misuse or the loss of such data could represent a breach of the relevant laws and provisions and result in fines, loss of reputation and the migration of customers. In addition, we could be confronted with lawsuits that relate to the breach of third party intellectual property rights. Equally, we may not be capable of appropriately protecting our own proprietary rights.

Contractual penalties or claims could result from contracts with sales partners, suppliers and customers if we do not comply with our contractual or legal obligations or fail to meet agreed purchasing quantities, for example.

In order to avoid legal risks, particularly from competition and data protection law, the Telefónica Deutschland Group has established a compliance management system. Components of this management system include the applicable business principles, a number of guidelines and ongoing employee training with regard to the main legal provisions and standands. In addition, legal risks are covered by insurance where permitted, particularly in the case of infrigement of intellectual property and trademark rights. The Telefónica Deutschland Group also maintains an internal compliance department and a legal department and has continuous contact with external law firms, authorities, associations and official groups. However, due to the numerous legal obligations, complex agreements and conflicting interests, particularly with consumer protection organisations, there is a moderate risk that our business result or reputation could be negatively influenced.

Specific risks from the acquisition of the E-Plus Group

Loss of expertise and management resources

The integration of the E-Plus Group will demand a lot of time and attention from the management. Should the integration efforts keep management from other responsibilities, this could have detrimental effects on the company's success.

In addition, the Telefónica Deutschland Group is dependent on successful integration, the implementation of the joint strategy and the future commitment of employees in key positions. A loss of employees in key positions and/or expertise could delay or negatively influence the integration of the E-Plus Group in the Telefónica Deutschland Group, which could detrimentally affect the business success of the Telefónica Deutschland Group.

Taking account of the organisational measures taken, particularly the rapid appointment of the Management Board members, the managing directors of the subsidiaries and managers at the top level below the Management Board, we consider this risk to be low.

Failure to achieve the anticipated synergies

Any significant delay or unplanned increase in costs in the integration of the E-Plus Group with the Telefónica Deutschland Group could detrimentally influence or delay the attainment of the planned synergy effects or lead to a reduction in customer satisfaction associated with increased customer migration, which could significantly detrimentally affect the business activity as well as the financial and earnings position of the Telefónica Deutschland Group. A delay in achieving the synergies could lead to the purchase price being perceived as excessive on the market and could have a negative impact on the share price performance.

In addition, a risk remains that the assumptions underlying the calculation of synergies about the future development of the company and the market environment do not occur as anticipated. If unforeseen changes occur in the macroeconomic situation, the legal and regulatory regime, the competitive environment, the customer behaviour, the acceptance of the product portfolio or the technological development, or should the synergy calculation supportive corporate strategy be fully or partly changed, this could have a negative impact on the timely achievement of the calculated synergies.

The operational risks of the acquisition have been recognised by the Management Board and taken into account in the planning of the integration of the E-Plus Group in the Telefónica Deutschland Group. Special working groups have been set up before the closing of the transaction that assumed operational responsibility for preparing the integration, thus reducing the overall risk to a low level. At the time this report was prepared, the Management Board of Telefónica Deutschland had already appointed managers with responsibility for both company groups and thereby ensured smooth business activity.

Major projects were launched, which will ensure the timely achievement of synergies. In particular, measures to reduce operating costs were initiated, such as the harmonisation of processes, integration of IT systems, merging mobile and transport networks, reduction of sites, reducing redundant staff and consolidation of suppliers. In addition, projects were launched to improve market position. For example, selected end customer and business customer products are already offered in all sales channels of both Groups. In some regions, it was started the enablement for a so-called national roaming which allows customers to use the UMTS networks of both groups to ensure a higher customer satisfaction and demonstrate the benefits of the transaction for the customer.

After the start of the joint operations, a separate area was established, which aims to ensure the smooth integration of the two companies, as well as the timely implementation of started projects to achieve the synergies. A matrix organisation with defined responsibilities in all operational areas as well as close interaction with the strategy area supports the exchange of information and allows adaptation to changing circumstances at any time. The Board is briefed regularly on the target achievements and the status of projects.

In view of the established policies and projects, the ongoing review and adaptation of the strategy to achieve the synergies and considering the financial results from the last quarter of 2014, we consider the risk of failure to achieve the synergies to be low.

Legal risks of the acquisition of the E-Plus Group

The transaction could entitle customers, suppliers, service providers or other contractual partners to terminate their contractual relationships with the E-Plus Group or could result in contractually agreed restrictions for the Telefónica Deutschland Group.

The E-Plus Group has a number of contracts that include a change-of-control clause or other provisions that could bring about a detrimental change in the contractual relationships. Furthermore, some contracts stipulate payment obligations or other benefit obligations in the event of a business transfer. The transaction meets the criteria of a change of control. In addition, some contracts with wholesale partners of the E-Plus Group contain clauses that prohibit the conclusion of contracts of the same type with competitors of these partners – including competitors that are already partners of the Telefónica Deutschland Group. If the E-Plus Group is unable to negotiate a release from these obligations or restrictions, then the acquisition of the E-Plus Group by the Telefónica Deutschland Group could lead to considerable restrictions of contractual rights and of the possibility to conclude contracts, to enforce rights from contracts (e.g. voting rights or revenues in corporate equity investments) or to make use of affected agreements on the joint use of licences. Moreover, the change-of-control clauses could be an obstacle to the extension of wholesale, supply or service agreements. This could have a significant impact on the earnings position and operational business of the Telefónica Deutschland Group. Furthermore, we could be exposed to risks from problems that have not been revealed as part of the due diligence investigations preceding the transaction or that are covered only to a limited extent by exemptions from liability or warranty in the purchase agreement. All contracts are currently going through an in-depth legal review and the organisational and legal options for eliminating or reducing the risks are being examined. Based on the currently available information and the status of the project, we consider this risk to be moderate.

Tax law risks of the acquisition of the E-Plus Group

The structure of the acquisition of E-Plus Mobilfunk could result in the Telefónica Deutschland Group being held liable for tax liabilities or utilised shareholder loans of KPN Mobile Germany.

The restructuring of the new E-Plus Mobilfunk prior to the transaction also included the reorganisation and combination of subsidiaries and the transfer of non-current assets and liabilities from KPN Mobile Germany (formerly E-Plus Mobilfunk) to a newly established company (established with the name E-Plus Transition GmbH & Co KG and subsequently renamed E-Plus Mobilfunk). All tax and payment liabilities of KPN Mobile Germany for the period prior to 1 January 2014, have been excluded from transfer and remain with KPN Mobile Germany. However, owing to the legal situation in Germany, E-Plus Mobilfunk remains liable in addition to the principal debtor for a period of five years after the restructuring. As part of the spin-off, KPN Mobile Germany exempted the Telefónica Deutschland Group from all these obligations. The same was agreed with KPN in the context of the purchase agreement. However, should both KPN Mobile Germany and KPN be unable to fulfil their exemption agreements, E-Plus Mobilfunk could still be called upon.

In view of the fact that this only relates to contingent liabilities in the event that the above-mentioned companies of the KPN Group can not meet their financial obligations and considering that these companies are regarded as solvent, we consider the risk as low.

Personnel

We are competing with other companies when it comes to qualified and experienced personnel. For this reason, we implement employee surveys, internal projects and a well-balanced remuneration, training and work structure to maintain high employee satisfaction and the positioning of the Telefónica Deutschland Group as an attractive employer. Taking as a basis the results of internal and external surveys, we consider the risk of a shortage in personnel to be low.

Financial risks

Taxes

Like every corporation, we are regularly subject to tax audits. These include per se the risk that higher subsequent tax payments for prior tax periods can be determined, if the tax authorities have a divergent opinion about the interpretations and calculation principles that form the basis of our tax declaration. That is a significant risk because of the potential financial impact of a different interpretation.

Changes in tax laws or in the interpretation of tax laws by courts or tax authorities may also have a material adverse effect on our business, financial condition and results of operations.

In addition, there is a low risk that we could be unable to use our tax loss carry forwards in full.

Liquidity

We operate a capital-intensive business, which makes significant investments necessary. We have established a comprehensive investment programme for which significant outlay will be necessary in the foreseeable future as well. Among other things, the programme is aimed at the maintenance and optimisation of our mobile telecommunications and fixed networks and further investments for the expansion of the HSPA (High Speed Package Access) and LTE technology. The costs for the frequency usage rights, which are necessary for the operation of our existing networks and technology, the costs and the rental expenses for their availability and the costs associated with our fixed networks form a significant part of our cost base and could increase (similarly part of the business risks). We are convinced that we can comply with our financial obligations in the next twelve months. We have negotiated favourable payment and delivery conditions with our suppliers and concluded cash pooling and factoring contracts to improve our working capital. However, it cannot be guaranteed that such arrangements or agreements will also be possible in future or can be concluded on favourable conditions. Further, in the future we may not be capable of generating sufficient inflows of financial funds to cover our investment needs. With regards to our further growth, our planned strategy, the market developments or the development of new technology, we may therefore need additional sources of finance for our working capital. As a result, we may have to take up additional debt or equity, possibly at a considerable level. Our ability to take additional capital to finance our business activity could be influenced by various factors here, for example by market interest rate changes, restrictive agreements in connection with our debt instruments or by a downgrading of our credit rating or the credit rating of our majority shareholder. Future loan agreements could contain clauses that limit our financing opportunities or work against us in the implementation of business changes. Because we are exposed to the credit risks of our customers, the recovery of receivables could be complicated and as a result our working capital position could be encumbered. Overall we assess the risk concerning liquidity as low.

Other (global) risks

At the end of the financial year, no significant other (global) risks are present.

6.4 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 the management of Telefónica Deutschland Group.

The opportunities and growth potential ascertained in the strategic goal-setting process are prioritised as part of an annual planning process in close cooperation with the individual business areas and relevant strategic goals are derived from this. To measure the strategic implementation, concrete financial objectives in the form of finance-related Key Performance Indicators (KPIs) are defined at the level of the organisation 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 long-term planning.

Opportunities are neither recognized in the risk register nor quantified.

Opportunities

Greater demand for mobile data and LTE

The development of the German telecommunications market will continue to be driven by mobile data business and the increased use of mobile data devices like smartphones and tablets. Generally, a substantial increase in demand for mobile data is conceivable via various effects. Firstly, demand for data will be strengthened in 2015 through the further roll-out of LTE networks and increased penetration of LTE devices and plans. The higher transmission rates of LTE in comparison to UMTS are also encouraging customers to make increasing use of data-intensive services such as music streaming and video streaming on mobile devices. As a consequence, LTE customers have higher data consumption than UMTS customers, meaning that LTE customers require a higher data volume in their tariff, which has a positive impact on their mobile service revenues. In addition, demand may also be influenced by potential new services, additional devices connected with the internet or growing popularity of existing data-intensive services.

Should the individual facets of the German telecommunications market, such as smartphone penetration, demand for LTE or average monthly data consumption per customer, develop more positively than set out in our forecast, then our financial and operating results could exceed our current outlook.

Expansion of our LTE network and extension of the UMTS network via roaming

As already mentioned in section 1.2 Goals and Strategies, in 2015 we will progress further with the expansion of our LTE network. We will also activate national roaming for both of our UMTS networks, which will have a very positive impact on network quality. Should our expansion of the LTE network proceed more quickly due to more positive general conditions or should our customers respond to the better 3G and 4G network quality more positively than illustrated in our prognosis, our share of mobile data business could grow more strongly than predicted and thus our financial revenue and operating results could exceed our current forecast.

Cooperation with Telekom Deutschland GmbH in the fixed network

Higher availability of high-speed VDSL connections due to a faster than planned roll-out by Telekom Deutschland GmbH or technical advances that increase the maximum transmission rate of this product to over 100MBit/s could lead to stronger than anticipated demand for our VDSL products on the basis of the fixed network cooperation described in section 1.1.2 Business activity. This would have a positive impact on our revenues and OIBDA and lead to us exceeding our forecast.

Digital innovation

In order to fully exploit our position on the German market for mobile telecommunications services and to monetise additional opportunities for growth, we have introduced innovative digital products and services in various areas such as communication, financial services, M2M, Car Connection and in the smart home area, or we plan the introduction of these shortly.

Should the demand for our digital products and services develop better than currently expected, this could positively affect our financial and operating results and lead to us exceeding our forecast.

Digitalisation of service processes

In many industries, including telecommunications, a trend towards "self-care" can be observed. Processes that were previously performed by service staff are now increasingly carried out by customers themselves online or using smartphone apps. Customers are seen in a more active role und are benefitting from an immediate visual feedback. Additionally, there is a permanent availability of "self-care" solutions at any time and on any day of the week as well as the avoidance of possible waiting loops. Therefore the Smartphone is increasingly developing into the centre of everyday digital life.

If this trend continues more strongly than expected, this could result in increased customer satisfaction and cost savings in customer service.

B2B market

In 2015, we will launch several initiatives to expand our market position in the business customer segment. Should our business customer segment develop better than currently expected, this could positively affect our revenues and our OIBDA and lead to us exceeding our forecast.

Belonging to the Telefónica, S.A. Group

As a part of one of the largest telecommunications corporations in the world, Telefónica Deutschland Group benefits from economies of scale in the areas of purchasing, cooperations and development of digital products.

Should these economies of scale develop better than currently expected, this could positively affect our revenue and our earnings position and lead to us exceeding our forecast.

Opportunities for higher synergies

As described in section 7 Acquisition of E-Plus, considerable synergies are expected as a result of the acquisition of E-Plus.

If economies of scale have a greater effect than anticipated (e.g. in the form of favourable results of negotiations with suppliers or land lords), this would have a positive impact on the forecast cost synergies. Higher revenue synergies could be generated if, for example, the market success of MS Mobile Service GmbH ("Drillisch") exceeds expectations.

6.5 Summary of the Risk and Opportunities Position

According to our evaluation, the greatest potential effects result from the intensive competition on the German telecommunications market, the regulatory environment and from the issue of the necessity of ensuring high-qualitaty service. New risks arise from the integration of the E-Plus Group in the Telefónica Deutschland Group. Compared to the previous year, we see the most prominent positive development in the risk position in connection with the final granting of approval for the acquisition of the E-Plus Group by Telefónica Deutschland.

With regard to our own measures in the past financial year, we note a reduction of the risks in relation to our ability to make technologically competitive, innovative products available in a timely fashion and to market these via adequate sales channels. The risk with regard to the results of the tax audit for the wage tax returns of the Telefónica Deutschland Group for the period from January 2008 to October 2012 no longer exists since we received the tax assessments (for the assessment period January 2008 to December 2013) in September 2014 and now only the appeals filed by us still remain to be resolved.

In accordance with our assessment, the situation regarding significant risks and opportunities for the Telefónica Deutschland Group has not changed significantly in comparison to the previous year, with the exception of the issues described above.

Presently, no risks have been identified by us that either alone or cumulatively with other risks would be capable of endangering the continued existence of our corporation.

We are convinced that, in the coming financial year as well, we will be able to identify relevant risks in good time and to take appropriate measures to counter them by continuing to implement the risk management approach applied to date.

We are confident that the profitability of our corporation forms a solid basis for our future business development and ensures the resources needed in order to pursue the opportunities that offer themselves to the corporation. Considering our technologically high-value product offering, our position in the market, our digital innovation power, the fact that we belong to one of the largest telecommunications corporations in the world, our committed employees and our structured processes to recognise risks early and identify opportunities, we are confident of being able to successfully meet the challenges that result from the risks and opportunities mentioned in 2015.

7. Acquisition of E-Plus_

7.1 Overview

On 23 July 2013, Telefónica Deutschland, Telefónica, S.A. and KPN concluded an agreement for the acquisition of KPN's German mobile business, E-Plus, by Telefónica Deutschland.

As consideration, KPN received shares representing a 24.9% interest in the extended company and approximately EUR 3.6 billion in cash ("cash purchase price"), which will be subsequently adjusted in a final purchase price reduction.

The cash component paid to KPN was financed as described below via a cash capital increase of Telefónica Deutschland. The shares issued as further consideration to KPN were generated via a capital increase against contribution in kind (see below).

Pursuant to the agreement as of 23 July 2013, in the amended version as of 26 and 28 August 2013, as well as of 5 December 2013, 24 March, 7 August and 30 September 2014, and the corresponding assignment agreement, Telefónica, S.A. acquired a share of 4.4% of Telefónica Deutschland from KPN for EUR 1.3 billion. Immediately after the transaction was completed, this resulted in a 62.1% stake in Telefónica Deutschland held by Telefónica, S.A. and a 20.5% stake held by KPN. The free float amounted to 17.4%.

As of 31 December 2014, the Telefónica Deutschland Group, which has also included the E-Plus Group since 1 October 2014, manages a total of 48 million customer connections and is the market leader in Germany in terms of the number of mobile connections, with around 42 million connections as of 31 December 2014.

If the E-Plus Group had been acquired on 1 January 2014, the Telefónica Deutschland Group's combined[2] revenues for the twelve-month period 2014 would have amounted to EUR 7,793 million.

7.2 Business of the E-Plus Group

The E-Plus Group, headquartered in Dusseldorf, Germany, provides customers in Germany with multi-brand mobile telecommunication services, offering postpaid and prepaid services targeted at multiple market segments. The E-Plus Group was the third largest mobile provider in Germany by number of subscribers, approximately 22.2 million[6] as of 30 June 2014. Total revenue of the E-Plus Group amounted to EUR 3,143 million for 2013[7]. EBITDA in the E-Plus Group amounted to EUR 916 million for 2013[8]. As of 30 June 2014, the E-Plus Group employed 4,347 full-time employees[9].

The E-Plus Group's multi-brand portfolio includes E-Plus and BASE as well as various other brands such as a youth-focused brand (yourfone) (section 5 Report on Events after the Reporting Period), a no-frills brand (Blau), and brands focused on affordable mobile services for various ethnic communities (Ay Yildiz and Ortel Mobile) and an online brand (Simyo), which provides SIM cards for mobile phones online with and without subscription. Wholesale partners of the E-Plus Group include MedionMobile (AldiTalk), ADAC, MTV and the Nature and Biodiversity Conservation Union of Germany (NABU). The BASE brand was transferred to KPN prior to completion of the transaction, it being agreed that Telefónica Deutschland may continue to use the BASE brand in Germany after the transaction.

7.3 Reasons for the Acquisition and Strategy

With the acquisition of the E-Plus Group, we intend to create the leading digital telecommunications company in the German market. We consider the merger as the best way to maintain and increase our competitiveness in the mid- and long-term. We believe that this transaction will create a

6 The number of customer accesses of the E-Plus Group determined on the basis of the definitions and calculation policies applied by Telefónica Deutschland Group in this regard.

7 Total revenue taken from the Consolidated Financial Statements of E-Plus Mobilfunk GmbH & Co. KG as of 31 December 2013; Total Revenue of the acquired E-Plus Group adjusted to the accounting standards of Telefónica Deutschland Group for the financial year 2013: EUR 3,252 million (Source: prospectus for the capital increase as of 9 September 2014).

8 EBITDA taken from the Consolidated Financial Statements of E-Plus Mobilfunk GmbH & Co. KG as of 31 December 2013; EBITDA of the acquired E-Plus Group adjusted to the accounting standards of Telefónica Deutschland Group for the financial year 2013: EUR 688 million (Source: prospectus for the capital increase as of 9 September 2014).

9 Source: prospectus for the capital increase as of 9 September 2014.

market player that is excellently positioned in the competitive environment to create an outstanding digital experience for customers. Despite the size of the new company, its self-perception as a "challenger" is to be maintained so that it can continue to set out on new and innovative paths in telecommunications. Section 1.2 Goals and Strategies contains a detailed description of the extended company's strategy. Furthermore, the acquisition is to generate significant synergies that will improve the earnings position and increase free cash flow while still allowing for investments in competitive network infrastructure. In this way, we are establishing the conditions for attractive dividend payments and long-term value for our shareholders.

7.4 Estimated Synergy Effects

We estimate that the transaction will lead to significant synergy effects of over EUR 5 billion[10], particularly in the areas of network, distribution and customer service, selling, general and administration costs, and CapEx. The cost synergies are offset by integration costs that have already been taken into account in calculating the synergy effects. In addition, revenue synergies and synergies from other areas are calculated in the total amount.

The majority of the estimated synergies will arise after the full integration of the E-Plus Group, which will be completed in the fifth year after the completion of the transaction. Before taxes, the anticipated cash flow from synergies will then amount to EUR 800 million per year. In 2015 (year one of the integration plan) we already expect to reach an annualised run rate of approximately 30% and positive cash flows are already expected in the second year of the integration in the fourth year, the group is aiming for 80% of the target run rate. We expect that the remedies the company offered to the European Commission in connection with the merger clearance will not have a significant impact on the cost-based synergy effects.

The Telefónica Deutschland Group plans to achieve these synergies in the various different areas by means of the following measures:

— Network synergies: The two existing networks are to be consolidated over the coming five years, including core, transport and access networks. In total, the new joint network is to have 14 thousand fewer base stations than the two initial networks combined. However, this would be around 20% to 30% more than the previous equipment of each of the groups on a stand-alone basis. The network integration will lead to reduced operational expenditure (i.e. rents, electricity, maintenance, operation, transport costs, overheads). In addition, the merger will enable the company to make better use of the scalable transmission agreement with Deutsche Telekom GmbH, resulting in increased efficiency. The same applies to the agreement for fixed business. The net present value of the anticipated network synergies amounts to EUR 1.7 billion.
— Distribution and customer service synergies: The integration of the two distribution networks will increase efficiency in distribution and customer service, leveraging best practices and economies of scale to become more cost-efficient in these areas as well as in channel management and overheads. We anticipate optimisation of the company's sales presence due to current overlaps in the distribution networks, which will lead to reduced rental and personnel costs. Furthermore, the extended company will focus on a higher share of digital channels. We anticipate synergies from online sales as a result of a strong, joint multi-brand proposition. It is planned to reduce the current distribution network of 1,800 shops by one third. It is planned to reduce the current distribution network of 1,800 shops by one third. The net present value of the estimated synergies from distribution and customer service amounts to EUR 1.1 billion.
— Selling, general and administration (SG&A) synergies: The merger of the two companies is expected to lead to reduced costs, including in the areas of IT, administration and rents. In addition, a reduction in joint advertising and marketing expenditure is anticipated. The synergies in this area are calculated as having a total net present value of EUR 0.8 billion.
— CapEx synergies: We expect to be able to reduce the CapEx level significantly in comparison to the combined initial values. Thanks to the network consolidation, the necessary quality and capacity upgrades for the integrated 3G network will decrease, partly due to the rapid expansion of a joint 4G network that will absorb part of the increase in traffic and thus improve the average production costs for data transmission. Furthermore, we expect to see lower CapEx requirements as a result of the reduction in mobile base stations and associated network technology. In total, the estimated CapEx synergies amount to a net present value of EUR 1.9 billion.
— Integration costs: Integration costs chiefly consist of one-time payments, for example for the termination of leases, severance payments to employees, IT and network migration costs, costs for repositioning brands and customer migration to target brands and networks. The net present value of the anticipated integration costs amounts to minus EUR 0.9 billion.

10 The total value of synergies is a net present value of the transaction calculated as the sum of the present values of forecasted future cash flows including the so-called "terminal value" (present value of expected future cash flows beyond the explicit forecast horizon) after tax.

— Revenues and other synergies: This area comprises the anticipated revenue synergies and the foreseeable effects of the merger control conditions. Owing to the improved network, higher customer satisfaction in the consumer segment is expected, as well as additional business opportunities in the segment of small office/ home office (SoHo) and small and medium-sized enterprises (SMEs). In addition, the expanded customer base, particularly that of E-Plus mobile customers, offers increased potential for cross-selling of fixed broadband products.

7.5 Course of the Transaction

The merger of the Telefónica Deutschland Group with the E-Plus Group was completed with effect from 1 October 2014. The main steps involved were as follows:

General Meetings
The transaction was approved by the extraordinary General Meeting of KPN on 2 October 2013.

The Annual General Meeting of Telefónica Deutschland approved the capital measures for implementing the transaction on 11 February 2014 and 20 May 2014 (see also the following paragraphs "Cash capital increase" and "Capital increase against contribution in kind").

Approval of the European Commission and contract with Drillisch
The transaction was, in particular, conditional upon the approval of the relevant antitrust authorities. The prenotification process had commenced soon after the purchase of the E-Plus Group by Telefónica Deutschland was announced. The formal notification was submitted in late October 2013.

As part of the approval process, the Telefónica Deutschland Group had agreed to fulfil a package of conditions that fully addresses the European Commission's concerns with regard to competition. In this context, the Telefónica Deutschland Group had undertaken to sell 20% of its capacity in the mobile network to a mobile virtual network operator (MVNO) via mobile bitstream access before concluding the transaction and to give this MVNO the opportunity to acquire up to 10% of additional network capacity. Mobile bitstream access is a product whereby the MNO offers network capacity in the form of data transfer and data volume. This enables the MVNO to offer its customers its own mobile services.

In this context, the Telefónica Deutschland Group had signed a contract with Drillisch (see section 2.2 Overview of the 2014 Financiel Year – Significant events) that serves to implement the measures to be taken before concluding the transaction.

On 2 July 2014, Telefónica Deutschland obtained conditional approval from the European Commission to acquire the E-Plus Group from KPN, and on 29 August 2014, the European Commission confirmed that the agreement with Drillisch (see section 2.2 Overview of the 2014 Financial Year – Significant events) fulfilled the conditions associated with the decision on approval to the extent that these conditions were required to be fulfilled before completing the transaction.

To enable another potential provider to enter the German market, the Telefónica Deutschland Group also offers interested parties a package with 2.1 and 2.6GHz frequencies, base stations, the option of national roaming and passive shared use of mobile locations. In addition, existing contracts with service providers are to be extended until 2025 and changing to another guest network operator is to be made easier.

Cash capital increase
To generate the cash purchase price that was agreed as consideration for E-Plus (see above), a cash capital increase was implemented at Telefónica Deutschland.

On the basis of the authorisation for the cash capital increase granted by the Annual General Meeting of 20 May 2014, the Management Board resolved on 8 September 2014, with the approval of the Supervisory Board, to increase the share capital of the company by EUR 1,116,945,400 from its previous level of EUR 1,116,945,400, divided into 1,116,945,400 no-par value registered shares, to EUR 2,233,890,800 by issuing 1,116,945,400 new shares. The cash capital increase was entered in the Commercial Register on 18 September 2014.

The new shares were offered to the shareholders for subscription in the period from 10 to 23 September 2014, at a subscription price of EUR 3.24 each in a ratio of 1:1 and with the further conditions as resolved by the Management Board on 8 September with the approval of the Supervisory Board and published accordingly.

On 24 September 2014, Telefónica Deutschland announced the successful conclusion of the cash capital increase.

The cash capital increase enjoyed high demand from investors, with a subscription ratio of 99.92% for the new shares on offer. The majority shareholder Telefónica, S.A. exercised all its allocated subscription rights.

Shares that were not placed as part of the subscription rights offer were sold by the banks involved in the transaction, known as the joint bookrunners, on 24 September 2014, on the stock exchange or by other means.

The newly issued shares each represent a proportionate amount of the company's share capital of EUR 1.00 (section 2.2 Overview of the 2014 Financial Year – Significant events).

Capital increase against contribution in kind
To generate the additional consideration for the acquisition of E-Plus, namely the 24.9% interest in the extended company (see above), the Management Board resolved on 24 September 2014, with the approval of the Supervisory Board, to increase the share capital of the company by EUR 740,664,193 from EUR 2,233,890,800 to EUR 2,974,554,993 by issuing 740,664,193 new no-par value registered shares. The new shares were subscribed for by KPN Mobile Germany in return for a contribution in kind in the form of the limited partner's interest in E-Plus Mobilfunk.

The capital increase against contribution in kind was entered in the Commercial Register on 7 October 2014.

Completion of the acquisition
The purchase agreement of 23 July 2013, in the amended version as of 26 and 28 August and as of 5 December 2013, 24 March, 7 August and 30 September 2014, was completed with effect from 1 October 2014.

8. Essentials of the Remuneration System_

Remuneration of Management Board members
Due to the resolution of the Annual General Meeting on 5 October 2012, in accordance with section 314 (2) sentence 2 and section 286 (5) HGB, Telefónica Deutschland Holding AG did not publicise the additional information for listed companies limited by shares in accordance with section 314 (1) no. 6a sentences 5 to 8 HGB (Handelsgesetzbuch – German Commercial Code). In this section, the essentials of the remuneration system for the Management Board will be illustrated with the above-mentioned limitation.

In accordance with section 314 (1) no. 6a HGB, the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG (including a former Management Board member) for the financial year ended 31 December 2014, amounted to EUR 5,468 thousand.

The current service agreements of the members of the Management Board of Telefónica Deutschland Holding AG were concluded on 2 July 2014, and came into force on 1 October 2014. The service agreement of one of the Management Board members was amended by way of an amendment agreement on 22 January 2015. The service agreements of the Management Board members expire on 30 September 2017.

The total remuneration of the Management Board members (including a former Management Board member) comprises a fixed salary, variable cash remuneration and long-term remuneration components, a merger bonus for the successful completion of the E-Plus transaction (due in 2015), a company car, life insurance, D & O and accident insurance, pension contribution, non-monetary benefits such as, among others, travel allowances, rental allowance, the reimbursement of the cost of British social insurance, reimbursement of moving costs, reimbursement of brokerage fees, flights home, school fees, employer expenditures, tax compensation including costs of tax advice, and compensation for exchange rate losses and for differences in the cost of living. Not all Management Board members receive these benefits. For further information, reference is made to the Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Note No. 14 Transactions with Management Board and Supervisory Board).

The remuneration of the Management Board members includes a fixed component and a variable component.

The fixed component comprises the annual fixed salary, which is paid in twelve equal monthly installments, and the above-mentioned benefits. The Management Board members receive either an allowance to establish a private pension fund of 20% of the annual fixed salary or a retirement commitment.

The variable portion of the remuneration comprises four variable performance-related remuneration components.

1) The first variable portion of the remuneration is an annual cash bonus (Bonus I). Bonus I is calculated in accordance with the formula target bonus times business performance times individual performance. The target bonus is set as a roll-outage of the relevant annual fixed salary.

For the business performance in 2013, three components were critical and these were aligned with the success of Telefónica Deutschland Holding AG (Telefónica Deutschland component), Telefónica Europe (Telefónica Europe component) and Telefónica, S.A. (Telefónica, S.A. component). The ratio between the Telefónica Deutschland component, the Telefónica Europe component and the Telefónica, S.A. component was 70:15:15. In the 2014 financial year, only two components were critical and these were aligned with the success of Telefónica Deutschland Holding AG (Telefónica Deutschland component) at 70% and Telefónica, S.A. (Telefónica, S.A. component) at 30%.

The parameters for measuring the Telefónica Deutschland component and its weighting are set by the Supervisory Board on an annual basis. If less than 50% of the relevant target value is achieved, then the value for the business performance factor is 0% (knock-out). In the event that the target achievement has a factor of 100%, and the performance target is exceeded, then there is an upper limit of 125%. Intermediate values of target achievement are not linearly interpolated, but rather are ascertained in accordance with a payout curve set by the Supervisory Board. The Telefónica, S.A. component is set by the Supervisory Board in accordance with discretionary obligations. The corporate performance of Telefónica, S.A. in the relevant year guides the exercise of the discretion.

In order to ascertain the individual performance of each of the Management Board members, personal objectives are set annually at the start of the year by the Supervisory

Board. At the start of the following year, the achievement of the goals is reviewed, and the Supervisory Board grades each Management Board member into one of five performer classes to which bandwidths of goal achievement roll-outages are allocated in each case, and allocates each Management Board member a certain roll-outage value; here the knockout threshold is also 30%. The individual performance is capped at 150%.

2) The second variable remuneration component is participation in the Performance and Investment Plan (PIP). The first plan ("Performance and Investment Plan 2011") was adopted by the Annual General Meeting of Telefónica, S.A. in 2011. The "Performance and Investment Plan 2014" was set up as the following plan and was adopted by the Annual General Meeting of Telefónica, S.A. in 2014. Members of the Management Board of Telefónica Deutschland Holding AG have participated in the PIP since 2011.

In accordance with the PIP, members of the Management Board with the approval of the Supervisory Board are allocated a certain number of performance shares as an award. The number of performance shares is calculated by dividing an amount that corresponds to a certain proportion of the fixed annual salary of the relevant Management Board member by the average listed price of Telefónica, S.A. shares (Core Award). After three years, the performance shares give the right to (free) acquisition of the corresponding number of Telefónica, S.A. shares if the relevant person still works for a company in the Telefónica, S.A. Group at the end of the time period and the price of Telefónica, S.A. shares over the "vesting period" together with the associated dividend distributions (Total Shareholder Return Telefónica, S.A.) in the period corresponds to at least the median of the Total Shareholder Return (share yield) of a reference index from worldwide telecommunications corporations. 30% of the performance shares awarded "vest" if Telefónica, S.A.'s Total Shareholder Return corresponds to the median of these corporations. The number of "vested" shares increases to 100% if Telefónica, S.A.'s Total Shareholder Return is in the upper quartile of the reference index. If Telefónica, S.A.'s Total Shareholder Return lies between the upper quartile and the median, the number of allocated shares is calculated on a linear proportionate basis. If Telefónica, S.A.'s Total Shareholder Return lies under the median of the reference index then the entitlements are forfeited. On the basis of the "Performance and Investment Plan 2014", members of the ExComm of Telefónica, S.A. receive an allocation of 125% if Telefónica, S.A.'s Total Shareholder Return reaches at least the level of Telefónica, S.A.'s Total Shareholder Return for the upper decile of the comparison group.

As an alternative to the Core Award, the PIP provides for an "Enhanced Award" whereby the number of performance shares is increased by 25% in comparison to the Core Award. The condition for achieving the Enhanced Award is that a Management Board member must acquire a certain number of shares in Telefónica, S.A. (currently 25% of the Core Award) at their own cost. If the prerequisites for the Enhanced Award are fulfilled, the number of shares actually to be allocated is calculated on the basis of the Enhanced Award rather than the Core Award. For further information, reference is made to the Notes to the Consolidated Financial Statements for the year ended 31 December 2014 (Note No. 15 Share-Based Payments).

3) The third variable remuneration component is a deferred bonus (Bonus II). In order to avoid an excessive incentive effect through the PIP and thus too strong an incentive for the pursuit of corporate goals, there is Bonus II. Here the Management Board members are provided with an amount equal to a share of the annually paid Bonus I as a prospective bonus. The Management Board member has the right to the full amount after a period of three years if the Total Shareholder Return of Telefónica Deutschland Holding AG is in the upper quartile of the Total Shareholder Return of a reference group comprising the DAX-30 companies. The Management Board member has the right to 50% of Bonus II if the Total Shareholder Return of Telefónica Deutschland Holding AG corresponds to the median of the reference group. If the Total Shareholder Return of Telefónica Deutschland Holding AG lies between the upper quartile and the median, Bonus II is calculated linear proportionally. If Telefónica Deutschland Holding AG lies below the median, there is no entitlement to payments.

4) The fourth variable remuneration component consists of a "Restricted Share Plan" in which one member of the Management Board participates. The "Restricted Share Plan" is a long-term remuneration plan of the Telefónica, S.A. Group for gaining and retaining top talents and employees with key qualifications.

The Supervisory Board has set the level of the Restricted Share Plan at a fixed annual salary of the plan beneficiary.

The shares are allocated in three equal tranches over a period of three years, provided the plan beneficiary is in employment at Telefónica Deutschland Holding AG at the relevant allocation date (if applicable, for each of the tranches). Shares will be distributed for the first time in September 2015.

For one former member of the Management Board of Telefónica Deutschland Holding AG, a termination agreement from 29 January 2014, gives rise to the following deviations from the remuneration system described above:

— The fixed remuneration – consisting of the fixed salary, fringe benefits and post-employment benefits – that the former Management Board member would have received between 1 October 2014, and 15 September 2015, in instalments as of the end of each calendar month was granted to him as a one-time lump sum due at the end of 30 September 2014.

- The amount of Bonus I for the financial years 2014 and 2015 is calculated based on the average of the Bonus I payments received by the former Management Board member for the financial years 2012 and 2013.
- The former Management Board member did not receive any shares for the PIP cycles for 2012 and 2013, but instead in each case received a compensatory payment payable at the end of 30 September 2014. These compensatory payments did not exceed the value of the shares to which the former Management Board member would have been entitled if the regulations of the plan had been applied.
- For the cycle that began on 30 October 2012, the former Management Board member received a proportionate Bonus II payment due at the end of 30 September 2014, whereby the entitlement was reduced in line with the fact that the employment of the former Management Board member ended before the scheduled allocation date for the cycle.

Remuneration of Supervisory Board members

The members of the Supervisory Board receive a fixed remuneration of EUR 20 thousand annually in accordance with the articles of association, which is payable at the end of the financial year. The Chair of the Supervisory Board receives EUR 80 thousand and the Vice-Chair of the Supervisory Board EUR 40 thousand. The Chair of the Audit Committee receives an additional EUR 50 thousand if the Chair of the Supervisory Board or the Vice-Chair does not hold the chair in this committee. Supervisory Board members who hold office in the Supervisory Board or the position of Chair of the Supervisory Board or Chair of a Committee only for a certain part of the financial year receive a time-based proportionate remuneration.

Alongside the remuneration, the corporation reimburses the Supervisory Board members for the expenses that arise in the fulfilment of their duties as Supervisory Board members as well as any value-added tax on their remuneration and their expenses.

All members of the Supervisory Board who work for Telefónica, S.A. or Telefónica Europe plc. have waived their remuneration for their current period of office to the extent that the remuneration rights exceed EUR 2 thousand per year.

No services were provided personally outside of the stated activities of the Supervisory Board and the Committees, in particular for consultancy or brokering services.

Please refer to the Notes to the Consolidated Financial Statements for the year ended 31 December 2014, for further information (Note No. 14 Transactions with Management Board and Supervisory Board).

9. Internal Control and Risk Management System_

Related to the Process of Group Accounting

The following statements contain information in accordance with section 289 (5) HGB and section 315 (2) no. 5 HGB.

The primary goal of our accounting-related internal control and risk management system is to ensure proper financial reporting in the sense of compliance of the Consolidated Financial Statements with all relevant provisions.

The risk management system described in section 6 Risk and Opportunity Management also includes an accounting-related perspective with the goal of reliability of financial reporting. In addition to the legal requirements of, for example, the German Stock Corporation Act (AktG) and the German Commercial Code (HGB), the accounting-related internal control system introduced by us also complies with the provisions of the US Sarbanes Oxley Act (SOX). The obligation for the Telefónica Deutschland Group to fulfil these SOX requirements results from the registration of its majority shareholder, Telefónica S.A., with the US SEC (Securities and Exchange Commission). In addition, the Telefónica Deutschland Group's accounting-related internal control system also complies with the global ICS control setup of Telefónica S.A. The accounting-related internal control system of the E-Plus Group, which was acquired as of 1 October 2014, also complies with the legal requirements of, for example, the German Stock Corporation Act (AktG) and the German Commercial Code (HGB). The following statements therefore apply likewise to the accounting-related internal control system of the E-Plus Group. Necessary additions in order to comply with the global SOX control setup of Telefónica S.A. are in implementation for the financial year 2015.

Establishing and effectively maintaining appropriate internal controls for financial reporting is the responsibility of the Management Board of Telefónica Deutschland and is performed taking account of company-specific requirements.

The conceptual framework for preparing the Consolidated Financial Statements primarily consists of the uniform group-wide accounting guidelines and the chart of accounts, both of which must be applied consistently by all companies of the Telefónica Deutschland Group. New laws, accounting standards and other official communiqués are analysed on an ongoing basis with regard to their relevance and effects on the proper preparation of the Consolidated Financial Statements. The resulting changes are taken into account by the Accounting Policies & External Reporting department of Telefónica Germany GmbH in our accounting guidelines and the chart of accounts.

The data basis for the preparation of the Consolidated Financial Statements consists of the financial statement information reported by Telefónica Deutschland, its subsidiaries and joint ventures, which in turn is based on the accounting entries recorded within the companies. The financial reporting of the individual companies is carried out either by the Finance & Accounting department of Telefónica Germany GmbH & Co. OHG or in close cooperation with it. For certain topics that require specialist knowledge, such as the valuation of pension obligations, we use the support of external service providers. Based on the reported financial statement information, the Consolidated Financial Statements are prepared in our consolidation system. The steps to be taken when preparing the Consolidated Financial Statements are subject to both manual and system-based controls at all levels.

Employees involved in the financial reporting process are already examined in terms of their professional suitability before they are hired, and are provided with regular training. The financial statement information must go through certain approval processes at every level. Critical task areas in the financial reporting process are divided appropriately for the purpose of an effective separation of duties and the dual control principle generally applies. Further control mechanisms include target/performance comparisons and analyses of the composition of content and changes in individual items, both in the financial statement information reported by the individual group companies and in the Consolidated Financial Statements. In the accounting-related IT systems, access authorisations are defined in order to ensure that accounting-related data is protected from unauthorised access, use and change.

The Management Board of Telefónica Deutschland assesses the appropriateness and effectiveness of the control system on an annual basis. In addition, our Internal Audit department performs continuous reviews to monitor compliance with guidelines, the reliability and functionality of our control system and the appropriateness and effectiveness of our risk management system, and reports on this to the Management Board of Telefónica Deutschland. In this context, it should be noted that in any control system there will nonetheless be certain limitations on its effectiveness, since no control system – even if it has been judged to be effective – can prevent or detect all incorrect disclosures.

The Supervisory Board of Telefónica Deutschland is also involved in the control system via the Audit Committee in accordance with section 171 (1) AktG in conjunction with section 107 (3) AktG. The Audit Committee particularly monitors the financial reporting process, the effectiveness of the control system, risk management system and internal audit system, and the audit of the financial statements. It is also responsible for examining the documents relating to the separate financial statements of Telefónica Deutschland and the Consolidated Financial Statements, and it discusses the annual financial statements of Telefónica Deutschland and the Consolidated Financial Statements with the Management Board and the auditor. In the closing meeting, the auditor also reports to the Supervisory Board on the findings of its review of the effectiveness of the internal control system.

10. Other Declarations_

10.1 Report on Relations with Affiliated Companies

In the period from 1 January to 31 December 2014, Telefónica Deutschland Holding AG was a directly dependent company of Telefónica Germany Holdings Limited, Slough, United Kingdom, within the meaning of section 312 AktG. In addition, Telefónica Deutschland Holding AG was an indirectly dependent company of O2 (Europe) Limited, Slough, United Kingdom and of Telefónica, S.A., Madrid, Spain, within the meaning of section 312 AktG. There is neither a domination agreement nor a profit and loss transfer agreement between Telefónica Deutschland Group and the previously mentioned companies.

Thus, the Management Board of Telefónica Deutschland Holding AG has prepared a report about the relationships with associated corporations in accordance with section 312 (1) AktG. This report includes the following final declaration:

"Our company has, with regard to the legal transactions and measures listed in the dependency report, and based on the circumstances which were known to us at the time at which the legal transactions were carried out or the measures were taken or refrained from, received adequate compensation for each legal transaction and has not been disadvantaged as a result of measures being taken or refrained from."

10.2 Management Declaration pursuant to Section 289a of the HGB

The corporation has published this declaration, which also contains the Declaration of Compliance pursuant to section 161 AktG, on its website (**WWW.TELEFONICA.DE/ERKLAERUNG-ZUR-UNTERNEHMENSFUEHRUNG**) and in the section Corporate Governance/Declaration of Compliance in the Annual Report. This management declaration pursuant to section 289a HGB is a part of this Management Report.

10.3 Takeover-related Disclosures pursuant to Section 315 (4) and Section 289 (4) of the HGB

Composition of the subscribed capital

The registered share capital of Telefónica Deutschland Holding AG amounts to EUR 2,974,554,993. The share capital is divided into 2,974,554,993 no-par value registered shares each with a proportionate share of the share capital of EUR 1.00 ("shares"). The registered share capital is fully paid. As of 31 December 2014, and at the time this Management Report was prepared, Telefónica Deutschland Holding AG did not hold any of its shares. In accordance with section 6 (2) of the articles of association, the shareholders have no right to securitise shares. Each non-par share in general grants one vote at the Annual General Meeting. The shares are generally freely transferable.

In the agreement for the acquisition of KPN's German mobile business E-Plus, KPN has committed itself, not to directly or indirectly sell, market, transfer or otherwise dispose any shares in Telefónica Deutschland within a period of 180 days from closing of the transaction.

Voting restrictions and restrictions on the transferability of shares

There are no general limitations on voting rights. We are not aware of any contractual agreements with Telefónica Deutschland Holding AG or other agreements about limitations on voting rights or the transferability of shares. Other than the statutory insider-trading provisions there are no internal governance provisions that provide for further lockout periods associated with the publication of quarterly and annual results for the purchase and sale of shares by Management Board members or employees.

In the agreement for the acquisition of KPN's German mobile business E-Plus, KPN has committed itself, not to directly or indirectly sell, market, transfer or otherwise dispose any shares in Telefónica Deutschland within a period of 180 days from closing of the transaction.

Participation in the share capital of more than 10% of the voting rights

In the context of the completion of the E-Plus transaction (section 7 Acquisition of E-Plus), Telefónica Germany Holdings Limited, Slough, United Kingdom, fell below the threshold of 75% and following the completion of the transaction and the acquisition of another 4.4% in accordance with the agreement with KPN, it held 62.1% of the shares of Telefónica Deutschland Holding AG; therefore, Telefónica Germany Holdings Limited holds more than 62% of the voting rights. Via Telefónica Germany Holdings Limited both O2 (Europe) Limited, Slough, United Kingdom, as well as Telefónica, S.A., Madrid, Spain, indirectly hold more than 62% of the shares in Telefónica Deutschland Holding AG. Following the completion of the E-Plus transaction and the sale of 4.4% to Telefónica, KPN held 20.5%. Other than this we were not informed of stake holdings in the share capital of Telefónica Deutschland Holding AG to the extent of more than 10% of the voting rights and we are not aware of such stake holdings.

Shares with special rights

There are no shares with special rights, in particular no shares with rights that grant control.

Control of voting rights when employees hold stakes in the capital

Just like all other shareholders, employees who hold shares in Telefónica Deutschland Holding AG exercise their control rights directly in accordance with the statutory provisions and the articles of association.

Appointment and recall of Management Board members

Pursuant to section 7 of the articles of association and section 84 AktG, the Supervisory Board determines the number of members on the Management Board and is responsible for their appointment and recall as well as for the appointment of the Chair of the Management Board (Chief Executive Officer (CEO)). Substitute members of the Management Board can be appointed. As of 31 December 2014, the Management Board of Telefónica Deutschland Holding AG consists of three members. Management Board members are appointed by the Supervisory Board for a period of office of no more than five years. They can be re-appointed and the period in office can be extended provided one period of office does not exceed a period of five years. The Supervisory Board may recall a Management Board member in the event of an important reason such as a gross breach of duties or if the Annual General Meeting adopts a no-confidence resolution in relation to the Management Board member in question. Other reasons for recall – such as a mutual terminated agreement – remain unaffected.

Telefónica Deutschland Holding AG is subject to the provisions of the German Co-Determination Act (Mitbestimmungsgesetz – MitbestG).

Pursuant to section 31 MitbestG, a majority of two thirds of the votes of Supervisory Board members is necessary for the appointment and recall of Management Board members. If this majority is not reached on a first round of voting by the Supervisory Board, then the appointment or recall can occur on the recommendation of the Mediation Committee, which is to be formed in accordance with section 27 (3) MitbestG, in a further round of voting with a simple majority of the votes of the Supervisory Board members. If the prescribed majority is again not achieved, then a third round of voting must occur which again requires a simple majority; however for this round of voting the Chair of the Supervisory Board has two votes.

If a required Management Board member is missing, then the Munich Local Court in urgent cases must appoint the member on application by a party concerned pursuant to section 85 (1) AktG.

Changes to the articles of association

In accordance with section 179 (1) sentence 1 AktG, any change to the articles of association of Telefónica Deutschland Holding AG requires a resolution of the Annual General Meeting. In accordance with section 27 of the articles of association together with section 179 (2) sentence 2 AktG, resolutions of the Annual General Meeting of Telefónica Deutschland regarding changes to the articles of association are passed with simple majority of the votes cast and by simple majority of the share capital represented at the passing of the resolution. If the law mandates a higher majority of votes or capital, then this majority must be applied. In connection with changes that only affect the wording of the articles of association, the Supervisory Board is entitled to make changes in accordance with section 179 (1) sentence 2 AktG together with section 17 (3) of the articles of association.

Authorisation of the Management Board to issue shares

The powers of the Management Board are governed by sections 76 et seq. AktG together with section 8 et seq. of the articles of association. In particular, the Management Board runs the company and represents it in and out of court.

Authorisation of the Management Board to issue shares is governed by section 4 of the articles of association in conjunction with the statutory provisions. As of 31 December 2014, the following authorisations of the Management Board for the issuing of shares exist:

Authorised capital

As of 31 December 2014, the Management Board is authorised, with the approval of the Supervisory Board, to increase the share capital of the company in the period until 17 September 2017, once or several times, by a total of

EUR 292,808,507 by issuing up to 292,808,507 new no-par value shares in exchange for cash and/or contribution in kind (authorised capital 2012/I). The authorisation stipulates that shareholders' subscription rights can in certain cases be completely or partially excluded (section 4 (3) of the articles of association).

Conditional capital

For the purpose of the issue of registered no-par value shares to the holders or creditors of bonds, the share capital of the company is conditionally increased by up to EUR 558,472,700 by issuing 558,472,700 new registered no-par value shares (conditional capital 2014/I).

Authorisation of the Management Board to buy back shares

The authorisation of the Management Board to buy back own shares is governed by section 57 (1) sentence 2 and sections 71 et seq. AktG. The Management Board is authorised to buy back own shares by the Annual General Meeting of 5 October 2012 pursuant to section 71 (1) no. 8 AktG.

Change in control/compensation agreements

Telefónica Deutschland Holding AG's significant agreements that contain a change in control clause relate to financing.

In the event of a change of control, the rating of Telefónica Deutschland or of its outstanding non-current liabilities will be examined with regard to capital market liabilities. In the event that a deterioration of the rating as defined in the contracts occurs, the contracts grant O2 Telefónica Deutschland Finanzierung GmbH as the issuer the option to terminate the financing early at a redemption amount of 101% of the nominal amount plus accrued interest. Otherwise, the interest is increased by 1.25% p.a. until the end of the term.

A small number of other contracts grant the contracting partners the right to terminate in the event of a change of control, in accordance with normal practice, which has as a consequence the obligation to fulfil all outstanding obligations.

The employment contracts of the Management Board members of Telefónica Deutschland Holding AG grant the right to terminate these contracts in the event, of a takeover offer by a third party with three months' notice to the end of the month; however this termination must occur within six months of a change in control. In this event, the relevant Management Board member can claim a one-off compensatory amount equal to one year's fixed salary plus the most recently received annual bonus, whereby the compensation may not exceed the remuneration that would have been payable up to end of the contract.

11. Outlook for the Telefónica Deutschland Group_

11.1 Economic Outlook for Germany

The leading economic research institutes expect economic growth in Germany to continue in 2015. For 2015 as a whole, the institutes anticipate an increase of 1.4% in gross domestic product. Economic momentum in Germany should benefit from factors such as the the low oil price and the weaker Euro exchange rate. The sharp decline in the oil price is currently having a similar effect to a tax cut for companies and consumers in the German economy. For companies, the falling energy costs are causing profits to rise. Private consumer spending will play an important role in the forecast upturn in the German economy again in 2015. Chiefly due to the lower energy prices, commodities such as fuel oil and petrol have become considerably cheaper. This gives private households significant scope for making other purchases.

A risk to the consumer economy, and thus also to the overall economic development in Germany, is still posed by any escalation at international trouble spots.

For the Euro area, a rise in economic growth by 1.1% is expected for 2015.

17 — GDP growth 2013–15 for Germany and the Euro area

In %	2013	2014	2015
Germany	0.4	1.5	**1.4**
Euro area	(0.4)	0.8	**1.1**

Source: Gfk Consumer Index December 2014/January 2015; FocusEconomics Consensus Forecast Euro Area Feb 2015

11.2 Market Expectations

The market development in Germany, one of the biggest telecommunications markets in Europe, will again be driven by rising customer demand for broadband and data services in mobile telecommunications and in the fixed network. The boom in smartphones and tablets as well as a growing demand for LTE are driving the growth in mobile data services. Thus the market for mobile internet will soon supersede mobile telephone calls as the most important driver of revenue for German mobile telecommunications service providers. At the same time the negative trend for mobile voice and SMS will continue through further price pressure and changed customer behaviour. The market for mobile services in Germany is expected to post negative growth overall in the coming years, with a decline in mobile service revenues of around 2% per year until 2016.

However, growing demand from customers for higher connection speeds in mobile and fixed networks and demand for convergent solutions will be growth drivers.

(Source: Company data, Analysys Mason)

11.3 Expectations for the Telefónica Deutschland Group

Germany has emerged from 2014 as one of the most attractive telecommunication markets in Europe, particularly around the mobile data monetisation theme. In this new environment, improving the quality of service is key to facilitate the steady adoption of a more digital lifestyle by customers.

The merger of Telefónica Deutschland Group and the E-Plus Group from 1 October 2014, is the main catalyst for a change of a more balanced market, with tangible benefits for our customers and shareholders.

Telefónica Deutschland Group's strategic framework is built around three key priorities:

— Keep the Momentum from a leading position in the mobile consumer and partner markets, while growing in customer segments, such as SMEs or digital households from a better quality platform.
— Integrate quickly and extract the full value of expected synergies from the integration of both infrastructures and organisations while progressing on the development of the LTE network.
— Transform the company into a truly end-to-end digitally oriented company, both from an internal and external perspective.

Our aspiration is to become the Leading Digital Telco, which will be cemented in the future by three success factors:

1. Offer the best high-speed access experience to our customers, with a flexible combination of the latest technologies for mobile and fixed broadband access.
2. Ensure a superior customer experience to customers across all channels and throughout their customer journey, with tailored offers per customer segment designed to monetise increased demand for mobile data and a more efficient and digital customer service.
3. Achieve Operational Excellence while the integration of both networks and organisations is taking place for gaining cost leadership with excellent value for money. This will be ensured with a progressive improvement of efficiencies while consistently delivering on customer expectations.

In 2015 (year one of the integration schedule), we already expect to achieve a run rate of around EUR 250 million Operating cash flow (OIBDA minus CapEx) synergies[11], which is approximately 30% of the target run rate of operating cash flwo synergies (EUR 800 million) expected after five years.

CapEx synergies (from the avoidance of dual network roll-outs) are anticipated to represent around 50% of total run rate operating cash flwo synergies expected for 2015.

We expect operating expenses savings (ca. 40% of total operating cash flwo synergies in 2015) to have an impact in financials mainly in the second half of the year from the initial execution of the headcount restructuring programme, related reduction of facilities and shop footprint reduction. Thus, for operating expense synergies, we anticipate a split of roughly 60% in commercial areas and 40% in SG&A (Selling, General and Administration) areas.

Revenue and other synergies (less than 10% of total run rate synergies expected in the year) are expected to come from cross and up-selling activities, the increase of market share in the SME segment and the initial contribution from the Mobile Bitstream Access agreement to our wholesale business.

In line with our vision to become the Leading Digital Telco in Germany, in 2015 we will put an even stronger focus on the development of our customer base. We will continue to be the value-for-money choice for our customers and partners while keeping a strong view on data monetisation. As a result, we expect mobile service revenue in 2015 to remain broadly stable over 2014 combined[2] figure (EUR 5,528 million). The fixed business will continue to play an important role, leveraging increased demand for high-speed access and flexible propositions to facilitate our customers' digital journey.

We expect a gradual progression of improvement in OIBDA before extraordinary effects throughout 2015 driven by the capture of synergies from the integration of organisations and initial projects for the combination of networks, the focus on operational excellence with increased scale of the business and a higher contribution from mobile data. From a 2014 combined[2] base of EUR 1,461 million, we expect OIBDA before extraordinary effects to grow more than 10% year-on-year in 2015.

The fourth quarter of 2014 reflected the start of a new investment cycle for the new Telefónica Deutschland Group, and for 2015 we expect synergies to outweigh the additional investments to be made to accelerate the deployment of the LTE network and the initial works for the consolidation of the two networks. As a result, we expect that CapEx (excluding investments related with the renewal/acquisition of spectrum licences) in 2015 to show a high single digit percentage decline year-on-year from a combined[2] base of EUR 1,161 million.

11 Synergies defined in terms of Operating Cash Flow (OIBDA-CapEx) with a target run rate after year 5 from start of integration of EUR 800 million. OpEx savings are referred to 2014 combined financials excluding restructuring costs. CapEx is net of restructuring activities and excludes investment in spectrum.

Munich, 9 March 2015

Telefónica Deutschland Holding AG

The Management Board

Thorsten Dirks | Rachel Empey | Markus Haas

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for the financial year ended 31 December 2014

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Consolidated Statement of Financial Position_

Assets (Euros in millions)	Notes	As of 31 December 2014	2013
A) Non-current assets		**14,393**	**7,266**
Goodwill	[5.1]	1,629	706
Other intangible assets	[5.2]	6,726	2,884
Property, plant and equipment	[5.3]	5,029	2,896
Trade and other receivables	[5.4]	236	83
Other financial assets	[5.5]	49	16
Other non-financial assets	[5.6]	142	98
Deferred tax assets	[6.6]	581	584
B) Current assets		**3,494**	**1,755**
Inventories	[5.7]	104	89
Trade and other receivables	[5.4]	1,513	877
Other financial assets	[5.5]	19	21
Other non-financial assets	[5.6]	71	60
Cash and cash equivalents	[5.8]	1,702	709
Assets held for sale	[8]	85	0
Total assets (A+B)		**17,887**	**9,021**

Equity and Liabilities (Euros in millions)	Notes	As of 31 December 2014	2013
A) Equity	**[5.9]**	**11,380**	**5,999**
Subscribed capital		2,975	1,117
Additional paid-in capital		4,800	0
Retained earnings		3,606	4,882
Equity attributable to owners of the parent		11,380	5,999
B) Non-current liabilities		**2,912**	**1,452**
Interest-bearing debt	[5.10]	1,800	1,344
Trade and other payables	[5.11]	19	3
Provisions	[5.12]	787	104
Deferred income	[5.11]	305	0
C) Current liabilities		**3,595**	**1,571**
Interest-bearing debt	[5.10]	615	104
Trade and other payables	[5.11]	2,283	1,271
Provisions	[5.12]	241	4
Other non-financial liabilities	[5.6]	18	23
Deferred income	[5.11]	400	170
Liabilities held for sale	[8]	40	0
Total equity and liabilities (A+B+C)		**17,887**	**9,021**

Consolidated Income Statement_

(Euros in millions)	Notes	1 January to 31 December 2014	2013
Revenues	[6.1]	5,522	4,914
Other income	[6.2]	106	169
Supplies		(2,144)	(1,958)
Personnel expenses	[6.3]	(828)	(419)
Other expenses	[6.4]	(1,976)	(1,469)
Operating income before depreciation and amortisation (OIBDA)		**679**	**1,237**
Depreciation and amortisation	[5.1], [5.2]	(1,325)	(1,132)
Operating income		**(646)**	**105**
Finance income		10	6
Exchange gains		1	1
Finance costs		(50)	(33)
Exchange losses		(2)	(1)
Net financial income/(expense)	**[6.5]**	**(41)**	**(27)**
Profit/(loss) before tax		**(687)**	**78**
Income tax	[6.6]	(34)	(1)
Total profit/(loss) for the period		**(721)**	**78**
Profit/(loss) for the period attributable to owners of the parent		**(721)**	**78**
Profit/(loss) for the period		**(721)**	**78**
Earnings per share	**[9]**		
Basic earnings per share in EUR		**(0.45)**	**0.07**
Diluted earnings per share in EUR		**(0.45)**	**0.07**

Consolidated Statement of Comprehensive Income_

		1 January to 31 December	
(Euros in millions)	Notes	2014	2013
Profit (loss) for the period		**(721)**	**78**
Other comprehensive income (loss)			
Items that will not be reclassified to profit or loss		**(31)**	**(6)**
Remeasurement of defined benefit plans	[5.12]	(45)	(9)
Income tax impact	[5.12]	15	3
Total other comprehensive income (loss)		**(31)**	**(6)**
Total comprehensive income		**(752)**	**72**
Total comprehensive income for the period attributable to owners of the parent		(752)	72
Total comprehensive income		**(752)**	**72**

Consolidated Statement of Changes in Equity_

(Euros in millions)	Subscribed capital	Additional paid-in capital	Retained earnings	Equity attributable to owners of the parent	Equity
Financial position as of 1 January 2013	**1,117**	**0**	**5,311**	**6,429**	**6,429**
Profit/(loss) for the period	0	0	78	78	78
Other comprehensive income/(loss)	0	0	(6)	(6)	(6)
Total comprehensive income	**0**	**0**	**72**	**72**	**72**
Dividends	0	0	(503)	(503)	(503)
Other movements	0	0	1	1	1
Financial position as of 31 December 2013	**1,117**	**0**	**4,882**	**5,999**	**5,999**
Financial position as of 1 January 2014	**1,117**	**0**	**4,882**	**5,999**	**5,999**
Profit/(loss) for the period	0	0	(721)	(721)	(721)
Other comprehensive income/(loss)	0	0	(31)	(31)	(31)
Total comprehensive income	**0**	**0**	**(752)**	**(752)**	**(752)**
Dividends	0	0	(525)	(525)	(525)
Capital increases	1,858	4,832	0	6,690	6,690
Costs of capital increases	0	(33)	0	(33)	(33)
Other movements	0	0	1	1	1
Financial position as of 31 December 2014	**2,975**	**4,800**	**3,606**	**11,380**	**11,380**

Consolidated Statement of Cash Flows_

	1 January to 31 December	
(Euros in millions)	2014	2013
Cash flow from operating activities		
Profit/(loss) for the period	**(721)**	**78**
Adjustments to profit/(loss)		
Net financial result	41	27
Gains on disposal of assets	(0)	(76)
Net income tax expense	34	1
Depreciation and amortisation	1,325	1,132
Change in working capital and others		
Other current and non-current assets	(89)	(45)
Other non-current liabilities and provisions	609	159
Other current liabilities and provisions	241	16
Taxes paid	(6)	0
Interest received	10	7
Interest paid	(41)	(28)
Cash flow from operating activities	**1,403**	**1,270**
Cash flow from investing activities		
Proceeds on disposals of property, plant and equipment and intangible assets	1	69
Payments on investments in property, plant and equipment and intangible assets	(689)	(664)
Proceeds on disposals of companies, net of cash and cash equivalents disposed	0	38
Payment for the acquisition of E-Plus net of cash acquired – change in group structure (refer to Note No. 7 Business Combinations)	(3,239)	0
Proceeds/Payments made on financial assets	4	(14)
Cash flow from investing activities	**(3,924)**	**(572)**
Cash flow from financing activities		
Payments made for capital increase costs	(25)	(2)
Proceeds from capital increases	3,620	0
Proceeds from interest-bearing debt	700	595
Repayment of interest-bearing debt	(240)	(404)
Dividends paid	(525)	(503)
Cash flow from financing activities	**3,530**	**(314)**
Less cash and cash equivalents attributable to assets and liabilities held for sale (refer to Note No. 8. Discontinued Operations and Disposal Groups)	**(16)**	**0**
Net increase/(decrease) in cash and cash equivalents	**994**	**385**
Cash and cash equivalents at the beginning of the period	**709**	**324**
Cash and cash equivalents at the end of the period (excluding cash and cash equivalents held for sale)	**1,702**	**709**

Notes to the Consolidated Financial Statements_ for the Year Ended 31 December 2014

1. Reporting Entity

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared as of and for the year ended 31 December 2014 and comprise Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland") and its subsidiaries as well as joint operations (together referred to as "Telefónica Deutschland Group" or "Group").

Telefónica Deutschland Holding AG is a corporation (AG) incorporated under German law.

The company's name is "Telefónica Deutschland Holding AG". The company's registered office is located in Munich, Germany. Telefónica Deutschland Holding AG is registered in the commercial register of the local court in Munich under registration number HRB 201055. The company's business address is Georg-Brauchle-Ring 23–25, 80992 Munich, Germany (telephone number: +49 (0) 89 2442-0; WWW.TELEFONICA.DE). Telefónica Deutschland Holding AG was established for an indefinite period.

The financial year is the calendar year (1 January to 31 December).

The company is listed on the regulated market of the Frankfurt Stock Exchange. The security identification number (Wertpapierkennnummer – WKN) is A1J5RX, the ISIN (International Securities Identification Number) is DE000A1J5RX9. As of 31 December 2014, Telefónica Deutschland Holding AG has share capital of EUR 2,974,554,993, divided into 2,974,554,993 no-par value registered shares, each accounting for a pro rata amount of share capital of EUR 1.00. In general, each non-par share grants one vote at the Annual General Meeting.

In 2014, Telefónica Deutschland's share capital was increased by EUR 1,116,945,400 by way of a capital increase for cash, entered in the commercial register on 18 September 2014, and by EUR 740,664,193 by way of a capital increase for contributions in kind, entered in the commercial register on 7 October 2014, to a total of EUR 2,974,554,993.

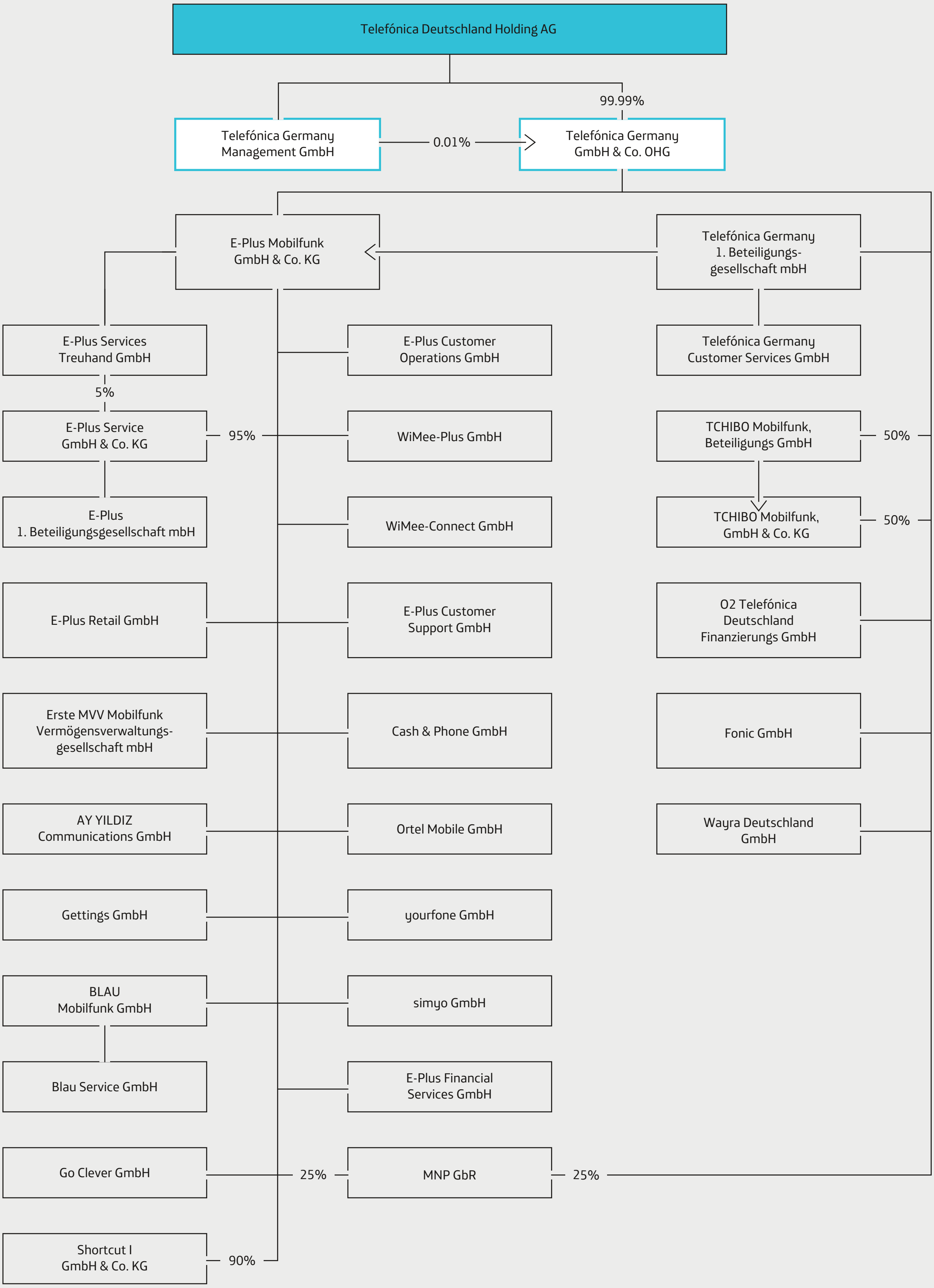
As of 31 December 2014, 17.1% of the shares were in free float. 62.4% were held by Telefónica Germany Holdings Limited, Slough, United Kingdom (Telefónica Germany Holdings Limited), an indirect wholly owned subsidiary of Telefónica, S.A., Madrid, Spain (Telefónica, S.A.). The remaining 20.5% were held by Koninklijke KPN N.V., The Hague, Netherlands (KPN).

As of 31 December 2014, Telefónica Deutschland Holding AG had authorised capital 2012/I of EUR 292,808,507.

The share capital of Telefónica Deutschland Holding AG was conditionally increased as of 31 December 2014 by up to EUR 558,472,700 by issuing up to 558,472,700 registered shares (conditional capital 2014/I).

Telefónica Deutschland Holding AG is the parent company of Telefónica Deutschland Group. It is included in the Consolidated Financial Statements (Telefónica, S.A. Group) of the ultimate holding company, Telefónica, S.A., Madrid, Spain. The parent company of Telefónica Deutschland Holding AG is Telefónica Germany Holdings Limited, a wholly owned subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited), and an indirect subsidiary of Telefónica, S.A.

As of 31 December 2014, the companies included in the Consolidated Financial Statements of Telefónica Deutschland Group were organised as shown in the following organisation chart:


Telefónica Deutschland Holding AG
99.99%
Telefónica Germany Management GmbH
0.01%
Telefónica Germany GmbH & Co. OHG
E-Plus Mobilfunk GmbH & Co. KG
Telefónica Germany 1. Beteiligungsgesellschaft mbH
E-Plus Services Treuhand GmbH
5%
E-Plus Service GmbH & Co. KG
95%
E-Plus 1. Beteiligungsgesellschaft mbH
E-Plus Retail GmbH
Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH
AY YILDIZ Communications GmbH
Gettings GmbH
BLAU Mobilfunk GmbH
Blau Service GmbH
Go Clever GmbH
25%
Shortcut I GmbH & Co. KG
90%
E-Plus Customer Operations GmbH
WiMee-Plus GmbH
WiMee-Connect GmbH
E-Plus Customer Support GmbH
Cash & Phone GmbH
Ortel Mobile GmbH
yourfone GmbH
simyo GmbH
E-Plus Financial Services GmbH
MNP GbR
25%
Telefónica Germany Customer Services GmbH
TCHIBO Mobilfunk, Beteiligungs GmbH
50%
TCHIBO Mobilfunk, GmbH & Co. KG
50%
O2 Telefónica Deutschland Finanzierungs GmbH
Fonic GmbH
Wayra Deutschland GmbH

On 23 July 2013, Telefónica Deutschland, Telefónica, S.A., and KPN concluded an agreement regarding the acquisition of KPN's German mobile business E-Plus by Telefónica Deutschland, which was executed effective 1 October 2014 following approval by the cartel authorities and implementation measures such as a capital increases for cash and contributions in kind (see Note No. 2 Significant Events and Transactions in the Financial Year). Since this date, Telefónica Deutschland Group has contained not only the companies that already belonged to it but also E-Plus Mobilfunk GmbH & Co. KG (E-Plus) and its direct and indirect subsidiaries (E-Plus Group). A list of the companies consolidated on 1 October 2014 is presented in Note No. 11 Group Companies of Telefónica Deutschland Group.

In the fourth quarter of 2014, Telefónica Deutschland Group agreed to sell yourfone GmbH, Hamburg, including its trademark rights, customers and employees, to Drillisch AG, Maintal, (see Note No. 2 Significant Events and Transactions in the Financial Year, Note No. 8 Discontinued Operations and Disposal Groups and Note No. 21 Events after the Reporting Period). With this agreement, Telefónica Deutschland Group is rapidly advancing the integration process. Further sales of customer bases from the shared portfolio of Telefónica Deutschland and E-Plus are not currently planned.

In the fourth quarter of 2014, in accordance with a corresponding resolution, the limited partner shares in E-Plus Mobilfunk GmbH & Co. KG were contributed to Telefónica Germany GmbH & Co. OHG. For further information see Note No. 21 Events after the Reporting Period.

In the reporting periods, Telefónica Deutschland Group has, according to IFRS 8, only the reportable segment Telecommunications.

Telefónica Deutschland Group, which since 1 October 2014 has also contained E-Plus Group, has been one of the three leading integrated network operators in Germany since the acquisition of E-Plus. Telefónica Deutschland Group offers private and business customers voice, data and added value services in wireless communications and wireline networks. In addition, Telefónica Deutschland Group is among the leading wholesale providers in Germany. Wholesale partners are offered access to their own infrastructure and services. Telefónica Deutschland Group is part of Telefónica, S.A. Group, one of the biggest telecommunications corporations in the world.

Since the merger with E-Plus Group, two nation-wide wireless telecommunications networks have been in operation. A nation-wide wireline network is also operated. The sales and marketing approach is based on a strong multi-brand strategy that addresses a broad range of customer segments with the product and services. The majority of the wireless communications products are offered via the brands O_2 and BASE. Wireline communications products and combined offers are offered via the premium brand O_2.

For several years, mobile phones and other hardware have also been sold under the O_2 brand independently of wireless communications charges at fixed prices, such as via the successful “O_2 My Handy” model. Here the customer can choose whether to pay the entire price upfront and to make a down-payment and pay the remaining purchase price in twelve or 24 monthly instalments.

The customers of former E-Plus brands are also offered bundled hardware alongside bundled wireless communications and hardware offerings. The main suppliers of mobile phones are the manufacturers Samsung, Apple, Nokia, HTC, Sony and Huawei.

With secondary and partner brands and via wholesale channels, Telefónica Deutschland Group reaches further groups of customers to whom the brands O_2 and BASE do not appeal. The secondary brands include the brands blau.de, Fonic, simyo, Ay Yildiz, Ortel Mobile and netzclub, which are fully controlled, as well as brands from joint operations and strategic partnerships such as, for example, TCHIBO mobil. The multi-brand approach enables the Group to address a broad spectrum of customers and to maximise the sales range through customised product offers, sales and marketing. As part of the wholesale business, wireless communications services are offered for customers such as Drillisch, MedionMobile (AldiTalk), ADAC, MTV, mobilcom/debitel and cable providers.

In the wireline area, a range of Unbundled Local Loop (ULL) services, including wireline telephony and high-speed internet, are provided to our wholesale partners. Furthermore, added value services such as e.g. billing services or the management of telephone numbers and SIP accounts are offered. This comprehensive portfolio enables the wholesale partners to independently service end-customers and at the same time provides the Group the opportunity to increase its range and to achieve economies of scale.

For business customers area small office/home office (SoHo) as well as small and medium-sized enterprises (SMEs) are addressed via our premium brand O_2, large international businesses via the Telefónica brand.

The products are marketed via a diversified sales platform. This includes direct selling channels like the nation-wide network of independently operated franchise and premium partner shops, online and tele-sales as well as indirect selling channels like partnerships in retail trade/online retail trade and retailers/cooperations.

2. Significant Events and Transactions in the Financial Year

Agreement on the acquisition of E-Plus and implementation of the acquisition

On 23 July 2013, Telefónica Deutschland, Telefónica, S.A. and KPN concluded an agreement for the acquisition of KPN's German mobile business, E-Plus, by Telefónica Deutschland. As consideration, KPN received new shares and approximately EUR 3.6 billion in cash (“cash purchase price”), which will be subsequently adjusted in a final purchase price reduction.

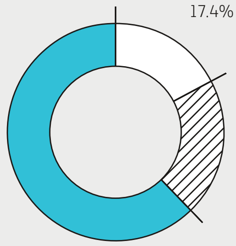
The cash component to be paid to KPN was financed via a cash capital increase of Telefónica Deutschland (Note No. 1 Reporting Entity).

The shares issued as further consideration to KPN were generated via a capital increase against contribution in kind, initially giving KPN a 24.9% stake in Telefónica Deutschland after the completion of the cash capital increase and the capital increase against contribution in kind. KPN held a stake of 4.4% of the 24.9% only in trust for Telefónica S.A.

Telefónica, S.A. then acquired the 4.4% share in Telefónica Deutschland indirectly from KPN for EUR 1.3 billion.

This resulted in a 62.1% stake in Telefónica Deutschland held by Telefónica, S.A. and a 20.5% stake held by KPN:

Shareholder structure



1 Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.
2 According to the voting rights notification dated 20 October 2014, Koninklijke KPN N.V. now holds these shares directly

Furthermore, Telefónica, S.A. concluded a call option agreement with KPN on 30 September 2014. This agreement grants Telefónica, S.A. the right to acquire from KPN a further share of up to 2.9% of Telefónica Deutschland. This right can be exercised one year after the conclusion of the call option agreement at an exercise price of up to EUR 0.51 billion.

The acquisition of E-Plus was completed with effect from 1 October 2014 (Note No. 1 Reporting Entity). Since this date, the Telefónica Deutschland Group also comprises E-Plus Mobilfunk together with its direct and indirect subsidiaries in addition to the existing companies.

Agreement for network access with regard to the E-Plus acquisition

On 25 June 2014, the Telefónica Deutschland Group concluded an agreement with MS Mobile Services GmbH ("Drillisch"), a group company of Drillisch AG, in which Drillisch undertakes to purchase 20% of the mobile network capacity under the control of the Telefónica Deutschland Group after the completion of the acquisition of the E-Plus Group in addition to the requirements for its existing customers already activated in the networks of the Telefónica Deutschland Group or E-Plus. This level of 20% will be reached by way of a five-year glide path. In addition, Drillisch acquires the right to purchase up to another 10% of the capacity of these networks.

The Telefónica Deutschland Group grants Drillisch access by way of a mobile bitstream model to the future joint network of Telefónica Deutschland and E-Plus and to current and future technical developments in this network, which Drillisch can offer to its customers.

The agreement was concluded in view of the European Commission's decision in the merger control procedure for the acquisition of E-Plus by Telefónica Deutschland. It is intended to ensure the implementation of individual commitments made by Telefónica Deutschland as part of the merger control procedure in order to dispel competition law concerns on the part of the European Commission.

The agreement with Drillisch entered into force after the European Commission confirmed on 29 August 2014 that this agreement fulfilled the conditions associated with the decision on approval to the extent that these conditions were required to be fulfilled before completing the transaction.

Changes in the Management Board of Telefónica Deutschland

As of 31 December 2014, the Management Board consisted of Thorsten Dirks, Rachel Empey and Markus Haas.

At the beginning of the 2014 financial year, the Management Board consisted of René Schuster, Rachel Empey and Markus Haas.

On 31 January 2014, René Schuster left in mutual agreement as CEO and member of the Management Board. The Supervisory Board of Telefónica Deutschland had approved a corresponding termination agreement on 29 January 2014.

From 1 February 2014, the responsibilities of the CEO were taken over jointly by Rachel Empey and Markus Haas, in addition to their previous responsibilities. Rachel Empey focused on the operative business and Markus Haas on the preparation for the E-Plus integration.

Since the completion of the acquisition of E-Plus, Markus Haas has been responsible for operating business as COO and Rachel Empey has been responsible for finance and strategy as CFO.

On 2 July 2014, the Supervisory Board of Telefónica Deutschland Holding AG resolved to appoint Thorsten Dirks as future Chief Executive Officer (CEO).

Thorsten Dirks was formally appointed as a member of the Management Board and as CEO in the context of the completion of the acquisition of the E-Plus Group by Telefónica Deutschland – specifically, by way of the Supervisory Board resolution of 9 October 2014.

By way of another resolution on the same date, the Supervisory Board extended the term of office of Rachel Empey and Markus Haas.

All current members of the Management Board are appointed for the period up until 30 September 2017.

Changes in the Supervisory Board of Telefónica Deutschland

The Annual General Meeting on 20 May 2014 elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as additional members of the Supervisory Board of Telefónica Deutschland Holding AG representing the shareholders. Their term of office began when the amendment to the articles of association regarding the expansion of the Supervisory Board from twelve to 16 members was registered on 18 September 2014.

Joachim Rieger and Jürgen Thierfelder were appointed as additional employee representatives on the Supervisory Board by order of the Munich Local Court on 31 October 2014.

Therefore, at full strength the Supervisory Board consists of 16 members with eight shareholder representatives and eight employee representatives as of 31 December 2014.

Decision by the Federal Network Agency on the return of frequencies in the ranges of 900MHz and 1,800MHz

In the telecommunication law ruling on the planned merger of Telefónica Deutschland and E-Plus on 4 July 2014, the presidential chamber of the Federal Network Agency ruled that, in the event of the transaction taking place, the Telefónica Deutschland Group and E-Plus Mobilfunk are required to return those frequencies in the ranges of 900MHz and 1,800MHz for which they do not have any allocation beyond 2016 at that time by 31 December 2015 (early return of 900/1,800MHz spectrum) and that the Federal Network Agency will carry out an overall examination, taking account of the future frequency spectra in the ranges of 900MHz and 1,800MHz, to determine whether measures are required with regard to the frequency spectrum resulting from the merger, particularly in the 2GHz range (frequency allocation review). On 4 August 2014, the Telefónica Deutschland Group filed a suit against the Federal Network Agency's ruling of 4 July 2014 with the Cologne Administrative Court. No ruling has been issued yet with regard to this suit. In addition, an application for temporary legal protection was submitted on 9 December 2014, for which likewise no ruling has been issued yet.

Extraordinary General Meeting

On 11 February 2014, an extraordinary General Meeting was held at which the following capital measures for the E-Plus transaction were approved:

— increase in the share capital by up to EUR 3.7 billion against cash with a subscription right of the shareholders, as well as a related amendment of the articles of association
— authorisation of the Management Board, with the approval of the Supervisory Board, to execute a capital increase against contribution in kind up to EUR 475 million and the related amendment of the articles of association (authorised capital 2014/I).

The resolution passed by the Annual General Meeting on the authorisation to increase share capital by up to EUR 3.7 billion applied to any implementation of the cash capital increase up until the end of 10 August 2014. It was replaced by the corresponding resolution on the cash capital increase by the Annual General Meeting on 20 May 2014 with an implementation deadline of 19 November 2014.

Furthermore, the extraordinary General Meeting resolved a new conditional capital 2014/I whilst suspending the former conditional capital 2012/I. The new conditional capital 2014/I was registered in the commercial register on 25 February 2014, whilst suspending the former conditional capital 2012/I (Note No. 1 Reporting Entity).

Annual General Meeting and dividend distribution

On 20 May 2014, the second Annual General Meeting of Telefónica Deutschland took place. Next to the discharge of the Supervisory Board and Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the 2014 Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG, the Annual General Meeting resolved to distribute a dividend of EUR 0.47 per dividend-entitled share, a total EUR 524,964,338.

In addition, an increase in the share capital of up to EUR 3.7 billion against cash contributions with a subscription right of the shareholders in connection with the acquisition of E-Plus (also referred to hereinafter as the "cash capital increase") and a corresponding amendment to the articles of association were resolved. This also established the possibility to use the cash capital increase beyond the term of validity of the corresponding resolution adopted under agenda item 1 of the extraordinary General Meeting on 11 February 2014, i.e. after 10 August 2014.

In addition, it was resolved to increase the number of Supervisory Board members from twelve to 16 and to amend the articles of association accordingly. The amendment to the articles of association was entered in the Commercial Register on 18 September.

The Annual General Meeting had elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as members of the Supervisory Board of Telefónica Deutschland subject to the registration of this amendment to the articles of association.

Issue of a 7-year bond (Bond II)

On 10 February 2014, Telefónica Deutschland Group issued a senior unsecured 7-year bond with a nominal value of EUR 500 million. The bond matures on 10 February 2021. It was issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the 7-year Euro Midswap Rate, resulting in a yield of 2.434%. The bond has a denomination of EUR 1 thousand and was issued on the basis of a bond security prospectus. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general corporate purposes.

In this context, an interest rate swap was concluded for a partial amount of EUR 150 million of the bond's nominal value. On the basis of this interest swap contract, Telefónica Deutschland Group pays a variable interest rate in the amount of the three-month Euribor on a nominal amount and receives a fixed interest rate of 1.268% on the same amount in return.

Conclusion of contract to expand the wireline cooperation

In May 2013, the Telefónica Deutschland Group concluded a Memorandum of Understanding with Telekom Deutschland GmbH via Telefónica Germany GmbH & Co. OHG to expand their wireline cooperation. This comprises the future intensified usage of the high-speed infrastructure of Telekom Deutschland GmbH by the Telefónica Deutschland Group for its fixed products. Within the scope of this cooperation, the Telefónica Deutschland Group will be able to implement the transition from the independent ADSL infrastructure through to a sustainable NGA platform. In future, the Telefónica Deutschland Group intends to increasingly use VDS Land vectoring wholesale products provided by Telekom Deutschland GmbH. The transition should be fully completed in 2019. A binding agreement for the wireline cooperation with Telekom Deutschland GmbH was concluded on 20 December 2013.

The cooperation includes regulating aspects which are subject to an inspection by the Federal Network Agency (Bundesnetzagentur – BNetzA) and the Federal Cartel Office (Bundeskartellamt – BKartA). The Federal Network Agency approved the cooperation in its draft decision from December 2013. The draft decision was subsequently discussed publicly at national level and with the European Commission. In its statement on 13 March 2014, the European Commission did not express any significant misgivings.

The Federal Network Agency published its final decision on 18 March 2014, positively confirming its draft decision from December 2013. With this decision, the binding agreement with Telekom Deutschland GmbH that had been signed in December 2013 entered into force on 18 March 2014.

The cooperation is not subject to antitrust approval but it was examined by the Federal Cartel Office with regard to general competition law aspects. A ruling was issued on 5 November 2014. As expected, the 7th Ruling Chamber of the Federal Cartel Office determined that, according to current information, the cooperation does not give rise to any grounds for the Ruling Chamber to take action.

With effect from 1 May 2014, the Telefónica Deutschland Group thus already uses the high-speed infrastructure to an increased extent for fixed products under the agreement concluded.

Dividend proposal for the 2014 financial year

On 8 September 2014, the Management Board of Telefónica Deutschland resolved and announced its intention to propose a cash dividend of at least EUR 700 million, to be paid in 2015, to the next Annual General Meeting for the 2014 financial year.

Cash capital increase

To generate the cash purchase price in the context of the E-Plus acquisition, a cash capital increase on the basis of the authorisation granted by the Annual General Meeting of 20 May 2014 and the resolutions of the Management Board and the Supervisory Board of 8 September 2014 was resolved, under which the share capital of the company was to be increased by EUR 1,116,945,400 from its previous level of EUR 1,116,945,400, divided into 1,116,945,400 no-par value registered shares, to EUR 2,233,890,800 by issuing 1,116,945,400 new shares. The cash capital increase was entered in the Commercial Register on 18 September 2014.

Capital increase against contribution in kind/new share capital

In connection with the acquisition of E-Plus, the Management Board resolved on 24 September 2014, with the approval of the Supervisory Board, to increase the share capital of the company by EUR 740,664,193 from EUR 2,233,890,800 to EUR 2,974,554,993 by issuing 740,664,193 new no-par value registered shares (capital increase against contribution in kind).

The new shares were subscribed for by KPN Mobile Germany GmbH & Co. KG (KPN Mobile Germany) in return for a contribution in kind in the form of the limited partner's interest in E-Plus Mobilfunk. According to the voting rights notification, KPN now holds these directly.

The capital increase against contribution in kind was entered in the Commercial Register on 7 October 2014. Since this date, the share capital of the company has amounted to EUR 2,974,554,993, divided into the same number of no-par value registered shares.

In connection with the implementation of the capital increase against contribution in kind, the authorised capital 2014/I, which had been used in full, was removed. The authorised capital 2012/I is still in place in the amount of EUR 292,808,507 after partial use (Note No. 1 Reporting Entity).

In the course of the above shown capital increase against cash and contribution in kind an increase in capital reserves resulted to an amount of EUR 4.799.744.944 as of 31 December 2014.

The increase in capital reserves results from the total subscription price of the shares from the capital increase in cash and contribution in kind reduced by the cost of the capital increase as well as the contribution in share capital.

Integration of E-Plus

Following the completion of the E-Plus acquisition, the Management Board of Telefónica Deutschland published the planned key points for the integration of E-Plus on 17 October 2014. The merger with E-Plus offers Telefónica Deutschland a unique opportunity to actively shape the revolution in the telecommunications sector and become the leading digital telecommunications provider.

With the goal of digital transformation of the business model and of leveraging the announced synergies with a net present value of over EUR 5 billion, next to other actions a restructuring programme was initiated in the course of which 1,600 of the total of around 9,100 full-time positions are to be cut by 2018. This will particularly be a case of eliminating duplicated functions. Telefónica Deutschland Group has set up a redundancy programme for employees leaving the company. Terminations of employment for operational reasons are to be avoided as far as possible.

In addition, the limited partner's interest in E-Plus Mobilfunk was contributed to Telefónica Germany GmbH & Co. OHG in the fourth quarter 2014 in accordance with the corresponding resolutions by the Management Board and the Supervisory Board. The Management Board and the Supervisory Board also resolved to convert E-Plus Mobilfunk into a limited liability company (GmbH) and conclude a profit and loss transfer agreement with Telefónica Germany GmbH & Co. OHG in the first quarter of 2015 (Note No. 21 Events after the Reporting Period).

In the fourth quarter 2014, the Telefónica Deutschland Group agreed to sell yourfone GmbH, including its trademark rights, customers and employees, to Drillisch AG. With this agreement, the Telefónica Deutschland Group is rapidly proceeding with the integration process. Further sales of customer bases from the shared portfolio of Telefónica Deutschland and E-Plus are not currently planned (Note No. 21 Events after the Reporting Period).

The integration of the E-Plus Group in operating business is also progressing rapidly. Since mid-November 2014, our sales employees have been serving business customers with a uniform product portfolio. At the same time, new O_2 products have been launched and LTE has been activiated without any extra charge for all contractual customers of O_2. Existing customers of E-Plus were given easy access to O_2 DSL tariffs a few weeks after the merger took place.

3. Basis of Preparation

The Consolidated Financial Statements of Telefónica Deutschland Holding AG are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

In addition, the accounting policies are the same as those used to prepare the published previous year's Consolidated Financial Statements for the year ended 31 December 2013, with the exception of the changes to IFRS and the measurement changes described in Note No. 4 Accounting Policies (letters q and s) and the changes to the structure of the statement of financial position outlined below.

Furthermore, the additional requirements of German commercial law pursuant to section 315a (1) HGB (German Commercial Code) are applied.

The Consolidated Financial Statements of Telefónica Deutschland Holding AG were forwarded to the Supervisory Board on 9 March 2015.

Functional currency and presentation currency
These Consolidated Financial Statements are presented in Euro, which is the functional currency of Telefónica Deutschland Group. The Euro (EUR) is the functional currency of all Telefónica Deutschland Group companies.

Unless otherwise stated, the figures in these Consolidated Financial Statements are presented in millions of Euros (EUR million) and rounded. The figures in these Consolidated Financial Statements are rounded according to established commercial principles. Additions of the figures can thus lead to amounts that deviate from those shown in the tables.

Other

The Consolidated Statement of Financial Position is structured in current and non-current in accordance with IAS 1. The Consolidated Income Statement is prepared using the nature of expense method.

Seasonal business activity

Previous earnings performance has provided no indications that the business activity is subject to material seasonal fluctuations.

Changes in the structure of the statement of financial position

To improve the clarity of the information provided in the Consolidated Financial Statements, additional statement of financial position accounts were introduced as of 31 December 2014 and in the comparative previous-year period already published, which in turn results in reclassifications within the statement of financial position in both reporting periods.

The effects of these reclassifications on the published previous-year figures in the statement of financial position as of 31 December 2013 are presented and explained below:

Reconciliation of the prior year figures of the Consolidated Statement of Financial Position to the new balance sheet structure

	Prior Year amount per new Balance Sheet structure	Reclassifica-tions	Reference	Prior Year amount per old Balance Sheet structure
				As of 31 December
Assets (Euros in millions)	2013			2013
A) Non-Current Assets				
Trade and other receivables	83	83	1	0
Other financial assets	16	(83)	1	99
Other non-financial assets	98	98	3	0
B) Current Assets				
Trade and other receivables	877	(158)	2, 3	1,035
Other non-financial assets	60	60	2	0

	Prior Year amount per new Balance Sheet structure	Reclassifica-tions	Reference	Prior Year amount per old Balance Sheet structure
				As of 31 December
Equity and Liabilities (Euros in millions)	2013			2013
B) Non-Current Liabilities				
Interest-bearing debt	1,344	1	4	1,343
Trade and other payables	3	(1)	4	5
Other payables	*3*	*(1)*	*4*	*5*
C) Current Liabilities				
Interest-bearing debt	104	2	5	102
Trade and other payables	1,271	(25)	5, 6, 7	1,296
Trade payables	*1,158*	*84*	*6*	*1,074*
Other payables	*113*	*(109)*	*5, 6, 7*	*222*
Other non-financial liabilities	23	23	7	0

1) In the previous-year reporting period, EUR 83 million is reclassified from non-current other financial assets into the new statement of financial position item non-current trade and other receivables (here: trade receivables). The non-current portion of the "O_2 My Handy" receivables will therefore be reported under non-current trade and other receivables in future.

2) In the previous-year reporting period, EUR 60 million is reclassified from current trade and other receivables (here: trade receivables) into the new statement of financial position item current other non-financial assets. This relates primarily to the current portion of advance payments for leased lines.

3) In the previous-year reporting period, EUR 98 million is reclassified from current trade and other receivables (here: trade receivables) into non-current other non-financial assets. This relates primarily to the non-current portion of advance payments for leased lines.

4) In the previous-year reporting period, EUR 1 million is reclassified from non-current trade and other payables (here: other payables) into non-current interest-bearing debt. Therefore, non-current finance lease liabilities will be presented under non-current interest-bearing debt in future.

5) In the previous-year reporting period, EUR 2 million is reclassified from current trade and other payables (here: other payables) into current interest-bearing debt. Therefore, current finance lease liabilities will be presented under current interest-bearing debt in future.

6) In the previous-year reporting period, EUR 84 million is reclassified within the statement of financial position item current trade and other payables. Specifically, debtors with credit balances of EUR 26 million are moved from trade payables into other payables, and as a contrary effect liabilities for outstanding invoices of EUR 109 million are moved from other payables into trade payables.

7) In the previous-year reporting period, tax liabilities of EUR 23 million are reclassified from current trade and other payables (here: other payables) into the new statement of financial position item current other non-financial liabilities.

4. Accounting Policies

The principal accounting policies used in preparing the accompanying Consolidated Financial Statements are as follows:

a) Acquisitions

Business combinations are accounted for in accordance with the purchase method. Telefónica Deutschland as the acquirer and the acquiree may have a relationship that existed before a business combination was contemplated. If the business combination in effect settles such a pre-existing relationship, Telefónica Deutschland as acquirer recognises a resulting gain or loss. The costs of an acquisition are measured according to the fair values of the assets transferred and the liabilities incurred or assumed on the acquisition date. Any agreed contingent consideration by Telefónica Deutschland as the acquirer is recognised at fair value as of the acquisition date. Later changes in the fair value of contingent consideration that constitutes an asset or a liability are recognised either in profit or loss or as a change in other comprehensive income. Contingent consideration classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Transaction costs are recognised in profit or loss at the date they are incurred. Telefónica Deutschland initially recognises identifiable assets acquired in a business combination and the liabilities assumed, including contingent liabilities, at fair value at the acquisition date.

b) Goodwill

For business combinations occurring after 1 January 2010, the effective date of revised IFRS 3-Business Combinations, goodwill represents the excess of acquisition costs over the fair values of identifiable assets acquired and liabilities assumed at the acquisition date. Cost of acquisition is the sum of the fair value of consideration delivered and the value attributed to existing non-controlling interests. For each business combination, Telefónica Deutschland Group determines the value of non-controlling interests at either their fair value or their proportional part of the net identifiable assets acquired. After initial measurement, goodwill is recognised less any accumulated impairment losses. Whenever an equity interest is held in the acquiree prior to the business combination (business combinations achieved in stages), the carrying value of such previously held equity interest is remeasured at its acquisition-date fair value and the resulting gain or loss, if any, is recognised in profit or loss. For business combinations that occurred after 1 January 2004, the date of the transition to IFRS, and before 1 January 2010, the effective date of revised IFRS 3-Business Combinations, goodwill represents the excess of the acquisition costs including transaction costs over the acquirer's interest, at acquisition date, in the fair values of the identifiable assets, liabilities and contingent liabilities of the acquired business. After initial measurement, goodwill is carried less any accumulated impairment losses.

In all cases, goodwill is recognised as an asset denominated in the currency of the company acquired.

Goodwill is not amortised, but tested for impairment annually or more frequently if there are certain events or changes in circumstances indicating the possibility that the carrying amount is higher than the recoverable amount (see Note No. 5.1 Goodwill).

c) Other intangible assets

Other intangible assets are carried at acquisition or production cost, less any accumulated amortisation and any accumulated impairment losses. Subsequent expenditure is capitalised only for existing other intangible assets if it increases the future economic benefit embodied in the asset to which it relates. All other expenditure on internally generated goodwill and brands is recognised in the Consolidated Income Statement as incurred.

The useful lives of other intangible assets either finite or indefinite are determined individually. Telefónica Deutschland Group has not recognised other intangible assets with indefinite useful lives. Other intangible assets with finite useful lives are amortised systematically over the economic useful life and are assessed for impairment if events or circumstances indicate that their carrying amount may not be recoverable. Other intangible assets that are not yet available for use are also tested for impairment annually. Residual values of assets, useful lives and amortisation methods are reviewed annually at year end and, where appropriate, adjusted prospectively.

Licences
Mainly the acquisition costs of the licences granted by public authorities to provide telecommunications services are subsumed here as well as values allocated to licences held by certain companies at the time they were included in Telefónica Deutschland Group.

These licences are amortised on a straight-line basis starting from the moment commercial operation begins (14–20 years).

Customer bases
This item primarily represents the allocation of acquisition costs attributable to customers acquired in business combinations, as well as the acquisition value of this type of asset in a third-party transaction for good and valuable consideration. Amortisation is on a straight-line basis over the estimated period of the customer relationship (mostly nine to ten years).

Software
Software is carried at acquisition or production cost and amortised on a straight-line basis over its useful life, generally estimated to be between two and five years.

Brand names
This includes brand names acquired and thus capitalised in connection with business transactions. The brand names are amortised on a straight-line basis over their expected economic useful lives (3–20 years).

d) Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any accumulated impairment losses. Land is not depreciated.

Cost includes external and internal costs comprising warehouse material used, direct labour used in installation work and the allocable portion of indirect costs required for the related investment. The latter two items are recorded as revenues in Other Income – Own Work Capitalised.

Cost includes in addition, where appropriate, the estimate of the costs at initial recognition for dismantling and removing the item and restoring the site on which it is located, the obligation which the entity incurs either when the item is acquired or as a consequence of having used it. Any corresponding valuation changes in subsequent years are allocated to the respective asset.

The costs of expansion, modernisation or improvement leading to increased productivity, capacity and efficiency or to an extension of the useful lives of assets are capitalised when the recognition criteria are met.

Upkeep and maintenance costs are expensed as incurred.

If an asset within property, plant and equipment consists of multiple components with different useful lives, each part of the asset having a significant acquisition value is assessed and depreciated separately over the term of the useful life of the individual component (component approach).

Telefónica Deutschland Group assesses the need to write down the carrying amount of each item of property, plant and equipment to its recoverable amount, whenever there are indications that the carrying amount of the asset exceeds the higher of the fair value less costs of disposal and its value in use. The impairment charge is reversed if the factors giving rise to the impairment no longer exist (see section e)).

Telefónica Deutschland Group depreciates its property, plant and equipment once they are in full working condition using the straight-line method based on the following estimated useful lives of the assets. The useful lives are calculated in accordance with technical studies which are reviewed periodically and, where appropriate, updated based on technological advances and the rate of dismantling:

	Estimated useful life in years
Buildings	5–20
Plant and machinery (incl. telephone installations, networks and subscriber equipment)	5–20
Furniture, tools and other items	2–10

The estimated residual values of assets and depreciation methods are also regularly reviewed and, where appropriate, adjusted prospectively at each financial year end.

e) Impairment of property, plant and equipment, goodwill and other intangible assets

Goodwill and intangible assets not yet available for use are tested for impairment annually at the reporting date or if there are any indications. Property, plant and equipment and intangible assets with a finite useful life are only tested for impairment if any indications of impairment exist at the reporting date. Assets are tested for impairment either individually or on the level of the cash-generating unit to which the asset belongs; goodwill is always tested on the level of a cash-generating unit to which it was allocated or groups of cash-generating units. An impairment is required if the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. The recoverable amount is determined as the higher of the fair value less costs to sell and the value in use.

The impairment test for goodwill is performed at the lowest level within the entity at which the goodwill is monitored for internal management purposes, but must be at least performed at segment level. If the recoverable amount of a cash-generating unit to which goodwill is allocated is less than the carrying amount of the unit, an impairment loss shall be recognised corresponding to the difference. If the impairment loss exceeds the carrying amount of the goodwill, the remainder shall be allocated pro rata on the basis of the respective carrying amounts of the other assets.

If the carrying amount of an asset exceeds its recoverable amount, the carrying amount written down to its recoverable amount and the resulting loss is recognised in the Consolidated Income Statement. Future depreciation or amortisation charges are adjusted for the asset's new carrying amount over its remaining useful life.

If new events or changes in circumstances indicate that an impairment loss recognised for an asset no longer exists or may have decreased, a new estimate of the recoverable amount of the asset will be determined. A previously recognised impairment loss shall be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. The reversal is limited to the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. The amount of the reversal is recognised in profit or loss, and the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount on a systematic basis over its remaining useful life. An impairment loss recognised for goodwill shall not be reversed in subsequent reporting periods.

As of 31 December 2014, Telefónica Deutschland Group comprises one single cash-generating unit, the reportable segment Telecommunications.

Telefónica Deutschland Group in principle determines the recoverable amount of a cash-generating unit based on its fair value less costs to sell.

The fair value is determined based on the market capitalisation of Telefónica Deutschland Holding AG as of the reporting date. Costs to sell contain costs such as legal and consulting fees that can be directly allocated to the sale of the cash-generating unit.

f) Investments in joint operations

Telefónica Deutschland Group's interests in companies over which it has joint control with third parties are recognised in accordance with the guidelines based on relation to its interest in the joint operation. Thus, Telefónica Deutschland Group's respective share of the assets and the liabilities of the joint operations are included in the Consolidated Financial Statements. The share of expenses incurred at Telefónica Deutschland Group in connection with the joint operations and its share of the revenues are recognised in the Consolidated Income Statement.

g) Foreign currency transactions

Transactions denominated in a foreign currency are translated to Euro at the exchange rate prevailing on the transaction day. At the end of the reporting period, monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate applicable at the reporting date.

The following exchange rates have been used for the respective Consolidated Financial Statements:

	Exchange rate		Average rate	
(EUR/Foreign Currency)	As of 31 December 2014	As of 31 December 2013	2014	2013
USD	1.214	1.379	1.326	1.327
GBP	0.779	0.834	0.806	0.849
BRL	3.225	2.343	3.117	2.158
CHF	1.202	1.228	1.215	1.231

All realised and unrealised foreign exchange gains and losses are included in the Consolidated Income Statement.

h) Inventories

Inventories are stated at the lower of cost and net realisable value and are written down in this regard, if necessary. Cost is determined on the basis of weighted average cost and comprises direct materials and, where applicable, direct labour cost that has been incurred in bringing the inventory to its present location and to condition. Estimates of the net realisable value are based on the most reliable evidence available at the time of the estimates are made of the amount the inventories are expected to realise. These estimates take into consideration the fluctuations of price or costs and the purpose for which the inventory is held.

If the circumstances that previously caused inventories to be written down to an amount below cost no longer exist, the amount of the write-down is reversed, so that the new carrying amount is the lower of cost and revised net realisable value.

The Group's inventory mainly consists of merchandise intended for sale to end customers. At the time of the sale or transfer of the risk to the customer, inventory is reduced accordingly through profit and loss. The change in inventory is recognised within supplies.

i) Financial instruments

A financial instrument, according to IAS 39, is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments are recognised as soon as Telefónica Deutschland Group becomes a party to the contractual provisions of the financial financial position on the trade day, i.e. the date that Telefónica Deutschland Group commits to purchase or sell the financial asset. Upon initial recognition financial instruments are measured at fair value. Transaction costs directly attributable to the acquisition or issuance are considered in determining the carrying amount if the financial instruments are not measured at fair value through profit or loss.

For the purpose of subsequent measurement, financial instruments are allocated to the following categories:

— financial assets or financial liabilities at fair value through profit or loss
— held-to-maturity investments
— loans and receivables

- available-for-sale financial assets
- financial liabilities measured at amortised cost.

Telefónica Deutschland Group does not allocate financial instruments to the category held-to-maturity in the reporting period.

Financial assets
The financial assets mainly include trade and other receivables, other financial assets as well as cash and cash equivalents.

Financial assets at fair value through profit or loss
Financial assets measured at fair value through profit or loss comprise financial assets that are designated as measured at fair value through profit or loss on initial recognition. This includes derivatives in the form of interest rate swaps that qualify for hedge accounting whose market values are positive on the reporting date. Changes to the fair value recorded on initial recognition for assets of this category are recognised in profit or loss at the date of value increase or decrease.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market (such as trade and other receivables). After initial recognition, loans and receivables are subsequently carried at amortised cost using the effective interest method less any impairment losses. Gains and losses are recognised in the Consolidated Income Statement when the loans and receivables are derecognised or impaired. Interest effects from the application of the effective interest method are also recognised in profit or loss.

Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or that cannot be classified in any of the other categories. These include equity instruments (investments in start-ups).

After initial measurement, available-for-sale financial assets are measured at fair value, with unrealised gains and losses being recognised in other comprehensive income. If objective evidence of impairment exists, these changes are recognised in the Consolidated Income Statement. Upon the disposal of financial assets, the accumulated gains and losses recognised in other comprehensive income/loss resulting from measurement at fair value are recognised in profit or loss.

If there is no active market for equity instruments and their fair value cannot be reliably determined, they are measured at acquisition cost.

Impairment of financial assets
At each reporting date, the carrying amounts of financial assets other than those measured at fair value through profit or loss are assessed to determine whether there is objective evidence of impairment. Objective evidence may, for example, exist if a debtor faces serious financial difficulties or is unwilling to pay.

Loans and receivables
The amount of impairment loss on loans and receivables is measured as the difference between the carrying amount of the asset and the present value of the expected future cash flows (excluding expected future credit losses that have not been incurred), discounted at the original effective interest rate of the financial asset. The amount of the impairment is recognised in the Consolidated Income Statement. If, in a subsequent reporting period, the amount of impairment loss decreases and the decrease can be attributed objectively to an event occurring after the impairment was recognised, the impairment loss recorded in prior periods is corrected and recognised in the Consolidated Income Statement. The impairment losses of loans and receivables (e.g. trade receivables) are recorded using allowance accounts. When receivables are assessed as uncollectible, the impaired asset is derecognised.

Available-for-sale financial assets

If an available-for-sale financial asset is impaired, the difference between its cost (less any principal payments and amortisation) and its current fair value (less any impairment loss previously recognised in the Consolidated Income Statement) is reclassified from other comprehensive income to the Consolidated Income Statement. Reversals with respect to equity investments classified as available-for-sale are recognised in the other comprehensive income. Reversals of impairment losses on debt instruments are recorded in the Consolidated Income Statement if the increase in fair value of the instrument can be objectively attributed to an event occurring after the impairment losses were recognised in the Consolidated Income Statement.

For financial assets classified as available-for-sale, objective evidence for impairment exists if there is a significant (> 20%) or prolonged decline (over a period of six months) in the fair value of the instrument.

Financial liabilities

Financial liabilities primarily include trade and other liabilities and interest-bearing debt (including bonds).

Financial liabilities at fair value through profit or loss

A financial liability is measured at fair value through profit or loss if it is held for trading or is designated as fair value through profit or loss on initial recognition. They are presented as current or non-current liabilities or debt depending on their maturity.

Financial instruments included in this category are recorded at fair value on initial recognition and on every subsequent reporting date. Any realised and unrealised gains or losses are recognised in the Consolidated Income Statement.

The company classifies *derivative financial instruments* as held for trading unless they are designated as a hedging instrument (hedge accounting) (see Note No. 5:10 Interest-bearing liabilities). The fair value used of listed derivatives is equal to their positive or negative market value. If a market value is not available, fair value is calculated using standard financial valuation models, such as discounted cash flow or option price models. Derivatives are presented as assets if their fair value is positive and as liabilities if their fair value is negative. Changes in the fair value of derivative financial instruments are recognised periodically in the Consolidated Income Statement. In the current financial year, Telefónica Deutschland Group has two interest rate swaps (derivative financial instrument) to hedge interest rate risks.

Hedging transactions: if the effectiveness of a hedging relationship can be demonstrated and documented accordingly, Telefónica Deutschland Group forms a hedge comprised of the hedged item and the corresponding hedging instrument.

If the company hedges a fair value (fair value hedges), the portion of profit or loss attributable to the hedged risk is allocated to the carrying amount of the hedged item. The carrying amount of the hedged item is increased or decreased by the profit or loss that is attributable to the hedged risk. For hedged items that are recorded at amortised cost, the increase or decrease of the carrying amount is completely released at maturity of the hedged item. When hedging pending transactions, the company increases or decreases the initial carrying amount of the assets or liabilities that result from the fulfilment of the pending transactions by the accumulated changes in the fair value of financial assets or liabilities that were previously separately recognised.

From the date the hedging instrument expires, is sold, terminated or exercised, the accounting of the hedging relationship also ends. The same applies if there is no longer a hedging transaction within the meaning of IAS 39 or Telefónica Deutschland Group ends the designation.

Financial liabilities measured at amortised cost

After initial recognition, financial liabilities are subsequently measured at amortised cost using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the interest rate that exactly discounts the estimated future cash payments through the expected life of the financial liability, or where appropriate, a shorter period to the net carrying amount on initial recognition. The interest expense is recognised on an effective interest basis.

Liabilities to members of partnerships with puttable shares are initially recognised at the present value of the buyout obligation. They are subsequently measured at amortised cost.

Derecognition of financial assets and liabilities
Financial assets are derecognised when the rights to receive cash flows from the assets expire or the financial assets are transferred and Telefónica Deutschland Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of consideration received including the cumulative gains or losses that had been recognised directly in equity, is recognised in the Consolidated Statement of Comprehensive Income. If Telefónica Deutschland Group does not retain or transfer substantially all risks and rewards, and retains control, it continues to recognise the transferred asset to the extent of its continuing involvement.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss.

j) Provisions

Pensions
Telefónica Deutschland Group's obligations under defined benefit pension plans are determined using the projected unit credit method and are in principle recognised as personnel expenses unless otherwise stated below.

Telefónica Deutschland Group determines the net interest expense (net interest income) by multiplying the net defined benefit liability (asset) at the beginning of the period by the interest rate used to discount the defined benefit obligation at the beginning of the period.

The discount rate is determined by reference to market yields at the end of the reporting period on high quality corporate bonds.

The net defined benefit liability (asset) is determined at every reporting date on the basis of an actuary report based on assumptions that are explained as follows. If the plan assets less the defined benefit obligation results in a surplus, then the level of the reported net defined benefit asset is limited to the present value of economic benefits associated with the plan asset surplus in the form of refunds from the plan or on the basis of reduced future contributions. In addition, in the event of a surplus of the plan, the new valuation components include the change in the net defined benefit asset from the application of the asset ceiling, to the extent not taken into account in the net interest component.

Assets incurred by Telefónica Deutschland Group to meet its pension obligations but which do not qualify as plan assets in accordance with IAS 19 are reported under other financial assets.

As part of the determination of the present value of economic benefits associated with the plan asset surplus, any existing minimum funding requirements are taken into account.

The remeasurement component includes on the one hand the actuarial gains and losses from the valuation of the defined benefit obligation and on the other hand the difference between actual return on plan assets and the amounts contained in the net interest on net defined benefit liability (assets).

The company recognises all remeasurement effects in other comprehensive income, whereas the remaining components of the net pension expense (service cost and net interest) are recognised in the Consolidated Income Statement.

In the case of defined contribution plans, the relevant company pays contributions to special purpose pension institutions that are presented in personnel expenses.

Other provisions including termination benefits
Provisions are recognised when Telefónica Deutschland Group has a present (legal or constructive) obligation, as a result of a past event that can be estimated reliably and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are discounted and the corresponding increase in the provision due to the passage of time is recognised as interest expense. For the purpose of discounting, the group applies non-risk market interest rates before tax which are matched to the duration. This does not apply to other long-term employee benefits (partial retirement obligations), for which the discount rate is determined on the same basis as for pension obligations. Potential risks are fully taken into account in determining the settlement amount. When Telefónica Deutschland Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented, if applicable net of any reimbursement, in the Consolidated Income Statement.

Provisions for the costs of decommissioning or dismantling and retirement are recognised if Telefónica Deutschland Group has a legal or constructive obligation to dismantle the relevant items after their utilisation. The estimated costs are recognised as an asset and a provision. Changes in the timing or estimation of the costs are reflected in the asset and in the provision, respectively.

Other provisions also include partial retirement obligations, to which the block model applies. Under this model, an outstanding settlement amount is incurred on the part of the employer during the employment phase that equates to the as yet uncompensated portion of work. After the end of the employment phase and during the reporting periods of the second block of the model (time-off phase), in which the employee receives part-time consideration without performing work, the liability is amortised accordingly.

Top-up amounts are accumulated in the amount of the present value of all future payments over a certain time period. The period over which the top-ups are earned extends to the end of the employment phase for all payments. The provision for partial retirement is allocated to other long-term employee benefits.

Provisions for restructuring including termination benefits are recognised if there is a detailed, formal plan that provides for the individual measures and has been adopted by the appropriate managing bodies. In addition, implementation is expected to begin as soon as possible and a valid expectation has been raised in those affected that the restructuring will be carried out.

The provisions for restructuring include only those expenses necessary and directly attributable to the respective measures. No provisions are recognised for future operating losses.

For further details, see **q) Significant change of estimates, assumptions and judgements**.

k) Revenues and expenses

Revenues and expenses are recognised in the Consolidated Income Statement in line with the accrual basis of accounting (i.e. when the goods or services represented by them take place) regardless of when actual payment or collection is made. Revenues are recognised if the amount can be measured reliably and the economic inflow of benefits from the transaction is classified as probable. Discounts, such as rebates, are reported with a negative effect on revenues.

The revenues of Telefónica Deutschland Group include all income attributable to the company's typical business activity.

Telefónica Deutschland Group principally obtains revenues from providing the following telecommunications services: traffic, connection fees, regular (normally monthly) network usage fees, interconnection services, network and equipment leasing, handset sales, added value services (e.g. text and data messaging) and maintenance. Products and services may be sold separately or in promotional packages (bundled services).

Traffic, connection fees, and regular network usage fees
Revenues from calls carried on Telefónica Deutschland Group networks (traffic) include an initial call establishment fee plus a variable call rate, based on call length, distance and type of service. Both wireline and wireless traffic is recognised as revenues as service is provided. For prepaid calls, the amount of unused traffic generates deferred revenues that are recognised in deferred income in the Consolidated Statement of Financial Position. Revenues from unused credit are received when the company is no longer obliged to provide service or utilisation can no longer be expected, whichever is earlier. Revenues from traffic sales and other services generated at a fixed rate over a specified period of time (flat rate) are recognised on a straight-line basis over the term covered by the rate paid by the customer.

Initial call establishment fees are recognised in deferred income and are subsequently realised in profit or loss for the period over the average estimated term of the customer relationship, which may vary according to the type of service. All related costs, with the exception of expenses for the network expansion and general administration costs and overheads, are recognised in profit or loss for the period in which they incurred.

Interconnection services
Interconnection revenues from wireline-wireless and vice versa calls and other customer services are recognised in the period in which the calls are made.

Handset sales
Revenues from handset and equipment sales are recognised once the sale is considered complete, i.e. generally when delivered to the end customer. Revenues from instalment sales are recognised in the amount of the discounted future receipts. The amount is discounted based on an interest rate derived from market interest rates.

Network and equipment leasing
Leases are classified according to the principles described under **o) Leases.**

Leases from operating lease agreements with customers and income from the leasing of equipment and other services are recognised in profit or loss as the income is earned or the service is provided and therefore on a straight-line basis over the contract term.

Leases with customers classified as finance leases are recognised in revenues at the fair value of the leased asset at the inception of the lease. If the present value of the minimum lease payment allocable to the Group is less than the fair value, the revenues are measured on this basis. Minimum lease payments are discounted based on an interest rate derived from market interest rates.

Multi-component agreements
The Group offers bundled packages which combine multiple elements from the wireline, wireless and internet business. They are assessed to determine whether it is necessary to separate the separately identifiable elements and apply the corresponding revenue recognition policy to each element. Total package revenues are allocated to the identified elements based on their respective fair value (i.e. the fair value of each element in relation to the total fair value of the package).

As connection fees or initial activation fees, or upfront non-refundable fees are not separately identifiable elements in these types of packages, any revenues received from the customer for these items are allocated to the remaining elements. However, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

All expenses related to bundled promotional packages are recognised in the Consolidated Income Statement as incurred.

l) Income tax

Income tax includes both current and deferred taxes. Current and deferred tax is recognised in the Consolidated Income Statement except to the extent that they relate to business combinations or items directly recognised in equity or in other comprehensive income.

Current tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. To calculate the amount tax rates and tax laws applicable or enacted on the reporting date are used.

Telefónica Deutschland Group determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability is settled. Tax rates and tax laws that are enacted (or substantively enacted) at the reporting date are used.

Deferred tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that a sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that a future taxable income will allow the deferred tax asset to be recovered.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint operations are not recognised if the parent company is in a position to control the timing of the reversal and if the reversal is unlikely to take place in the foreseeable future. Cases in which no deferred tax liabilities were recognised for subsidiaries are of minor significance in terms of amount.

To the extent that deferred taxes relate to items recognised directly in equity or in other comprehensive income, these are also recognised in equity or in other comprehensive income. Deferred tax assets and liabilities arising from the initial recognition of the purchase price allocation of business combinations impact the amount of goodwill. However, subsequent changes in tax assets acquired in a business combination are recognised as an adjustment to profit or loss.

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

m) Discontinued operations and disposal groups

Components of a company that meet the criteria of IFRS 5 are classified as discontinued operations and are presented separately in the Consolidated Income Statement and the Consolidated Statement of Cash Flows if they meet the definition of a major line of business under IFRS 5. All changes made in the current reporting period to amounts that are directly related to the sale of discontinued operations in one of the prior reporting periods are likewise presented within this separate category. If a component of the company is no longer classified as held for sale, the profit or loss of this component, which had previously been presented within discontinued operations, is reclassified as continuing operations in all presented reporting periods. If supply of goods and services between continued and discontinued operations also continue after disposal, these supplies are recorded prior to consolidation in the Consolidated Income Statement.

Disposal groups, if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, are classified accordingly if the criteria of IFRS 5 are met. The disposal groups are measured at the lower of carrying amount and fair value less costs to sell and are classified as held for sale. Individual assets of the disposal group are no longer depreciated or amortised. If an impairment loss is recognised for the disposal group, then on any subsequent increases in the fair value less costs to sell, the previously recognised impairment loss has to be reversed. The reversal of the impairment is limited to the cumulative impairment loss that was recognised for the respective disposal group previously. The assets and liabilities of the disposal group are presented separately in the Consolidated Statement of Financial Position.

n) Share-based payments

Telefónica, S.A. grants employees of Telefónica Deutschland Group share options. The determination of fair value is based on the performance of the shares of Telefónica, S.A. Some of the share option plans are cash-settled whereas others are equity-settled.

In the case of cash-settled share-based payment transactions, the total cost of the share options is measured at fair value, taking into account the terms and conditions of the specific plan. The total cost is recognised as an expense in the Consolidated Income Statement from the grant date until the vesting date with recognition of a corresponding liability. The fair value is first determined on the grant date by applying statistical techniques. In contrast to equity-settled share-based payments, the Group must remeasure the fair value at each reporting date and settlement date and recognise all changes in profit or loss until the debt is settled.

For equity-settled share option plans, fair value at the grant date is determined by applying statistical techniques or using a benchmark securities model. The costs are recognised as expenses and the corresponding increase in equity over the vesting period.

o) Leases

The assessment of a lease for accounting purposes is based on the substance of the agreement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to Telefónica Deutschland Group to use the asset.

Leases where the lessor does not transfer substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense or as income on a straight-line basis over the term of the lease in the Consolidated Income Statement.

Leases are classified as finance leases when the terms of the lease transfer substantially all risks and rewards incidental to ownership of the leased item to Telefónica Deutschland Group or from Telefónica Deutschland Group to the end customer. These are classified at the inception of the lease, in accordance with its nature and the associated liability or receivable, at the lower of the present value of the minimum lease payments or the fair value of the leased object. Lease payments are apportioned between the financing and reduction of the principal of the lease liability so as to achieve a constant interest rate on the remaining liability balance over the period. Finance costs and income are recognised over the term of the lease in the financial result in the Consolidated Income Statement.

In sale and leaseback transactions resulting in a finance lease, the asset sold is not derecognised, and the funds received are considered financing for the asset during the term of the lease. If the corresponding assets are leased on under a finance lease, the asset is immediately derecognised through profit and loss (see also **k) Revenues and expenses**).

However, when the sale and leaseback transaction results in an operating lease, and it is clear that both the transaction and subsequent lease income are established at fair value, the asset is derecognised and any gain or loss generated on the transaction is recognised.

p) Use of estimates, assumptions and judgements

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the Consolidated Financial Statements within the next financial year are discussed below. The estimated and associated assumptions are based on historical experience as well as other factors considered to be relevant.

A significant change in the facts and circumstances on which these estimates and related judgements are based could have a material impact on Telefónica Deutschland Group's net assets, financial position and earnings.

Unforeseeable development outside management's control may cause actual amounts to differ from the original estimates. In this case the underlying assumptions, and if necessary the carrying amounts of the pertinent assets and liabilities, will be adjusted accordingly.

Changes in estimates are recognised in the period in which they occur, and also in subsequent periods if the changes affect both the reporting period and the subsequent periods.

Pensions – defined benefit plans
The determination of the present value of defined benefit obligations involves the application of actuarial assumptions.

To determine the interest rate for the defined benefit pension plans, first the so-called bond universe is established on the basis of the AA corporate bonds available on the reporting date. On the basis of these bonds a yield curve is calculated. Then a uniform average interest rate is calculated with a cash flow that corresponds to the duration of Telefónica Deutschland Group. This latter interest rate is the actuarial discount rate used.

The determination of the expected increase in pensions is aligned with the long-term inflation expectations in the Euro area.

The assumption on the fluctuation of the respective employees is based on historical experience. The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables. The mortality tables underlying the actuarial calculation of the defined benefit obligations (DBO) as of the reporting date are the Heubeck Mortality Tables 2005 G (Heubeck Richttafeln 2005 G).

Property, plant and equipment, intangible assets and goodwill
Accounting for investments in property, plant and equipment and intangible assets involves the use of estimates to determine the useful life for depreciation and amortisation purposes and to assess the fair value of assets acquired in a business combination at the acquisition date.

Determining the useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgement involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognised in the Consolidated Income Statement for the period. The decision to recognise an impairment loss involves estimates of the timing of the expected use and the amount of the impairment, as well as an analysis of the reasons for the potential loss. Furthermore, additional factors, such as technical obsolescence, the suspension of certain services and other circumstantial services are taken into account.

Telefónica Deutschland Group evaluates the recoverable amount of its cash-generating unit regularly to identify potential goodwill impairment. Determining the recoverable amount of the cash-generating unit to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgement. The fair value is determined based on the market capitalisation of the Telefónica Deutschland Holding AG as of the reporting date.

Deferred income taxes
Telefónica Deutschland Group assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on Telefónica Deutschland Group's ability to generate taxable income over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of the taxable income, which are based on internal projections and continuously updated to reflect the latest trends. In the past, time horizons of five to seven years have been used to measure loss carry forwards and temporary differences. The time horizons used have not changed since the previous year.

The recognition of tax assets and liabilities depends on a series of factors, including estimates with respect to timing and the realisation of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments of Telefónica Deutschland Group could differ from the estimates made by Telefónica Deutschland Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balance.

Provisions
Both the recognition and the valuation of provisions involve judgements to a high extent. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the reporting date, including the opinions of independent experts such as legal counsel or consultants.

Given uncertainties inherent in the estimates used to determine the amount of provisions, the actual outflows of resources may differ from the amounts recognised originally on the basis of the estimates.

Termination benefits
If employees are offered voluntary severance, the benefits are measured on the basis of the number of employees expected to accept the offer. Benefits attributable to a period of more than twelve months after the reporting date are recognised at present value.

The amount for termination benefits is determined on the basis of various assumptions, which also require judgements and estimates and can therefore entail uncertainties. These primarily include the assumed salary, length of employment and gardening leave period until the date of departure.

Financial liabilities measured at amortised cost
The amortised cost on which the subsequent measurement of liabilities to members of partnerships with puttable shares is based depends on the expected payment obligations.

If the estimate of the payment obligation changes, the amortised cost is adjusted.

Revenue recognition

Revenues from equipment leasing
The determination of minimum lease payments should in some cases account for future fair values determined by the Group on the basis of past and current transactions.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognised.

Connection fees
Initial connection fees are deferred and recognised as revenues over the average estimated term of the customer relationship.

The estimate of the average estimated customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of future recognition of revenues.

Bundled offers
Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. The total package revenues are allocated among the identified elements based on their respective fair values.

Determining fair values for each identified elements requires estimates that vary from case to case.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognised.

Joint operations
The classification of interests in businesses as joint operations or as joint ventures requires partly a certain degree of judgement. The classification is made in accordance with the contractual and actual circumstances.

q) Significant change of estimates, assumptions and judgements

In line with current company and business development, Telefónica Deutschland Group assumes that the dismantling of a portion of the network can now be achieved earlier than previously estimated. As a result, and as a result of the annual review of recognised costs, there was an additional provisioning requirement of EUR 243 million in the financial year.

The time-adjustment of the provision consequently resulted in a corresponding adjustment of the associated assets. The useful life of the non-current assets attributable to this part of the network was thus adjusted downwards in the financial year. In the past financial year, this resulted in an additional impairment of approximately EUR 35 million. This amount relates almost exclusively to adjustments within the last quarter of the financial year.

The supplemental impairment is expected to occur to the same extent within the following financial years. For the medium-to-long-term, depreciation expense will be lower compared to the initial assumptions due to compensation effects.

r) Consolidation methods

The consolidation methods applied are as follows:

- Full consolidation method for companies where Telefónica Deutschland Group has control. Control is assumed if Telefónica Deutschland Group has power over an investee and is exposed to variable returns or has rights to these returns. In addition, the ability must exist to use its power over the investee to affect the returns.
- Proportionate consolidation of the attributable assets, liabilities as well as expenses and income for companies jointly controlled with third parties (Joint Operations). Similar line items are combined so that the corresponding share of total assets, liabilities, expenses and income as well as the cash flows of these companies is integrated in the corresponding items in the Consolidated Financial Statements.

All material receivables and liabilities and transactions between the consolidated companies were eliminated in consolidation. The returns generated on transactions involving capitalisable goods or services by subsidiaries with other Telefónica Deutschland Group companies were also eliminated in consolidation.

The financial statements of the consolidated companies are prepared using the same accounting policies and have the same financial year-end as the parent company's individual financial statements. In the case of Group companies whose accounting and valuation methods differ from those of Telefónica Deutschland Group, adjustments are made in consolidation in order to present the Consolidated Financial Statements on a consistent basis.

The Consolidated Income Statement and Consolidated Statement of Cash Flows include the revenues and expenses as well as the cash flows of companies that are no longer in Telefónica Deutschland Group up to the date on which the related interest was sold or the company was liquidated.

Revenues and expenses as well as the cash flows of new Group companies are included from the date on which the interest was acquired or the company was established until the end of the year.

s) Accounting policies adopted as of 31 December 2014

Accounting policies applied in the financial year from 1 January 2014 to 31 December 2014 but deviating from the accounting policies of the previous year are described below. These relate to new standards as well as changes to the standards and interpretations as published by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC) and endorsed for application by the European Union (EU) as of 1 January 2014.

Offsetting financial assets and financial liabilities
The changes to IAS 32 Offsetting Financial Assets and Financial Liabilities, which were published on 16 December 2011 by the IASB and endorsed on 13 December 2012 by the EU do not intrinsically alter the present offsetting model of IAS 32, but provide additional support and clarification by adding implementation guidelines.

Recoverable amount disclosures for non-financial assets
The changes to IAS 36 Recoverable amount disclosures for non-financial assets, which were published in May 2013, on the one part restrict the currently valid mandatory information required regarding the recoverable amount, but also increase the scope of the information that is to be specified in the case of a recognition or reversal of impairment. In its official journal, published on 20 December 2013, the European Union endorsed the changes to IAS 36 and approved obligatory application for financial years beginning on or after 1 January 2014.

Levies
In May 2013, the IASB published IFRIC 21. This interpretation is a clarification for levies which are imposed by a government authority and do not fall in the scope of another IFRS as to how and when these

obligations are to be recognised as a liability in accordance with IAS 37. The overriding factor is the event that triggers the payment obligation (obligating event).

As of 1 January 2014, the Group has applied IFRIC 21 – Levies early. By regulation dated 13 June 2014, the European Union (EU) approved obligatory application of the interpretation for financial years beginning on or after 17 June 2014. Earlier application was permitted.

The described amendments and additional standards or amendments to standards that had to be implemented on 1 January 2014, or earlier had no or no material effect on the net assets, financial position and earnings of the Group.

t) New standards and IFRIC interpretations issued, but whose application is not yet mandatory as of 31 December 2014

At the time of publication of the Consolidated Financial Statements, the following standards and interpretations were published, but their application was not yet mandatory.

Standards and amendments		Application for financial years beginning on or after
Amendments to IAS 19	Defined Benefits Plans: Employee Contributions	1 July 2014
Annual Improvements to the IFRSs 2010–2012	Amendments to IAS 16, IAS 24, IAS 38, IFRS 2, IFRS 3, IFRS 8 and IFRS 13	1 July 2014
Annual Improvements to the IFRSs 2011–2013	Amendments to IAS 40, IFRS 1, IFRS 3 and IFRS 13	1 July 2014
IFRS 14	Regulatory Deferral Accounts	1 January 2016[1]
Amendments to IAS 16 and IAS 38	Clarification of Acceptable Methods of Depreciation and Amortisation	1 January 2016[1]
Amendments to IFRS 11	Accounting for Acquisitions of Interests in Joint Operations	1 January 2016[1]
Amendments to IAS 16 and IAS 41	Bearer Plants	1 January 2016[1]
Amendments to IAS 27	Equity Method in Separate Financial Statements	1 January 2016[1]
Amendments to IFRS 10 and IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	1 January 2016[1]
Annual Improvements to the IFRSs 2012–2014	Amendments to IAS 19, IAS 34, IFRS 5 and IFRS 7	1 January 2016[1]
Amendments to IFRS 10, IFRS 12 and IAS 28	Applying the Consolidation Exception	1 January 2016[1]
Amendments to IAS 1	Presentation of Financial Statements	1 January 2016[1]
IFRS 15	Revenue from Contracts with Customers	1 January 2017[1]
IFRS 9 and amendments to IFRS 7	Financial Instruments	1 January 2018[1]

1 Endorsement by the EU is still outstanding, statement of compulsory application according to IASB.

On 21 November 2013, the IASB published a slight amendment to IAS 19 Defined Benefit Plans: Employee Contributions, which was adopted by the EU on 17 December 2014. This change represents a relief for the company with regard to recording employee or third party contributions to a pension plan. As a result of this change to IAS 19.93, it is permitted for a company to record contributions from employees or third-parties in the periods in which the associated performance is rendered as a reduction in the current service costs, provided the contributions are independent of the number of years of service.

Under its annual improvements project, the IASB published “Annual Improvements to the IFRSs 2010-2012” and “Annual Improvements to the IFRSs 2011–2013” in December 2013, which are both applicable for financial years beginning on or after 1 July 2014. EU approval was granted on 17 and 18 December 2014 respectively. The amendments made under the annual improvements project mainly serve to provide necessary clarifications within various standards.

With the amendments to IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets issued on 12 May 2014, the IASB provides additional guidance for determining an acceptable method of depreciation and amortisation. In particular, the permissibility of revenue-based methods is denied for property, plant and equipment and limited to exceptional cases for intangible assets.

On 6 May 2014, the International Accounting Standards Board (IASB) issued amendments to IFRS 11 Joint Arrangements in relation to the acquisition of interests in joint operations. An acquirer of interests in a joint operation that meets the definition of a business according to IFRS 3 must apply the accounting guidelines of IFRS 3 unless they contradict IFRS 11.

On 12 August 2014, the IASB issued amendments to IAS 27 that reinstate the permissibility of applying the equity method in separate financial statements.

The amendment to IFRS 10/IAS 28 issued by the IASB in September 2014 clarifies for the compiler of financial statements that transactions with associates or joint ventures require profit or loss recognition if the assets sold or contributed constitute a business.

Under its annual improvements project, the IASB published “Annual Improvements to the IFRSs 2012-2014” in September 2014. These include minor changes and clarifications to IFRS 5, IFRS 7, IAS 19 and IAS 34.

On 18 December 2014, the IASB issued amendments to IAS 1 Presentation of Financial Statements. The amendments primarily concern the clarification that disclosures must be made if the content is not immaterial and explanations regarding the aggregation and disaggregation of items in the statement of financial position and statement of comprehensive income. In addition, the prescribed structure of the notes is discarded in favour of presentation relevant to the entity.

Also on 18 December 2014, the IASB issued amendments to IFRS 10, IFRS 12 and IAS 28. The aim of these amendments is to clarify the application of the consolidation exception according to IFRS 10 if the parent company meets the definition of an investment entity.

All the amendments just described have not yet been approved by the EU and are applicable for financial years beginning on or after 1 January 2016. Unless otherwise stated, no effects or no material effects are expected to result for the Group’s net assets, financial position and earnings.

On 28 May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers with the aim of enshrining regulations from various standards and interpretations in a single standard for all industries. The new standard provides a five-step model to determine revenue amount and revenue date. In addition, the standard includes some additional detailed guidance. Mandatory application is planned for financial years beginning on or after 1 January 2017. Telefónica Deutschland Group is currently analysing the standard for its potential impact.

On 24 July 2014, the IASB issued IFRS 9 Financial Instruments on comprehensive accounting for financial instruments. Particularly notable in comparison to the predecessor standard IAS 39 are the new classification requirements for financial assets, revised in the latest version of IFRS 9. Also new are the requirements for recognising impairment, which are now based on an expected loss model. Accounting for hedging relationships is also adjusted under IFRS 9 in order to more closely reflect operational risk management. Mandatory application is planned for financial years beginning on or after 1 January 2018. Telefónica Deutschland Group is currently analysing the standard for its potential impact.

According to information currently available, the Group is assuming that the application of the standards (with the exception of IFRS 15 and IFRS 9), the changes and the interpretations of their implementation will have no or only a negligible influence on the net assets, financial position and earnings. The Group is planning to implement the changes pursuant to the mandatory application.

5. Selected Explanatory Notes to the Consolidated Statement of Financial Position

5.1. Goodwill

The carrying amount of goodwill as of 31 December 2014 was EUR 1,629 million. The EUR 924 million increase in the reporting year resulted primarily from the acquisition of E-Plus (for further information see Note No. 7 Business Combinations).

(Euros in millions)	2014	2013
Carrying amount of goodwill at 1 January	**706**	**706**
Acquisitions (refer to Note No. 7 Business Combinations)	928	0
Reclassifications (refer to Note No. 8 Discontinued Operations and Disposal Group)	(5)	0
Carrying amount of goodwill at 31 December	**1,629**	**706**

As of 31 December 2014, goodwill comprised the following components:

— The carrying amount of the goodwill in the amount of EUR 423 million resulted from the acquisition of MediaWays GmbH by HighwayOne Germany GmbH, which was executed on 30 September 2002. On 2 October 2002, HighwayOne Germany GmbH and MediaWays GmbH merged into Telefónica Deutschland GmbH. On 23 March 2011, Telefónica Deutschland GmbH was changed to Telefónica Germany Customer Services GmbH.

— The carrying amount of the goodwill of EUR 282 million resulted from the acquisition of HanseNet Telekommunikation GmbH by Telefónica Germany Customer Services GmbH from Telecom Italia Deutschland Holding GmbH, Hamburg, on 16 February 2010. Under the agreement dated 4 March 2011, and as of the agreed merger date on 1 January 2011, Telefónica Germany Customer Services GmbH has transferred the carrying amount of goodwill to Telefónica Germany GmbH & Co. OHG.

— Goodwill of EUR 928 million was added in the reporting year, resulting from the acquisition of E-Plus Mobilfunk GmbH & Co. KG with its direct and indirect subsidiaries by Telefónica Deutschland Holding AG effective 1 October 2014.

— Due to the planned disposal of yourfone GmbH (for further information see Note No. 8.1 Disposal Group in 2014), EUR 5 million of the goodwill was reclassified to assets held for sale.

The annual impairment test for goodwill was carried out in January 2015. The impairment test carried out at the level of the cash-generating unit Telecommunications did not result in a need to recognise any write-downs to goodwill as of the end of 2014, because the recoverable amount of EUR 13,042 million, based on the fair value less costs to sell, was higher than the carrying amount. No write-downs occurred in financial year 2013 either.

The impairment test is described in Note No. 4 Accounting Policies.

5.2. Other intangible assets

The other intangible assets comprise the following:

Euros in millions	Service concession arrangements and licenses	Customer bases	Software	*thereof own work capitalised*	Brand names	Others	Prepayments on intangible assets	Other intangible assets
Gross cost								
As of 1 January 2013	**9,831**	**267**	**1,335**	***139***	**0**	**107**	**13**	**11,552**
Additions	0	0	124	*27*	0	4	14	142
Disposals	0	0	(107)	*(5)*	0	(9)	(0)	(117)
Reclassifications	0	0	7	*0*	0	0	(7)	0
Change in group structure	0	0	(27)	*0*	0	(11)	0	(38)
As of 31 December 2013	**9,831**	**267**	**1,331**	***161***	**0**	**91**	**21**	**11,540**
As of 1 January 2014	**9,831**	**267**	**1,331**	***161***	**0**	**91**	**21**	**11,540**
Additions	0	0	187	*32*	0	3	3	192
Disposals	(0)	0	(562)	*(56)*	0	(2)	0	(565)
Reclassifications[1]	0	(45)	28	*0*	(1)	(0)	(32)	(50)
Change in group structure (refer to Note No. 7 Business Combinations)	1,342	2,718	143	*21*	105	6	14	4,328
As of 31 December 2014	**11,172**	**2,940**	**1,126**	***158***	**104**	**98**	**6**	**15,446**
Accumulated amortisation								
As of 1 January 2013	**(7,185)**	**(50)**	**(954)**	***(94)***	**0**	**(86)**	**0**	**(8,275)**
Additions	(272)	(27)	(218)	*(21)*	0	(12)	0	(528)
Disposals	0	0	107	*5*	0	9	0	117
Reclassifications	0	0	0	*0*	0	0	0	0
Change in group structure	0	0	27	*0*	0	4	0	30
As of 31 December 2013	**(7,457)**	**(77)**	**(1,038)**	***(110)***	**0**	**(85)**	**0**	**(8,656)**
As of 1 January 2014	**(7,457)**	**(77)**	**(1,038)**	***(110)***	**0**	**(85)**	**0**	**(8,656)**
Additions	(340)	(98)	(175)	*(33)*	(5)	(12)	0	(629)
Disposals	0	0	562	*56*	0	2	0	565
Reclassifications[1]	0	0	1	*0*	0	0	0	1
As of 31 December 2014	**(7,796)**	**(174)**	**(649)**	***(87)***	**(5)**	**(95)**	**0**	**(8,720)**
Intangible assets								
As of 31 December 2013	**2,374**	**190**	**293**	***51***	**0**	**6**	**21**	**2,884**
As of 31 December 2014	**3,376**	**2,765**	**477**	***72***	**99**	**3**	**6**	**6,726**

1 The transfers mainly relate to assets from yourfone GmbH, classified as assets held for sale as of December 31, 2014 (please refer to Note No. 8.1 Disposal group in 2014).

Licences

As of 31 December 2013 and 2014, licences consist primarily of the licences listed below:

In May 1997, Telefónica Germany GmbH & Co. OHG acquired a GSM Licence (Global System for Wireless Communications) (2G). In connection with the E-Plus acquisition on 1 October 2014, another GSM Licence was acquired by Telefónica Deutschland Group. As of 31 December 2014, the carrying amount of the GSM Licences was EUR 185 million (2013: EUR 1 million). The GSM Licences expire on 31 December 2016. The remaining amortisation period is two years.

In August 2000, Telefónica Germany GmbH & Co. OHG acquired a UMTS Licence (3G) that expires on 31 December 2020. In May 2010, Telefónica Germany GmbH & Co. OHG acquired frequency usage rights in the UMTS band that expire in December 2025 or December 2020. As part of the E-Plus acquisition on 1 October 2014, another UMTS Licence that expires on 31 December 2020 was acquired as well as additional frequency usage rights in the UMTS band that expire in December 2025. The carrying amount as of 31 December 2014 was EUR 1,168 million (2013: EUR 1,297 million). The remaining amortisation period is six and eleven years respectively.

In May 2010, Telefónica Germany GmbH & Co. OHG also acquired frequency usage rights used for LTE (4G), among others, that likewise expire in 2025. With the acquisition of E-Plus on 1 October 2014, additional frequency usage rights were acquired by Telefónica Deutschland Group that can be used for LTE and also expire in 2025. The carrying amount of the usage rights as of 31 December 2014 was EUR 2,023 million (2013: EUR 1,076 million). The remaining amortisation period is eleven years.

Customer bases

The customer bases of EUR 2,765 million resulted primarily from the acquisition of E-Plus Group by Telefónica Deutschland. The customer base from the acquisition of HanseNet Telekommunikation GmbH (for further information see Note No. 5.1 Goodwill) reported under other intangible assets in the previous year amounting to EUR 136 million (2013: EUR 163 million) is amortised over a remaining period of five years. The customer bases acquired in the E-Plus acquisition on 1 October 2014 are amortised over a remaining period of nine to ten years.

Software

Software mainly includes licences for office and IT applications. The carrying amount as of 31 December 2014 was EUR 477 million (2013: EUR 293 million). The software is amortised on a straight-line basis over its useful life, which is generally estimated to be between two to five years. In the financial years 2014 and 2013 there were no significant individual additions to software. The software disposals primarily relate to application software that reached the end of its useful life.

Brand names

After the reclassification of yourfone GmbH (for further information refer to Note No. 8.1 Disposal group in 2014), the brand names acquired in the E-Plus acquisition on 1 October 2014 had a carrying amount of EUR 99 million as of 31 December 2014. The brand names are amortised over a remaining period of three or twenty years.

5.3. Property, plant and equipment

Property, plant and equipment as of 31 December 2014 and 2013 was made up as follows:

(Euros in millions)	Land and buildings	Plant and machinery	Furniture, tools and other items	PP&E in progress	Property, plant and equipment
Gross cost					
As of 1 January 2013	**674**	**5,393**	**302**	**63**	**6,433**
Additions	8	486	17	13	524
Disposals	(11)	(112)	(43)	0	(166)
Reclassifications	9	(3)	1	(7)	(0)
Change in group structure	(18)	(7)	(15)	(1)	(41)
Others	20	4	0	0	23
As of 31 December 2013	**681**	**5,761**	**262**	**69**	**6,772**
As of 1 January 2014	**681**	**5,761**	**262**	**69**	**6,772**
Additions	14	550	27	65	656
Disposals	(12)	(348)	(56)	(0)	(416)
Reclassifications	(0)	76	2	(79)	(0)
Change in group structure (refer to Note No. 7 Business Combinations)	43	1,712	8	169	1,931
Others	28	215	0	0	243
As of 31 December 2014	**753**	**7,966**	**243**	**224**	**9,186**
Accumulated depreciation					
As of 1 January 2013	**(374)**	**(2,862)**	**(224)**	**0**	**(3,459)**
Additions	(70)	(497)	(37)	0	(604)
Disposals	11	112	43	0	166
Reclassifications	(4)	4	0	0	0
Change in group structure	6	4	11	0	21
As of 31 December 2013	**(431)**	**(3,239)**	**(207)**	**0**	**(3,877)**
As of 1 January 2014	**(431)**	**(3,239)**	**(207)**	**0**	**(3,877)**
Additions	(64)	(604)	(29)	0	(696)
Disposals	12	348	56	0	416
Reclassifications	1	(1)	0	0	(0)
As of 31 December 2014	**(482)**	**(3,496)**	**(179)**	**0**	**(4,157)**
PP&E					
As of 31 December 2013	**250**	**2,521**	**55**	**69**	**2,896**
As of 31 December 2014	**272**	**4,470**	**63**	**224**	**5,029**

The additions to property, plant and equipment of EUR 656 million in 2014 related mainly to investments in faster network expansion, including by optimising UMTS (3G), the increased LTE expansion, the expansion of IP technologies, and the expansion of the mobile data services with even faster download speeds.

Within property, plant and equipment assets connected to decommissioning, dismantling and shutdown obligations increased by a change of assumptions regarding the redemption date of EUR 243 million.

The changes in the group structure resulted from the acquisition of E-Plus (for further information see Note No. 7 Business Combinations).

Property, plant and equipment deriving from finance leases amounted to EUR 64 million as of 31 December 2014 was EUR 3 million as of 31 December 2013. The obligations from finance leases resulted primarily from agreements for network elements that were concluded under sale and leaseback transactions and were classfied as finance leases in accordance with their form. The most significant finance leases are disclosed in Note No. 5.10 Interest-Bearing Debt (finance leases).

The PP&E in progress resulted mainly from the expansion of the network.

5.4. Trade and other receivables

The breakdown of this item in the Consolidated Statement of Financial Position is as follows:

	As of 31 December			
	2014		2013	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade receivables	252	1,702	85	969
Receivables from related parties (Note No. 13 Related Parties)	0	53	0	25
Other receivables	0	19	0	1
Provisions for bad debts	(16)	(261)	(2)	(118)
Trade and other receivables	**236**	**1,513**	**83**	**877**

The trade receivables include receivables from finance leases. For further information refer to Note No. 5.10 Interest-Bearing Debt (finance leases).

The breakdown of trade receivables is as follows:

	As of 31 December			
	2014		2013	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade receivables billed	153	994	85	749
Trade receivables unbilled	99	708	0	220
Trade receivables	**252**	**1,702**	**85**	**969**

The following table shows the development of the allowances for the years ended as of 31 December 2014 and 2013.

(Euros in millions)	Non-current	Current
Allowance as of 31 December 2014	**(16)**	**(261)**
Additions	(8)	(80)
Reductions	2	0
Utilisation	0	73
Reclassifications[1]	3	16
Change in group structure (refer to Note No. 7 Business Combinations)	(11)	(153)
Allowances as of 31 December 2013	**(2)**	**(118)**
Additions	(2)	(56)
Reductions	0	5
Utilisation	0	61
Disposals of subsidiaries	0	2
Allowances as of 1 January 2013	**0**	**(130)**

1 The transfers mainly relate to assets from yourfone GmbH, classified as assets held for sale as of 31 December 2014 (please refer to Note No. 8.1 Disposal group in 2014).

In 2014 and 2013 Telefónica Deutschland Group sold “O_2 My Handy” receivables in order to optimise the working capital and to access an alternative source of funding. The nominal value of the receivables transferred in 2014 was EUR 302 million (2013: EUR 320 million) and the carrying amount was EUR 294 million (2013: EUR 312 million). The buyer of the receivables bears the majority of the risk of these receivables. A small portion (2014 less than 5%, 2013 less than 5%) of the sold receivables was not derecognised at the time of the sale due the continuing involvement. The carrying amount of these assets, which Telefónica Deutschland Group continues to recognise, was EUR 24 million as of 31 December 2014 and EUR 27 million as of 31 December 2013. A liability was recognised in the same amount. The continuing involvement that was recognised was the maximum risk that would have had to be borne by Telefónica Deutschland Group and essentially results from a possible default of the receivables. Between now and the end of 2016, the Group could be obligated to repurchase EUR 21 million if customers should default on their respective debts. The actual defaults are compared to the originally expected ones every month to monitor the associated risk.

In addition, Telefónica Deutschland Group recorded a provision in the amount of the fair value of the guarantees given of EUR 2 million (2013: EUR 1 million).

The total loss on the date of the receivables transfer in 2014 was EUR 1 million (2013: EUR 1 million).

After the completion of the transactions, the impact on profit and loss from continuing involvement comprises profit of EUR <1 million in 2014 and a loss of EUR <1 million in 2013.

5.5. Other financial assets

As of 31 December 2014 and in the previous year, the other financial assets comprised the following:

				As of 31 December
		2014		2013
(Euros in millions)	Non-current	Current	Non-current	Current
Investments in start-ups	13	0	0	0
Interest Rate Swaps	12	2	0	0
Reimbursement Rights	12	0	6	0
Silent factoring deposit	9	16	9	20
Deposits	1	0	0	0
Current financial assets	1	1	0	0
Other financial assets	**49**	**19**	**16**	**21**

The other non-current financial assets primarily comprise:

— Investments in start-ups of EUR 13 million;
— Interest rate swaps of EUR 12 million belonging to the two issued bonds (for further information see Note No. 5.10 Interest-Bearing Debt);
— Financial assets of EUR 12 million (2013: EUR 6 million) incurred to meet pension and partial retirement obligations but not plan assets according to IAS 19. The recognised fair values are based on the values received from the insurance company, which are based on the insurance company’s internal calculation models;
— And a deposit of EUR 9 million (2013: EUR 9 million). This deposit was pledged as collateral to cover the maximum risk from silent factoring to be borne by Telefónica Deutschland Group and the guarantee of the servicing of the receivables over the term of the sold receivables. Telefónica Deutschland Group receives a fixed interest for the deposit.

Other current financial assets primarily include the current portion of the security deposit for silent factoring of EUR 16 million (2013: EUR 20 million).

5.6. Other non-financial assets and other non-financial liabilities

The other non-financial assets as of 31 December, comprised the following:

	As of 31 December			
	2014		2013	
(Euros in millions)	Non-current	Current	Non-current	Current
Prepayments	142	54	98	58
Prepayments to Group companies	0	1	0	1
Tax receivables indirect taxes	0	16	0	0
Other non-financial assets	**142**	**71**	**98**	**60**

The non-financial assets primarily relate to prepayments for leased lines.

The other non-financial liabilities as of 31 December comprised the following:

	As of 31 December	
	2014	2013
(Euros in millions)	Current	Current
Payroll taxes and social security	13	6
Current tax payables for indirect taxes	0	14
Other current taxes	5	3
Non-financial liabilities	**18**	**23**

5.7. Inventories

As of 31 December 2014, inventories amounted to EUR 104 million (2013: EUR 89 million) and mainly comprised smartphones and accessories.

	As of 31 December	
(Euros in millions)	2014	2013
Merchandises	109	93
Allowances	(5)	(4)
Inventories	**104**	**89**

The total cost of inventories recognised as an expense in the Consolidated Income Statement was EUR 919 million (2013: EUR 648 million) in financial year 2014.

As is typical for the industry, the suppliers of the inventories hold title retention to the inventories.

5.8. Cash and cash equivalents

The cash and cash equivalents line item mainly includes deposits in connection with cash pooling agreements with Telfisa Global B.V., Amsterdam, Netherlands (Telfisa Global B.V.), receivables from banks with an original term of up to three months, and cash in hand.

The newly acquired E-Plus companies (for further information see Note No. 1 Reporting Entity) have been included in the cash pooling agreements with Telfisa Global B.V. from 1 October 2014.

(Euros in millions)	As of 31 December 2014	2013
Cash at bank and in hand	30	8
Cash pooling	1,673	701
Cash and cash equivalents	**1,702**	**709**

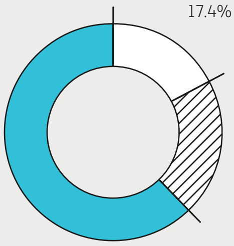
5.9. Equity

Subscribed capital
The registered share capital of Telefónica Deutschland Holding AG amounts to EUR 2,975 million. The share capital is divided into 2,974,554,993 no-par value registered shares each with a proportionate share of the share capital of EUR 1.00 (“shares”). The registered share capital is fully paid.

As of 31 December 2014, Telefónica Deutschland Holding AG did not hold any of its own shares.

After the capital increases for cash and contributions in kind in connection with the acquisition of E-Plus and Telefónica, S.A.’s acquisition of another 4.4% of the shares in Telefónica Deutschland Holding AG from KPN Mobile Germany, and according to the corresponding voting rights notifications received, Telefónica Deutschland has the following shareholder structure:

Shareholder structure



1 Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.
2 According to the voting rights notification dated 20 October 2014, Koninklijke KPN N.V. now holds these shares directly

In accordance with section 6 para. 2 of the Articles of Association the shareholders have no right to securitise shares. Each non-par share in general grants one vote at the Annual General Meeting. The shares are freely transferable.

In 2014, Telefónica Deutschland’s share capital was increased by EUR 1,117 million by way of a capital increase for cash, entered in the commercial register on 18 September 2014, and by EUR 741 million by way of a capital increase for contributions in kind, entered in the commercial register on 7 October 2014, to a total of EUR 2,975 million.

Authorised capital
Before the partial utilisation in connection with the acquisition of E-Plus, the authorised capital of Telefónica Deutschland Holding AG allowed the Management Board of the company, with the approval of the Supervisory Board, to increase the share capital of Telefónica Deutschland in the period up until 17 September 2017 once or repeatedly up to a total of EUR 558 million by issuing new no-par value registered shares for cash or contributions in kind (authorised capital 2012/I) and to carry out a capital increase for contributions in kind of up to EUR 475 million (authorised capital 2014/I).

For the capital increase for contributions in kind in connection with the acquisition of E-Plus, the Management Board resolved on 24 September 2014, with the approval of the Supervisory Board, to utilise the authorised capital 2014/I in full and the authorised capital 2012/I in a partial amount of EUR 266 million. This capital increase for contributions in kind was entered into the commercial register on 7 October 2014, deleting the authorised capital 2014/I and adjusting the authorised capital 2012/I.

As of 31 December 2014, Telefónica Deutschland Holding AG had authorised capital 2012/I of EUR 293 million.

Conditional capital

The share capital of Telefónica Deutschland Holding AG was conditionally increased by up to EUR 558 million by issuing up to 558,472,700 registered shares (conditional capital 2014/I). The conditional capital 2014/I was resolved by the Annual General Meeting on 11 February 2014, suspending the conditional capital 2012/I.

Additional paid-in capital

As a result of the abovementioned capital increases for cash and for contributions in kind in connection with the acquisition of E-Plus, which were entered into the commercial register on 18 September, and 7 October 2014, additional paid-in capital increased by EUR 4,800 million to the level as of 31 December 2014 of EUR 4,800 million.

The increase in additional paid-in capital resulted from the total exercise price of the shares from the capital increases for cash and contributions in kind of EUR 6,690 million, less the contributions to share capital of EUR 1,858 million and less the costs of the capital increases of EUR 33 million.

Retained earnings

Legal reserve

Retained earnings contain a legal reserve in accordance with section 150 (2) of the German Stock Corporation Act (Aktiengesetz – AktG) of EUR 0.014 million (2013: EUR 0.014 million).

Proposed dividend for financial year 2014 to be paid in 2015

On 8 September 2014, the Management Board of Telefónica Deutschland resolved and announced that it is intended to propose a cash dividend of at least EUR 700 million to the next Annual General Meeting for the 2014 financial year, which is payable in 2015.

Second Annual General Meeting and dividend distribution in 2014

The second Annual General Meeting of Telefónica Deutschland took place on 20 May 2014. Besides the discharge of the Supervisory Board and Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the 2014 Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG, the Annual General Meeting resolved to distribute a dividend of EUR 0.47 per dividend-entitled share, a total EUR 525 million.

First Annual General Meeting and dividend distribution in 2013

The first Annual General Meeting of Telefónica Deutschland Holding AG took place on 7 May 2013. Besides the discharge of the Supervisory Board and Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the 2013 Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG, the Annual General Meeting resolved to distribute a dividend of EUR 0.45 per dividend-entitled share, a total EUR 503 million.

5.10. Interest-bearing debt

	As of 31 December			
	2014		2013	
(Euros in millions)	Non-current	Current	Non-current	Current
Bonds	1,103	12	590	1
Interest Rate Swaps	0	0	3	0
Loan liabilities	500	226	750	101
Finance lease	197	374	1	2
Contribution obligations	0	3	0	0
Interest-bearing debt	**1,800**	**615**	**1,344**	**104**

Bond and interest rate swaps

This item contains two bonds with a carrying amount of EUR 1,115 million as of 31 December 2014 (2013: EUR 591 million), of which EUR 1,103 million (2013: EUR 590 million) is classified as non-current and EUR 12 million (2013: EUR 1 million) as current. In addition, interest rate swaps of EUR 3 million are included in the previous year, which are reported under other financial assets in the reporting year (see Note No. 5.5 Other Financial Assets). Telefónica Deutschland Group issued these bonds in November 2013, with an original nominal value of EUR 600 million, and in February 2014, with an original nominal value of EUR 500 million.

These bonds (except for EUR 350 million of the nominal value) are accounted for by using the effective interest method after deduction of the disagio and transaction costs. EUR 350 million of the nominal value of the bonds is accounted for as a fair value hedge with interest rate swaps.

The senior unsecured 7-year bond issued on 10 February 2014 has a nominal value of EUR 500 million. The bond has a maturity on 10 February 2021 and was issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price 99.624%. The issue spread was 100 basis points over the 7-year Euro Midswap 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. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general corporate purposes. In connection with this, an interest rate swap was concluded for a partial amount of EUR 150 million of the bond's nominal value. On the basis of this interest swap contract, Telefónica Deutschland Group pays a variable interest rate at the level of the three-month Euribor on a nominal amount and receives a fixed interest rate of 1.268% on the same amount in return.

In 2013, Telefónica Deutschland Group, via its subsidiary O2 Telefónica Deutschland Finanzierungs GmbH, Munich, issued an unsecured 5-year bond (Senior Unsecured Bond) with a nominal value of EUR 600 million and a maturity on 22 November 2018 in the regulated market of the Luxembourg Stock Exchange. The bond is guaranteed by Telefónica Deutschland Holding AG. The annual nominal interest rate of the bond is 1.875%. Based on the issue price of 99.162%, the bond yields an annual return of 2.053%. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general corporate purposes. In connection with this, an interest rate swap was concluded for a partial amount of EUR 200 million of the bond's nominal value. On the basis of this interest swap contract, Telefónica Deutschland Group pays a variable interest rate at the level of the three-month Euribor on a nominal amount and receives a fixed interest rate of 0.927% on the same amount in return.

All factors that market participants would consider are included in the measurement of the fair value of the interest rate swaps, including the credit risks of the contract parties. The fair value of the interest swaps results from discounting of the expected future payments over the remaining term of the contract using current market interest rates and yield curves.

The adjustments to the carrying amount of the non-current financial liabilities result in a cumulative loss of EUR 13 million (EUR 3 million profit in 2013 and EUR 15 million loss in 2014), while the corresponding clean prices of the interest rate swaps result in cumulative profit of EUR 13 million (EUR 3 million loss in 2013 and EUR 15 million profit in 2014). Under the interest rate swaps, Telefónica Deutschland Group pays a variable quarterly interest rate amounting to the three-month Euribor and receives fixed interest rates of 0.927% and 1.268%. The hedged nominal value of the financial liabilities amounts to EUR 350 million. Thus, 19% (2013: 14%) of the bonds and debentures of the company were switched from fixed interest to variable interest. The fair value of the dirty prices of the interest rate swaps that hedge financial liabilities amounted to EUR 14 million as of 31 December 2014 (2013: EUR –3 million) and is recognised as a financial asset. The fair value of the bonds is determined by discounting the expected future cash flows at currently applicable interest rates with comparable conditions and residual terms.

Loan liabilities

This item includes a loan with an original total value of EUR 1,250 million, which was borrowed by Telefónica Germany GmbH & Co. OHG from Telfisa Global B.V. on 12 September 2012 (see Note No. 13 Related Parties). Repayments of EUR 125 million were made in 2014.

Of the EUR 726 million of the loan remaining as of 31 December 2014 (2013: EUR 851 million), EUR 500 million (2013: EUR 750 million) is classified as non-current and EUR 226 million (2013: EUR 101 million) as current. The current portion also includes accrued interest for the abovementioned non-current loan liabilities.

Finance leases

This item contains finance lease liabilities of EUR 571 million as of 31 December 2014 (2013: EUR 3 million), of which EUR 197 million (2013: EUR 1 million) is classified as non-current and EUR 374 million (2013: EUR 2 million) as current.

The obligations from finance leases result mainly from agreements for mobile phones and network elements concluded under sale and leaseback transactions and classified as finance leases in accordance with their form.

In connection with these finance leases, Telefónica Deutschland Group recognised the assets attributable to the network elements under property, plant and equipment in the Consolidated Financial Statements as of 31 December 2014 and in the previous year (for further information see Note No. 5.3 Property, Plant and Equipment). Mobile phones are not capitalised because they are passed on to end customers under a finance lease.

		As of 31 December
(Euros in millions)	**2014**	2013
Plant and machinery	64	3
Net carrying amount of lease assets	**64**	**3**

The breakdown of minimum lease payment obligations is as follows:

	As of 31 December 2014		
(Euros in millions)	Minimum future lease payments obligation	Unamortised interest expense	Present value of minimum future lease payments obligation
due within one year	395	21	374
due between 1 and 5 years	203	6	197
due in more than 5 years	0	0	0
Present value of minimum lease payments	**598**	**27**	**571**

	As of 31 December 2013		
(Euros in millions)	Minimum future lease payments obligation	Unamortised interest expense	Present value of minimum future lease payments obligation
due within one year	2	0	2
due between 1 and 5 years	1	0	1
due in more than 5 years	0	0	0
Present value of minimum lease payments	**3**	**0**	**3**

Receivables from finance leases (subleases)

Telefónica Deutschland Group subleases mobile phones to its end customers. The Group thus acts as a lessor to the customers. The contracts concluded with the customers comprise fixed lease payments over a term of two years. This business model was refinanced entirely under sale and lease back agreements.

The following table shows the expected minimum lease payments by end customers:

	As of 31 December 2014		
(Euros in millions)	Minimum future lease payments receivables	Unamortised interest income	Present value of minimum future lease payments receivables
due within one year	226	3	224
due between 1 and 5 years	100	1	99
due in more than 5 years	0	0	0
Present value of minimum lease payments	**326**	**3**	**323**
Accumulated allowance	0	0	(36)
Present value of minimum lease payments after accumulated allowance	**0**	**0**	**286**

	As of 31 December 2013		
(Euros in millions)	Minimum future lease payments receivables	Unamortised interest income	Present value of minimum future lease payments receivables
due within one year	0	0	0
due between 1 and 5 years	0	0	0
due in more than 5 years	0	0	0
Present value of minimum lease payments	**0**	**0**	**0**
Accumulated allowance	0	0	0
Present value of minimum lease payments after accumulated allowance	**0**	**0**	**0**

The impairment of receivables from finance leases is recognised as an expense. The credit risk is determined on the basis of past empirical values.

Extension and purchase options expected to be exercised are included in the calculation of the minimum lease payments to be made and those expected.

The receivables from finance leases are included in the trade receivables. For further information refer to Note No. 5.4 Trade and other receivables.

Contribution obligations
This item includes contribution obligations to partners in investments in start-ups that hold puttable shares.

5.11. Trade and other payables and deferred income

The composition of trade and other payables and deferred income is as follows:

				As of 31 December
		2014		2013
(Euros in millions)	Non-current	Current	Non-current	Current
Trade payables against third parties	0	592	0	425
Accruals	16	1,246	0	513
Payables to related parties (Note No. 13 Related Parties)	0	254	0	220
Trade payables	**16**	**2,092**	**0**	**1,158**
Other creditors non-trade	3	80	3	57
Other payables to related parties (Note No. 13 Related Parties)	0	42	0	31
Other current other payables	0	70	0	26
Other Payables	**3**	**191**	**3**	**113**
Trade and other payables	**19**	**2,283**	**3**	**1,271**
Deferred income	**305**	**400**	**0**	**170**

Accruals relate mainly to outstanding invoices for goods and services and for non-current assets.

Current other creditors non-trade consist mainly of liabilities due to personnel.

Non-current other creditors non-trade mainly consist of liabilities for deferred rent-free units (non-current portion).

The other current payables especially include debtors with credit balances.

For the maturity profile of the listed liabilities, see Note No. 17 Financial Instruments and Risk Management.

Deferred income primarily includes advance payments received for prepaid credit and other advance payments received for future service performance. The latter are broken down by maturity according to expected utilisation. Advance payments received for prepaid credit are classified exclusively as current.

5.12. Provisions

The provisions are recognised at the following amounts:

	As of 31 December			
	2014		2013	
(Euros in millions)	Non-current	Current	Non-current	Current
Pension obligations	89	0	5	0
Other provisions	698	241	100	4
Provisions	**787**	**241**	**104**	**4**

Pensions

Telefónica Deutschland Group has defined benefit plans. These primarily include defined benefit rights against an external provident fund (Gruppen-Unterstützungskasse), which is managed in accordance with its Articles of Association, and direct commitments.

The overriding investment policy and strategy for the defined benefit plans are based on the goal of generating returns from the plan assets as well as from the reimbursement rights deriving from reinsurance policies which, together with the contributions, are sufficient to meet the pension obligations.

The plan assets are invested in reinsurance policies that are taken out directly by Telefónica Deutschland Group or indirectly by the provident fund. The reimbursement rights from insurance policies result from those insurance policies, which were not pledged to the employees.

The requirements for the financing of pension obligations arise from the financing strategy of the provident fund and are anchored in its guidelines. The guidelines define that the expected defined benefit obligation will be settled by the provident fund. They are fully financed by Telefónica Deutschland Group. Telefónica Deutschland Group provides the provident fund with the necessary financial resources.

However, under its Articles of Association the fund must cease or reduce its payments if the company does not make or no longer makes the necessary financial resources available to the fund. In this case the employees can bring their legal right to post-employment benefits against Telefónica Deutschland Group.

The amount of the committed benefits for the defined benefit pension plans essentially depends on the basic salary of the individual employee during the period of employment. The benefits paid include old age pensions, payments for the inability to work and benefits in the event of death to surviving relatives.

In order to minimise the biometric risks of the committed benefits (such as an early benefits claim through invalidity or death of the beneficiary) the pension or promised retirement capital is covered to the full extent (congruent) or in part by insurance policies. In addition, the pledging of the insurance policies to the pension beneficiary acts as security for the claims of the beneficiary in the event of the insolvency of the sponsoring company.

This defined benefit plan is subject to actuarial and financial risks such as life expectancy and interest rate risk.

In the financial year 2014, the employer's share of the statutory pension insurance amounted to EUR 32 million (2013: EUR 28 million).

The following table contains the key data for the defined benefit plans:

	As of 31 December	
(Euros in millions)	**2014**	2013
Defined benefit obligation from funded plans	(143)	(83)
Defined benefit obligation from unfunded plans	(58)	(10)
Present value of the defined benefit obligation	**(201)**	**(93)**
Plan assets	111	91
Surplus/(deficit)	**(89)**	**(2)**
Effect of the asset ceiling	0	(3)
Net defined benefit liability	**(89)**	**(5)**
Reimbursement Rights	**10**	**6**

The development in the present value of the defined benefit obligation in 2014 and 2013 is as follows:

	As of 31 December	
(Euros in millions)	**2014**	2013
Defined benefit obligation as of 1 January	**(93)**	**(81)**
Current service cost (personnel expenses)	(4)	(3)
Interest income (expense) (financial result)	(4)	(3)
Remeasurement of defined benefit obligation	(47)	(6)
thereof: actuarial gains (losses) arising from changes in demographic assumptions	*0*	*0*
thereof: actuarial gains (losses) arising from changes in financial assumptions	*(47)*	*(8)*
thereof: experience adjustments	*0*	*2*
Benefits paid	2	1
Change in group structure (refer to Note No. 7 Business Combinations)	(55)	0
Others	(0)	(1)
Defined benefit obligation as of 31 December	**(201)**	**(93)**

The restructuring measures taken (see other provisions) result in a curtailment as per IAS 19 with regard to the pension entitlements of departing employees that have not yet vested on the date of departure. However, the effects on the defined benefit obligation as of 31 December 2014 are immaterial.

The present value of the defined benefit obligation is distributed as follows across the individual groups of those entitled to pensions:

	As of 31 December	
(Euros in millions)	**2014**	2013
Amounts owing to active members	(83)	(40)
Amounts owing to deferred members	(81)	(43)
Amounts owing to retirees	(36)	(10)
Defined benefit obligation	**(201)**	**(93)**

The fair value of the plan assets developed as follows in 2014 and 2013:

(Euros in millions)	2014	2013
Fair value of plan assets as of 1 January	**91**	**73**
Return on plan assets excluding amounts included in interest income (expense)	(2)	(0)
Interest income (Net financial income (expense))	4	3
Employer contributions	9	15
Benefits paid	(2)	(1)
Change in group structure (refer to Note No. 7 Business Combinations)	11	(0)
Others	0	1
Fair value of plan assets as of 31 December	**111**	**91**

The effect of the asset ceiling developed as follows in 2014 and 2013:

(Euros in millions)	2014	2013
Effect of the asset ceiling as of 1 January	**3**	**0**
Change of the effect of asset ceiling	(3)	3
Effect of the asset ceiling as of 31 December	**0**	**3**

The fair value of the reimbursement rights from insurance contracts developed in 2014 and 2013 as follows:

(Euros in millions)	2014	2013
Fair value of reimbursement rights as of 1 January	**6**	**7**
Return on reimbursement rights excluding amounts included in interest income	0	(0)
Interest income	0	0
Employer contributions	2	0
Benefits paid	(0)	(0)
Change in group structure (refer to Note No. 7 Business Combinations)	2	0
Fair value of reimbursement rights as of 31 December	**10**	**6**

The net pension expense recognised in the Income Statement is comprised as follows:

(Euros in millions)	2014	2013
Current service costs (personnel expenses)	4	3
Interest expense (income) (net financial income/expense)	0	0
Total amount of expense	**4**	**3**

The actual returns from plan assets for the financial year ending 31 December 2014 were EUR 2 million and for 2013 EUR 3 million.

The main actuarial assumptions on which the determination of the present value of the defined benefit obligation as of the reporting date is based are provided in the following (information in the form of average factors).

(In percent)	As of 31 December 2014	2013
Discount rate	2.25%	3.80%
Nominal rate of pension payment increase	2.00%	2.00%
Fluctuation rate	[0%–20%]	[0%–20%]

The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables. The mortality tables on which the actuarial calculation of the DBO as at the reporting date is based are the Heubeck Mortality Tables 2005G (Heubeck Richttafeln 2005G).

(In years)	As of 31 December 2014	2013
Life expectancy at age 65 for a retiree currently	21	21
Life expectancy at age 40 for a deferred member currently	24	24

An increase or decrease in the main actuarial assumptions would have had the following effects on the present value of the defined benefit obligation as of 31 December 2014:

(Euros in millions)	Increase parameters	Decrease parameters
Discount rate (+0.25%/–0.25%)	(11)	12
Nominal rate of pension payment increase (+0.50%/–0.50%)	12	(10)
Fluctuation rate (+1.00%/–1.00%)	(1)	1
Life expectancy (+1 year)	7	0

Increases and reductions in the discount rate and increases to pension payments do not have the same level of effect on the determination of the DBO due to the interest effects. If several assumptions are changed at the same time, the overall effect will not necessarily correspond to the sum of the individual effects due to the changes in the assumptions. In addition, the sensitivity of a change in the DBO only reflects each specific order of magnitude in the change of assumptions (for example 0.25%). If the assumptions change by a different order of magnitude, the effect on the DBO does not necessarily have to be linear.

The following table contains information regarding the analysis of the due date of expected payments:

(Euros in millions)	1 January to 31 December 2014
Benefits expected to be paid within 1 year	2
Benefits expected to be paid within 2 years	2
Benefits expected to be paid within 3 years	2
Benefits expected to be paid within 4 years	3
Benefits expected to be paid within 5 years	3
Benefits expected to be paid within 6 years and 10 years	19

The average of the expected term of the defined benefit obligation is between 20.0 and 25.6 years.

The best estimate of the contributions that will be paid into the plans in the financial year ending 31 December 2015 amounts to EUR 9 million.

Other provisions

Other provisions include provisions for restructuring, dismantling, onerous contracts and others. The movement is as follows:

(Euros in millions)	Restructuring	Dismantling	Onerous Contract	Other	Total
As of 1 January 2014	**0**	**80**	**23**	**0**	**103**
Additions	409	7	1	0	416
Utilisation	(13)	(7)	(4)	(11)	(36)
Reversal	0	0	0	(1)	(1)
Other	0	243	0	0	243
Unwinding of discount	0	2	0	0	2
Change in group structure (refer to Note No. 7 Business Combinations)	3	176	2	28	210
As of 31 December 2014	**399**	**501**	**22**	**17**	**939**
thereof non-current	*179*	*492*	*18*	*9*	*698*
thereof current	*220*	*9*	*3*	*9*	*241*
As of 1 January 2013	**0**	**56**	**26**	**0**	**82**
Additions	0	6	0	0	6
Utilisation	0	(6)	(7)	0	(14)
Reversal	0	(0)	0	0	(0)
Transfers	0	0	0	0	0
Other	0	23	0	0	23
Unwinding of discount	0	2	5	0	6
As of 31 December 2013	**0**	**80**	**23**	**0**	**103**
thereof non-current	*0*	*80*	*20*	*0*	*100*
thereof current	*0*	*0*	*4*	*0*	*4*

The provision for restructuring primarily includes measures resulting from the transformation of Telefónica Deutschland Group in connection with the integration of E-Plus that aim to increase profitability through synergies.

The amount of EUR 399 million as of 31 December 2014 (2013: EUR 0) is allocated to personnel adjustments, the suspension of contracts with sales agents and other measures.

The majority of the provision amount recognised as of 31 December 2014 is attributable to severance payments in connection with personnel adjustments. These relate to the planned reduction by 2018. For further information see Note No. 21 Events after the Reporting Period.

The amount of EUR 409 million for restructuring is recognised in the financial year 2014 in other expenses and in personnel expenses (for further information see Note No. 6.3 Personnel Expenses and 6.4 Other Expenses).

The provisions for dismantling obligations include the estimated costs for the dismantling and removal of assets (e.g. mobile masts and other fixed assets), partially based on the respective agreements.

The onerous contracts provision essentially includes expected losses from the sub-letting of leased objects and for vacancies. The expected utilisation covers short and mid-term periods of time depending on the date of the rent payment and the rental income.

The “other” item primarily includes obligations from litigation and partial retirement agreements.

6. Selected Explanatory Notes to the Consolidated Income Statement

6.1. Revenues

Revenues are comprised as follows:

	1 January to 31 December	
(Euros in millions)	2014	2013
Rendering of services	4,718	4,224
Other sales	803	690
Revenues	**5,522**	**4,914**

Revenues from the rendering of services include revenues from wireless service as well as revenues from wireline business. The remaining revenues include handset revenues and other revenues.

None of Telefónica Deutschland Group's customers account for more than 10% of total revenues.

The breakdown of revenues according to wireless business and wireline business is shown in the following table:

	1 January to 31 December	
(Euros in millions)	2014	2013
Wireless business	4,375	3,673
Mobile service revenues	3,580	2,989
Handset revenues	795	684
Wireline business	1,138	1,235
Other revenues	8	6
Revenues	**5,522**	**4,914**

Mobile service revenues
The mobile service revenues are largely based on basic fees and the fees levied for voice (including incoming and outgoing calls), messaging (including SMS and MMS) and wireless data services as well as the revenues from service contracts. Alongside roaming revenues, mobile service revenues include access and interconnection fees that are paid for by other service providers for calls and SMS delivered via our network.

Handset revenues
Handset revenues include the income from the sale of mobile phones as part of the "O_2 My Handy" model, for the former E-Plus brands the hardware portion of bundle packages (hardware bundled offers) and cash sales. In addition, handset revenues include further components from the wireless business such as activation fees and accessories.

The customer can choose with the "O_2 My Handy" model whether to pay the entire price of the mobile phone up front or to make an initial payment to start with and pay the remaining purchase price in twelve or 24 monthly instalments. Revenues from the "O_2 My Handy" model are discounted according to their term.

Regarding the hardware bundled offers provided by the former E-Plus brands, the customer can choose between the purchase or lease of a device.

Wireline business

Wireline business revenues mainly comprise revenues from DSL services for private customers, DSL activation fees for private customers, revenues from DSL products and non-recurring items (e.g. fees for change of address, number transfers, etc.), services and hardware revenues from pay TV, revenues from wholesale ULL, also called wholesale DSL, revenues from the sale of the company's own DSL network, from services and from hardware to other service providers who re-bundle these and sell them on to end customers, data traffic revenues from carriers in connection with the sale and trade of minutes between carriers to connect their customer calls via the networks of other operators as well as revenues from the hosting of customer content on the company's own computer centre infrastructure and from associated administrative services such as the use of this infrastructure to host applications that are developed and operated by third parties. In addition, DSL revenues also include fixed line revenues.

Other revenues

Other revenues relate to new businesses, such as advertising and financial services, e.g. "O_2 More Local" mobile location-based services or "mpass" mobile payment system.

6.2. Other income

Other income comprised the following in 2014 and 2013:

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Own work capitalised and ancillary income	105	93
Gain on disposal of assets	1	76
Other income	**106**	**169**

The own work capitalised includes direct labour used as well as the allocable portion of indirect costs in connection with investments in non-current assets.

In 2013, the gain on disposal of assets mainly included the gains of EUR 76 million from the sale of Telefónica Germany Online Services GmbH (TOS) and GKHH Fibre Optic GmbH. For further information see Note No. 8.2 Disposal Groups in 2003.

6.3. Personnel expenses

In the financial year 2014, personnel expenses amounted to EUR 828 million (2013: EUR 419 million). Personnel expenses from share-based payments is presented in Note No. 15 Share-Based Payments; personnel expenses relating to pension plans are presented in Note No. 5.12 Provisions.

In addition, restructuring expenses of EUR 322 million are recognised in personnel expenses. For further information, see Note No. 5.12 Provisions.

6.4. Other expenses

The other expenses mainly comprise of costs for sales and marketing, infrastructure, administration, other external services and the restructuring provisions recognised in connection with the integration. Other expenses include restructuring expenses of EUR 87 million (for further information see Note No. 5.12 Provisions).

6.5. Financial result

For the current financial year, Telefónica Deutschland Group's net financial income (expense) amounts to EUR –41 million (2013: EUR –27 million).

The breakdown of net financial income/(expense) is as follows:

	1 January to 31 December	
(Euros in millions)	2014	2013
Interest income from financial assets	10	6
Interest expenses from financial liabilities	(50)	(29)
Accretion of provisions and other liabilities	(0)	(4)
Other exchange gains (losses)	(1)	0
Net financial income (expense)	**(41)**	**(27)**

The interest income from financial assets mainly comprises the interest income in connection with "O_2 My Handy" receivables, receivables from finance leases and cash pooling balances at Telfisa Global B.V.

In 2014, the interest expenses from financial liabilities mainly include the interest expense for the loan granted from Telfisa Global B.V. in September 2012 and for the bonds issued in November 2013 and February 2014. Interest from the finance lease obligation is also included.

6.6. Income taxes

Consolidated income tax group

As of 31 December 2014, the consolidated income tax group of Telefónica Deutschland Group (in its structure before the acquisition of E-Plus on 1 October 2014), which comprised six entities (six in 2013), and the consolidated income tax group of E-Plus Group (in its structure as acquired on 1 October 2014), which comprised 17 entities, continued to exist.

The integration of the consolidated income tax group of E-Plus Group into the consolidated income tax group of Telefónica Deutschland Group is anticipated in the tax planning.

For further information see Note No. 21 Events after the Reporting Period.

Current and deferred taxes

The income taxes recorded in the Consolidated Income Statement essentially comprise deferred taxes. The reported current taxes relate to adjustments of tax assessments from previous years:

	1 January to 31 December	
(Euros in millions)	2014	2013
Current tax (expense)	(1)	0
Deferred tax (expense)	(33)	(1)
Income tax (expense)	**(34)**	**(1)**

The movements in deferred taxes are as follows:

(Euros in millions)	2014	2013
As of 1 January	**584**	**581**
Deferred tax expense	(33)	(1)
Movement in deferred taxes recognised directly in equity as shown in the Consolidated Statement of Comprehensive Income	15	3
Amount for deferred taxes directly recorded within assets and liabilities held for sale (refer to Note No. 8. Discontinued Operations and Disposal Groups)	16	0
As of 31 December	**581**	**584**

Tax loss carry forwards and temporary differences

Tax losses carried forward for which no deferred tax asset are reported as of 31 December 2014 amount to EUR 12,060 million for corporate income tax and EUR 11,632 million for trade tax (2013: EUR 12,000 million and EUR 11,976 million). For temporary differences of EUR 277 million in 2014, EUR 354 million in 2013, no deferred tax assets were recognised.

Temporary differences arise due to the difference between the tax bases of the assets and liabilities and their respective carrying amounts. Deductible temporary differences and tax losses carried forward give rise to deferred tax assets in the Consolidated Statement of Financial Position. Taxable temporary differences in tax bases give rise to deferred tax liabilities in the Consolidated Statement of Financial Position.

The breakdown of deferred tax assets and deferred tax liabilities from temporary differences and tax losses carried is as follows:

				As of 31 December
	2014		2013	
(Euros in millions)	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Goodwill and other intangible assets	642	(311)	906	(163)
Tangible Assets	1	(478)	71	(344)
Trade and other receivables	85	(90)	5	(24)
Other current financial assets	351	(29)	10	(4)
Debt, trade and other payables	171	(454)	7	(11)
Provisions including pension provisions	210	(0)	29	(1)
Other current financial liabilities	2	(13)	2	(4)
Tax loss carry forwards	494	0	106	0
Tax assets (liabilities)	**1,956**	**(1,375)**	**1,136**	**(552)**
Set off	(1,375)	1,375	(552)	552
Net tax assets (liabilities)	**581**	**(0)**	**584**	**(0)**

Reconciliation of profit before tax to income tax expense recognised

The reconciliation between profit before tax and income tax expense recognised in the Consolidated Income Statement for 2014 and 2013 is as follows:

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Profit/(loss) before tax	**(687)**	**78**
Tax expense at prevailing statutory rate (32%)	220	(25)
Non-deductible expenses	(17)	(10)
Tax free income	0	0
Change in unrecognised temporary differences and tax loss carry forwards	(220)	37
Other	(17)	(3)
Income tax (expense)	**(34)**	**(1)**
Current tax (expense)	(1)	0
Deferred tax expense	(33)	(1)
Income tax (expense)	**(34)**	**(1)**

7. Business Combinations

Acquisition of E-Plus Group

Per sale and purchase agreement (SPA) dated 23 July 2013, as amended on 26 August 2013, 28 August 2013, 5 December 2013, 24 March 2014, 7 August 2014 and 30 September 2014 between Telefónica S.A., Telefónica Deutschland Holding AG, and KPN (and together with its direct and indirect subsidiaries, the KPN Group), Telefónica Deutschland Holding AG together with its direct and indirect subsidiaries acquired 100% of the voting equity interests in E-Plus Mobilfunk GmbH & Co. KG, Dusseldorf and its direct and indirect subsidiaries (E-Plus Group) as of 1 October 2014 and hence obtained control of E-Plus Group. E-Plus Group dates back to the founding of E-Plus Mobilfunk GmbH in 1993. It provides customers in Germany mainly with multi-brand mobile telecommunications services, offering post-paid and pre-paid services targeted at multiple customer segments. The increased market opportunities and the expected synergies were the main reasons for the acquisition.

The preliminary consideration paid comprises a cash payment of EUR 3,636 million and equity instruments of EUR 3,070 million. The recognised goodwill of EUR 928 million, as the difference between the preliminary consideration of EUR 6,706 million and the acquisition-date fair value of E-Plus Group's identifiable net assets of EUR 5,777 million, mainly results from expected synergies in particular with respect to distribution, customer service and network infrastructure. The final amount of the purchase price is based on contractually defined mechanisms for the adjustment of the purchase price, based on the determination of working capital and net financial debt. A reduction to the preliminary purchase price is expected.

As of the acquisition date, the total amount of goodwill that is expected to be deductible for tax purposes amounts to EUR 1,252 million.

The following table summarises the consideration paid for the acquisition, the fair values of the identified assets and the liabilities assumed at the acquisition date.

As the purchase price allocation is not yet finalised, changes in the fair values of assets and liabilities may result, especially for the usage of wireless licences. In addition the calculation of the final purchase price based on the determination of working capital and net debt as defined in the sale and purchase agreement is not yet finalised.

(Euros in millions)	Preliminary fair values at acquisition date
Other intangible assets	4,328
Property, plant and equipment	1,931
Trade and other receivables	677
Other financial assets	19
Other non-financial assets	93
Inventories	21
Cash and cash equivalents	396
Interest-bearing debt	505
Trade and other payables	703
Other non-financial liabilities	6
Provisions	254
Deferred income	220
Net assets	**5,777**
Goodwill	928
Preliminary purchase price	**6,706**

Frequency usage rights were valued using the Greenfield method, which consists of the valuation of a hypothetical newly created company that starts its business with no assets except the asset being measured. The cash flows attributable to the built-up and operation of the company are determined and discounted to the present value.

Customer relationships were valued using the MEEM ("Multiple Excess Earnings Method") which is based on calculating the present value of the future cash flows reflecting the economic benefits resulting from the customer base after consideration of all value contributions of other assets.

Acquisition-related costs of EUR 9 million for the twelve-month period ended 31 December 2014 and EUR 6 million for the twelve-month period ended 31 December 2013 have been recognised in other expenses in the Consolidated Income Statement.

The fair value of the EUR 3,070 million ordinary shares issued as part of the consideration (EUR 6,706 million) was based on the published opening share price on 1 October 2014. Issuance costs for the cash capital increase and the contribution-in-kind totalling EUR 33 million have been recognised without affecting net income.

The following table summarises the fair value of acquired receivables:

(Euros in millions)	Gross amount	Impairment	Preliminary fair value
Trade and other receivables	841	164	677
Trade receivables	797	164	633
Other receivables	44	0	44
Lease receivables included in trade receivables	*223*	*31*	*192*

Had E-Plus Group been acquired on 1 January 2014, the Consolidated Statement of Income of Telefónica Deutschland Group for the twelve-month period ended 31 December 2014 would show pro-forma revenues of EUR 7.8 billion and a net loss of EUR 1.2 billion. The derivation of the net result already includes the tax situation of Telefónica Deutschland Group as well as the effects resulting from amortisation of other intangible assets and property, plant and equipment if they had been included as of 1 January 2014.

As of the acquisition date, a small amount of contingent liabilities were recognised, of which a partial amount results from pending lawsuits in which E-Plus Group is a defendant.

8. Discontinued Operations and Disposal Groups

8.1. Disposal group in 2014

Disposal of yourfone GmbH:
On 11 December 2014, E-Plus Mobilfunk GmbH & Co. KG, Dusseldorf, and Drillisch AG, Maintal, concluded an agreement on the sale of yourfone GmbH. yourfone GmbH, with its registered office in Hamburg and almost 210,000 active customers as of 31 December 2014, operates as a provider in the field of wireless communications and offers bill-based all-network flat-rate products. The company mainly focuses on young and modern users of smartphones. Based on the status as of 31 December 2014, the transaction will be closed in the first quarter of 2015.

The major assets and liabilities of yourfone GmbH, which were held for sale as of 31 December 2014, comprise the following:

(Euros in millions)	As of 31 December 2014
Goodwill	5
Other intangible assets	50
Property, plant and equipment	0
Financial assets	3
Trade and other receivables	12
Cash and cash equivalents	16
Interest-bearing debt	(19)
Trade and other payables	(5)
Provisions	(0)
Deferred tax liabilities	(16)
Net assets and liabilities	**45**

The cash and cash equivalents in the assets and liabilities held for sale include restricted cash of EUR 15 million from Telefónica Deutschland Group's perspective.

For further information see Note No. 21 Events after the Reporting Period.

8.2. Disposal groups in 2013

a) Sale of Telefónica Germany Online Services GmbH (TOS)
On 12 September 2013, Telefónica Germany GmbH & Co. OHG and Host Europe GmbH entered into an agreement regarding the sale of Telefónica Germany Online Services GmbH (TOS). TOS is a provider of managed hosting and cloud services for business customers. In this context, the domination agreement and the profit and loss transfer agreement between TOS and Telefónica Germany GmbH & Co. OHG were mutually terminated on 30 September 2013.

With the fulfilment of all the necessary closing conditions, the shares in TOS were transferred to the Host Europe Group on 31 October 2013.

The sale of TOS impacted the financial position of the Group with effect from 31 October 2013 as follows:

(Euros in thousands)	As of 31 October 2013
Intangible assets	0
Property, plant and equipment	5
Trade and other receivables	4
Financial assets	1
Deferred tax assets	0
Trade and other payables	(2)
Deferred tax liabilities	0
Provisions	0
Prepaid expenses and deferred income	0
Net assets and liabilities	**8**
Cash consideration received, satisfied in cash	42
Cash and cash equivalents disposed of	(4)
Net cash inflow	**38**

In connection with the sale of TOS, a gain on disposal of EUR 30 million was recognised in the Consolidated Income Statement within other income.

b) Versatel and Telefónica Deutschland entered into long-term fibre optic cooperation agreement

On 30 December 2013, Versatel Holding GmbH took over all shares in GKHH Fibre Optic GmbH pursuant to the share purchase and transfer agreement dated 16 October 2013. By means of a spin-off for new foundation out of Telefónica Germany GmbH & Co. OHG in accordance with section 123 (3) no. 2 of the German Transformation Act (Umwandlungsgesetz – UmwG), GKHH Fibre Optic GmbH was created with registration in the commercial registry on 4 December 2013. Thus, Telefónica Deutschland's fibre optic network in the Hamburg city area with approx. 93,000 kilometres of fibre and accordingly 1,000 cable kilometres, a newly built computer centre as well as selected wholesale and business customer contracts were spun out of Telefónica Germany GmbH & Co. OHG.

The sale of GKHH Fibre GmbH impacted the financial position of the Group with effect from 30 December 2013 as follows:

(Euros in millions)	As of 30 December 2013
Intangible assets	8
Property, plant and equipment	15
Trade and other receivables	2
Provisions	0
Financial assets	(6)
Trade payables	0
Deferred income	(0)
Net assets and liabilities	**19**
Cash consideration received, satisfied in cash	69
Cash and cash equivalents disposed of	0
Net cash inflow	**69**

In connection with this sale, a gain on disposal of EUR 46 million was recognised in the Consolidated Income Statement within other income.

9. Earnings per Share

Basic earnings per share are calculated by dividing the profit for the year after tax attributable to the ordinary shareholders of the parent company by the weighted average number of ordinary shares outstanding during the reporting period.

Diluted earnings per share are calculated by adjusting the profit after tax attributable to the ordinary shareholders of the parent company and the weighted average number of ordinary shares outstanding in the reporting period for the effects of any dilutive effects inherent in converting potential ordinary shares.

Both basic as well as diluted earnings per share attributable to the ordinary shareholders of the parent company are calculated based on the following data in accordance with IAS 33.

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Total profit (loss) attributable to equity holders of the parent for basic earnings	(721)	78
Dilutive effects of the conversion of potential ordinary shares	0	0
Total profit (loss) attributable to equity holders of the parent for diluted earnings	(721)	78

There were no dilutive equity instruments outstanding in the reporting periods shown.

In addition, the share capital of Telefónica Deutschland Holding AG was conditionally increased (see Note No. 1 Reporting Entity). Shares from the conditional capital of a stock corporation are not part of the calculation of the earnings per share as they can be contingently issued.

	As of 31 December	
(Number of shares in millions)	**2014**	2013
Weighted average number of ordinary shares for basic earnings per share	1,620	1,117
Weighted average number of ordinary shares for diluted earnings per share	1,620	1,117

In the 2014 reporting period, the share capital of the company was increased from EUR 1,117 million to EUR 2,975 million by issuing new shares. The number of shares increased by 1,116,945,400 effective 18 September 2014 as a result of the cash capital increase, and to 740,664,193 effective 1 October 2014 as a result of the capital increase for contributions in kind. Because of the increase, the weighted average number of ordinary shares outstanding in the reporting period changed. For further information see Note No. 5.9 Equity on the Capital Increases for Cash and for Contributions in kind.

Basic and diluted earnings per share attributable to the ordinary shareholders of the parent company amount to:

	1 January to 31 December	
(Earnings per share)	**2014**	2013
Basic earnings per share in EUR	(0.45)	0.07
Diluted earnings per share in EUR	(0.45)	0.07

10. Measurement Categories of Financial Assets and Financial Liabilities

In the following tables the fair value of all financial assets and financial liabilities of Telefónica Deutschland Group are disclosed in accordance with the measurement categories from IAS 39 considering the requirements of IFRS 13.

As of 31 December 2014, the carrying amount of the financial assets and financial liabilities represents an appropriate approximation for the fair value (with the exception of the portion of the bonds that is not hedged – see below).

In addition, the tables show the categorisation of the financial assets and financial liabilities in accordance with the importance of the input factors that were used for their respective measurement. For this purpose three levels or measurement hierarchies are defined:

- Level 1: Primary market value: quoted prices (unadjusted) in active markets for identical assets and liabilities
- Level 2: Significant other observable input parameters: inputs observable, either directly or indirectly, which are subject to certain limitations
- Level 3: Significant unobservable input parameters: all unobservable inputs which might include the entity's own data as a starting point and which should be adjusted if reasonably available information indicates that other market participants would use different data.

	As of 31 December 2014									
	Financial assets									
					Measurement hierachy					
(Euros in millions)	Financial assets at fair value through profit or loss	Available-for-sale financial assets	Held-to maturity financial assets	Loans and receivables	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in the scope of IFRS 7 (measured at fair value)
Non-current trade and other receivables (Note No. 5.4)	0	0	0	236	0	0	0	236	236	0
Other non-current financial assets (Note No. 5.5)	12	13	0	11	0	12	13	37	37	12
Current trade and other receivables (Note No. 5.4)	0	0	0	1,513	0	0	0	1,513	1,513	0
Other current financial assets (Note No. 5.5)	2	0	0	17	0	2	0	19	19	0
Cash and cash equivalents (Note No. 5.8)	0	0	0	1,702	0	0	0	1,702	1,702	0
Total	**14**	**13**	**0**	**3,480**	**0**	**14**	**13**	**3,507**	**3,507**	**12**

(Euros in millions)	Financial assets at fair value through profit or loss	Available-for-sale financial assets	Held-to maturity financial assets	Loans and receivables	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in the scope of IFRS 7 (measured at fair value)
					Measurement hierachy					
										As of 31 December 2013 Financial assets
Non-current trade and other receivables (Note No. 5.4)	0	0	0	83	0	0	0	83	83	0
Other non-current financial assets (Note No. 5.5)	0	6	0	9	0	6	0	16	16	0
Current trade and other receivables (Note No. 5.4)	0	0	0	877	0	0	0	877	877	0
Other current financial assets (Note No. 5.5)	0	0	0	21	0	0	0	21	21	0
Cash and cash equivalents (Note No. 5.8)	0	0	0	709	0	0	0	709	709	0
Total	**0**	**6**	**0**	**1,699**	**0**	**6**	**0**	**1,705**	**1,705**	**0**

As of 31 December 2014, EUR 12 million of the other non-current financial assets and EUR 2 million of the current financial assets are classified as financial assets at fair value through profit or loss. These relate to the swaps concluded in connection with the bond issue (for further information, see Note No. 5.5 Other Financial Assets).

In addition, EUR 13 million of the other non-current financial assets (see Note No. 5.5 Other Financial Assets) are classified as available-for-sale financial assets. These relate to investments in start-ups (for further information, see Note No. 5.5 Other Financial Assets). The assets were measured according to level 3; as a reliable measurement using a market price is not possible. These entities generate a start-up loss, and the existing business plans contain numerous unpredictable assumptions. For this reason, the measurement was made in accordance with IAS 39.46c.

All other financial assets as of 31 December 2014 were categorised as loans and receivables.

For further information, see the respective Notes.

The ageing structure of the financial assets that are overdue and not impaired was as follows:

	As of 31 December	
(Euros in millions)	**2014**	2013
overdue for 1–90 days	46	42
overdue for 91–180 days	3	4
overdue for more than 180 days	12	21
Total	**61**	**67**

With regards to these financial assets, there are no indications of circumstances that could have a negative impact on their value as of the respective reporting date.

(Euros in millions)	Financial liabilities at fair value through profit or loss	Liabilities at amortized costs	Finance Leases	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value
	As of 31 December 2014							
	Financial liabilities							
				Measurement hierachy				
Non-current interest-bearing debt (Note No. 5.10)	360	1,244	197	0	360	0	1,800	1,865
Non-current trade and other payables (Note No. 5.11)	0	19	0	0	0	0	19	19
Current interest-bearing debt (Note No. 5.10)	3	237	374	0	0	3	615	615
Current trade and other payables (Note No. 5.11)	0	2,283	0	0	0	0	2,283	2,283
Total	**363**	**3,783**	**571**	**0**	**360**	**3**	**4,717**	**4,782**

(Euros in millions)	Financial liabilities at fair value through profit or loss	Liabilities at amortized costs	Finance Leases	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value
	As of 31 December 2013							
	Financial liabilities							
				Measurement hierachy				
Non-current interest-bearing debt (Note No. 5.10)	200	1,142	1	0	200	0	1,344	1,348
Non-current trade and other payables (Note No. 5.11)	0	3	0	0	0	0	3	3
Current interest-bearing debt (Note No. 5.10)	0	102	2	0	0	0	104	104
Current trade and other payables (Note No. 5.11)	0	1,271	0	0	0	0	1,271	1,271
Total	**200**	**2,519**	**3**	**0**	**200**	**0**	**2,722**	**2,726**

As of 31 December 2014, EUR 360 million of the other non-current interest-bearing debt are classified as financial liabilities at fair value through profit or loss. These relate to a portion of the bonds, which are each accounted for with an interest rate swap as a fair value hedge and therefore classified as financial liabilities at fair value through profit or loss (for further information see Note No. 5.10 Interest-Bearing Debt).

The fair value of the bonds (non-current interest-bearing debt) is determined based on primary market values (unadjusted quoted prices in active markets).

Furthermore, EUR 3 million of the current interest-bearing debt are classified as financial liabilities at fair value through profit or loss as of 31 December 2014. This amount includes contribution obligations to partners in start-up investments (for further information refer to Note No. 5.10 Interest-Bearing debt). These obligations were measured according to level 3, as a reliable measurement, using a market price is not possible. For further information see above (investments in start-ups).

The non-current and current trade and other payables are classified as financial liabilities at amortised cost.

For further information, see the respective Notes.

11. Group Companies of Telefónica Deutschland Group

In accordance with sections 285 and 313 of the German Commercial Code (HGB), the following table lists the companies comprising Telefónica Deutschland Group as of 31 December 2014.

For detailed information, please refer to the list of shareholdings published with the Annual Financial Statements of Telefónica Deutschland Holding AG in the German Federal Gazette.

Company name, registered office	Country	Consolidation	Share in % as of 31 December 2014
Parent company			
Telefónica Deutschland Holding AG, München	Germany	n/a	n/a
Subsidiaries			
Telefónica Germany Management GmbH, Munich	Germany	full fiscal year	100%
Telefónica Germany GmbH & Co. OHG, Munich[1]	Germany	full fiscal year	100%
Telefónica Germany 1. Beteiligungsgesellschaft mbH, Munich	Germany	full fiscal year	100%
Telefónica Germany Customer Services GmbH, Munich	Germany	full fiscal year	100%
Wayra Deutschland GmbH, Munich	Germany	full fiscal year	100%
Fonic GmbH, Munich	Germany	full fiscal year	100%
O2 Telefónica Deutschland Finanzierungs GmbH, Munich	Germany	full fiscal year	100%
E-Plus Mobilfunk GmbH & Co. KG, Dusseldorf[1]	Germany	since 1 October 2014	100%
E-Plus Services Treuhand GmbH, Dusseldorf	Germany	since 1 October 2014	100%
E-Plus Service GmbH & Co. KG, Potsdam[1]	Germany	since 1 October 2014	100%
E-Plus Customer Operations GmbH, Dusseldorf	Germany	since 1 October 2014	100%
E-Plus Customer Support GmbH, Potsdam	Germany	since 1 October 2014	100%
E-Plus Retail GmbH, Dusseldorf	Germany	since 1 October 2014	100%
Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH, Dusseldorf	Germany	since 1 October 2014	100%
WiMee-Plus GmbH, Dusseldorf	Germany	since 1 October 2014	100%
WiMee-Connect GmbH, Dusseldorf	Germany	since 1 October 2014	100%
AY YILDIZ Communications GmbH, Dusseldorf	Germany	since 1 October 2014	100%
simyo GmbH, Dusseldorf	Germany	since 1 October 2014	100%
Cash & Phone GmbH, Dusseldorf	Germany	since 1 October 2014	100%
Gettings GmbH, Dusseldorf	Germany	since 1 October 2014	100%
Ortel Mobile GmbH, Dusseldorf	Germany	since 1 October 2014	100%
BLAU Mobilfunk GmbH, Hamburg	Germany	since 1 October 2014	100%
Blau Service GmbH, Hamburg	Germany	since 1 October 2014	100%
yourfone GmbH, Hamburg	Germany	since 1 October 2014	100%
Go Clever GmbH, Stuttgart	Germany	since 1 October 2014	100%
E-Plus Financial Services GmbH, Potsdam		since 1 October 2014	100%
Shortcut I GmbH & Co. KG, Dusseldorf	Germany	since 1 October 2014	90%
E-Plus 1.Beteiligungsgesellschaft mbH, Munich	Germany	since 31 December 2014	100%

Company name, registered office	Country	Consolidation	Share in % as of 31 December 2014
Joint operations			
TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg	Germany	full fiscal year	50%
TCHIBO Mobilfunk GmbH & Co. KG, Hamburg	Germany	full fiscal year	50%

1 The entities are using the exemption provisions pursuant to section 264b HGB.

Other investments			
Montan GmbH Assekuranz-Makler, Dusseldorf	Germany	full fiscal year	1%
MNP GbR, Cologne	Germany	full fiscal year	25%
MNP GbR, Cologne	Germany	since 1 October 2014	25%
Mediakraft Networks GmbH, Munich	Germany	since 1 October 2014	22%
tado GmbH, Munich	Germany	since 1 October 2014	18%
Yuilop S.L., Barcelona	Spain	since 1 October 2014	18%
Sum Up Holdings Ltd, Grand Cayman	Cayman Islands	since 1 October 2014	7%
Zen Guard GmbH, Berlin	Germany	since 1 October 2014	5%

12. Joint Operations

Telefónica Germany GmbH & Co. OHG jointly controls TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg, and TCHIBO Mobilfunk GmbH & Co. KG, Hamburg. In application of IFRS 11.17 and the respective application guidelines, the companies were classified as joint operations considering other facts and circumstances.

The business objective of TCHIBO Mobilfunk Beteiligungs GmbH is the holding of interests in other companies. The business objective of TCHIBO Mobilfunk GmbH & Co. KG, where TCHIBO Mobilfunk Beteiligungs GmbH is its personally liable shareholder, is the marketing and sales of wireless communications services to be rendered by third parties and the marketing and sales of hardware.

As part of the joint operation in TCHIBO Mobilfunk GmbH & Co. KG, Telefónica Germany GmbH & Co. OHG reimburses the company for sales and marketing services provided by the latter, on the one hand and otherwise supplies the company with wireless communications devices. Telefónica Germany GmbH & Co. OHG has committed to providing the company with capital amounting to up to EUR 6 million, if needed. As of 31 December 2014, EUR 1 million of that amount was still outstanding.

The share of the assets, liabilities and expenses and income to be attributed to Telefónica Deutschland Group from both companies corresponds in each case to 50%. Thus, the actual share is identical to the contractually agreed share of voting rights.

The shares of assets, liabilities, income and expenses before consolidation for 2014 and 2013 are comprised as follows:

TCHIBO Mobilfunk GmbH & Co. KG (Euros in millions)	**2014**	2013
Financial Position:		As of 31 December
Current assets	14	16
thereof cash and cash equivalents	*2*	*6*
Current liabilities	(9)	(11)
Income Statement:		1 January to 31 December
Revenues and other income	30	29
Expenses	(29)	(28)
thereof amortisation and depreciation	*(0)*	*(0)*
Operating income	0	1
Net financial income (expense)	0	0
Income tax	(0)	(0)
Profit for the year	0	1

The shares of assets, liabilities, income and expenses before consolidation in TCHIBO Mobilfunk Beteiligungs GmbH are not shown in detail because of their insignificance.

13. Related Parties

The transactions with related parties include transactions between Telefónica Deutschland Group and Telefónica, S.A. Group and between Telefónica Deutschland Group and KPN Group, as KPN acquired a share of currently 20.5% on conclusion of the E-Plus transaction (for further information see Note No. 2 Significant Events and Transactions in the Financial Year) and thus exerts significant influence over Telefónica Deutschland.

In addition, the transactions with related parties also include transactions between Telefónica Deutschland Group and joint operations and transactions with other related parties.

Telefónica Deutschland Holding AG is the parent company of Telefónica Deutschland Group. It is included in the Consolidated Financial Statements of the ultimate holding company, Telefónica, S.A. The parent company of Telefónica Deutschland Holding AG is Telefónica Germany Holdings Limited, a subsidiary of O2 (Europe) Limited and an indirect subsidiary of Telefónica, S.A. Telefónica, S.A. Group companies are related companies because Telefónica, S.A. controls Telefónica Deutschland Group.

13.1. Transactions with Telefónica, S.A. Group

Telefónica Deutschland Group has entered into a series of contractual relationships that are considered to be transactions with related parties.

In accordance with a service agreement with O2 Holdings Limited dated 12 August 2002, Telefónica Germany GmbH & Co. OHG receives consulting and support services from companies of Telefónica, S.A. Group in the United Kingdom and Spain.

As part of a licence agreement with Telefónica, S.A. dated 1 January 2011, Telefónica Germany GmbH & Co. OHG is permitted to use the brand “Telefónica” in return for payment of a licensing fee.

In addition, Telefónica Germany GmbH & Co. OHG uses the core brand O_2 (as well as all brands that have a relationship to the O2 brand) of O2 Holdings Limited as part of a licence agreement and participates in the costs as part of a Group cost sharing agreement with O2 Holdings Limited and other companies in Telefónica, S.A. Group. Both contracts were concluded on 15 October 2007. O2 Holdings Limited holds the rights to the core brand O_2 and all brands that have a relationship to the O_2 brand and bears the responsibility and the cost for the central administration and development and the protection of the O_2 trademark rights.

Telefónica, S.A. Group has established several departments called "innovation fields". They work on the development of new business opportunities and technology in the following areas: cloud computing, propagation of video and digital content via home networks, machine to machine communication, applications, financial services, wireless security solutions and e-health. As part of a cost sharing agreement, Telefónica Germany GmbH & Co. OHG participates in the associated development and coordination costs, which are apportioned to the companies belonging to Telefónica, S.A. Group that benefit from these developments. In the reporting year, Telefónica Germany GmbH & Co. OHG concluded an agreement with Telefónica Digital UK that replaced the previous one. According to this agreement, Telefónica Digital UK grants Telefónica Germany GmbH & Co. OHG a licence to the "Digital Portfolio", which includes the areas Media, M2M, Cloud, Financial Services, Security, eHealth, Future Comms, Big Data and Advertising. In addition, Telefónica Digital UK provides consulting services with regard to the commercial expertise at Telefónica Digital UK and best practices. In return, Telefónica Germany GmbH & Co. OHG has committed to paying a licence fee to Telefónica Digital UK.

Further, Telefónica Germany GmbH & Co. OHG concluded a service agreement with Telefónica Global Roaming GmbH (TGR) that became effective on 5 December 2009. TGR administers the wholesale roaming business with third parties as well as the mutual roaming rebates for the Group companies of Telefónica, S.A. Group. For the roaming agreements with all companies of Telefónica, S.A. Group, Telefónica Germany GmbH & Co. OHG concluded international roaming agreements. Effective 1 October 2014, E-Plus Mobilfunk GmbH & Co. KG concluded a similar service agreement with TGR.

Telefónica Deutschland Group benefits from international sales and marketing activities that are coordinated by Telefónica Global Solutions, a global Telefónica, S.A. Group business unit. Telefónica Global Solutions has its own central budget and employees within the Telefónica, S.A. Group. Further, all participating companies of the Telefónica, S.A. Group make an array of employees and resources available for the activities of Telefónica Global Solutions.

With effect as of 17 May 2013, a contract (Master Service Agreement) was concluded between Telefónica Germany GmbH & Co. OHG and Telefónica International Wholesale Services, S.L. (TIWS). The contract governs the conditions for the procurement of VPN site networking via TIWS as part of the global mWAN project.

On 30 June 2014, Telefónica Germany GmbH & Co. OHG and TIWS entered into an agreement regarding the performance of "global roaming technical unit services". TIWS provides services such as SCCP signalling for international roaming and traffic steering for roaming.

On 13 December 2010, Telefónica Germany GmbH & Co. OHG concluded a development and service contract with Telefónica Global Technology S.A.U. (TGT) regarding the introduction of an SAP system. TGT grants the companies licences for various functions of the SAP software. In addition, TGT provides among other things development services as well as master data management, user support services and access services. On 3 May 2011, a further agreement with TGT regarding the provision and operation of an integrated desktop workspace and e-mail system for the business was concluded. In accordance with this agreement, TGT makes software as well as tools, network linking and IP communication services available to the business.

On 1 August 2014, Telefónica Germany GmbH & Co. OHG signed a production service agreement with TGT, which arranged for the migration of local computer centres to computer centres operated by TGT, mainly in Madrid.

On 1 September 2014, Telefónica Germany GmbH & Co. OHG and Telefónica Móviles España, S.A.U. entered into an agreement regarding the performance of services in connection with Rich Communication Services (RCS) by Telefónica Móviles. RCS is a communication platform for the transmission of short messages, files, voice and video telephony, which Telefónica Germany GmbH & Co. OHG would like to offer to its customers in Germany.

In addition, on 1 August 2011, Telefónica Germany GmbH & Co. OHG concluded a contract with Telefónica Global Applications S.L. (TGA) under which TGA is contracted by the business to be responsible for cooperation with the developers in connection with the development, marketing and sales of wireless communications applications. The contract was terminated with effect as of 30 June 2013.

On 29 August 2011, two contracts were concluded with Telefónica Czech Republic, a.s. (Telefónica Czech). In accordance with these, Telefónica Czech renders monitoring services for Telefónica Germany GmbH & Co. OHG's wireline networks; Telefónica Germany GmbH & Co. OHG renders monitoring services for Telefónica Czech's wireless communications network. On the closing of the sale of Telefónica Czech on 28 January 2014, the company left the group of affiliated companies.

As part of an interconnection contract with the Telefónica, S.A. Group company Telefónica Digital Inc. (formerly Jajah, Inc.) dated 11 October 2011, Telefónica Digital Inc. was connected to the Group's network and Telefónica Germany GmbH & Co. OHG to the network of Telefónica Digital Inc. The goal is the scheduling of voice and data traffic in the relevant networks as well as the transfer to the network of a third party where the third party's network is connected to that party's network. With effect from 14 February 2014, this contract was terminated due to the cessation of Telefónica Digital Inc.'s operations in this area.

On 21 January 2015, Telefónica Germany GmbH & Co. OHG concluded a service contract with retroactive effect for 2014 with the Irish Telefónica Europe People Services Limited, which provides for the rendering of services in the area of administrative personnel management and employment-related services.

In addition, on 1 January 2010, Telefónica Germany GmbH & Co. OHG concluded a framework contract with Telefónica Global Services GmbH (TGS) and on 20 October 2010 a framework contract with TGR. Telefónica Germany GmbH & Co. OHG in this respect has individual service agreements with TGR and TGS under which it renders central services and operative support for TGR and TGS. In the reporting year, adjustments were made with regard to the agreed scope of services.

As part of the service agreement with TGS dated 6 October 2010, Telefónica Germany GmbH & Co. OHG has outsourced its procurement process to TGS. TGS carries out the purchasing of various goods and services on behalf of the company and is responsible for everything associated with the procurement processes including tenders, evaluations and negotiations.

Effective 1 October 2014, E-Plus Mobilfunk GmbH & Co. KG and TGS concluded a service agreement whereby TGS renders consulting services with regard to the procurement process including tenders, valuations and negotiations for E-Plus Mobilfunk GmbH & Co. KG.

With the contract dated 14 November 2013, Telefónica Germany GmbH & Co. OHG concluded an agreement with Telefónica Insurance S.A. and ACE European Group Limited for the sales and marketing of mobile phone insurance via the O_2 channels (Distribution Agreement). Telefónica Germany GmbH & Co. OHG offers its customers this insurance and makes use of Telefónica Insurance S.A. as the insurance company. ACE European Group Limited acts here as the re-insurer. The contract replaces the contract that was in place up until 13 November 2013 between Telefónica Germany GmbH & Co. OHG and Telefónica Insurance S.A.

Telefónica Germany GmbH & Co. OHG maintains an insurance policy from Telefónica Insurances S.A., an insurance company in Telefónica, S.A. Group registered in Luxembourg, for insurance against damage to property and business interruption. The insurance programme is administered and carried out by Pleyade Peninsular Correduria de Seguros, S.A. in Madrid as insurance broker, which likewise belongs to Telefónica, S.A. Group. On the recommendation of the insurance broker, the existing insurance contracts with Telefónica Insurance S.A. for general liability, financial loss and media content as well as damages resulting from a breach of patent, employment law and pension-related disputes were terminated with effect as of 30 June 2013. The policies for the above-mentioned risks were then concluded with a non-Group third party insurance company (Mapfre Global Risks S.A.) with effect as of 1 July 2013. The costs arising in 2014 were partially reimbursed to Telefónica Germany GmbH & Co. OHG by Telefónica Europe plc.

In the framework of cash pooling and deposit agreements, Telefónica Deutschland Holding AG and its subsidiaries are included in the cash management system of Telefónica, S.A. Group. The cash funds of Telefónica, S.A. Group are centralised via these agreements. In this way, the economies of scale of the entire Telefónica, S.A. Group can be used, and use can likewise be made of the internal administration of the receivables and liabilities between Telefónica Deutschland Group and the participating Group companies of Telefónica, S.A. Group. As part of the cash pooling agreements, the total cash surpluses in the bank accounts of the companies in the cash pool are automatically transferred daily to master accounts of Telfisa Global B.V., which is a subsidiary of Telefónica, S.A. Since 1 October 2014, E-Plus Mobilfunk GmbH & Co. KG has also been included in the cash pooling with Telefónica, S.A. Group.

On 12 September 2012, Telefónica Germany GmbH & Co. OHG concluded a loan contract with Telfisa Global B.V., a company in Telefónica, S.A. Group, as lender, under which Telfisa Global B.V. grants a credit facility ("facility") in the amount of EUR 1.25 billion; this facility carries interest at the level of the three-month Euribor plus a margin of 120 basis points, increased annually by 40 basis points. The interest is calculated daily from the date of drawdown of funds, whereby a year is recorded as 360 days. The facility is repayable until 2017 at the level of 20% annually. Telefónica Germany GmbH & Co. OHG is entitled to fully or partially repay the facility with repayments of at least EUR 0.1 million on each interest date or on condition that a market-based break fee is paid.

In 2014, an amount of EUR 125 million was repaid. In 2013, there were repayments of EUR 250 million (scheduled) and EUR 150 million (mandatory repayment).

In addition, the facility is subject to a mandatory early repayment if Telefónica Germany GmbH & Co. OHG obtains financing that is repayable after 13 September 2017. In this event, 25% of the proceeds of the financing must be used for early repayment of the facility. If Telefónica Germany GmbH & Co. OHG does not comply with its payment obligations under the loan contract, default interest of an additional two roll-outage points above the relevant interest rate will be due. The loan contract contains certain restrictive clauses, for example, for the disposal of assets, the granting of charges or for mergers and consolidations.

In preparing for the IPO, Telefónica Deutschland concluded an indemnity and cost sharing agreement with Telefónica Germany Holdings Limited. Under this contract, Telefónica Germany Holdings Limited is obliged to indemnify Telefónica Deutschland against certain liability risks and to bear the transaction costs that arise from or in connection with the stock market listing. The costs of the IPO were invoiced in 2013 and settled in the reporting year.

On 23 July 2013, Telefónica Deutschland, Telefónica, S.A. and KPN entered into a notarised agreement (Share Purchase Agreement) of which the subject matter is the acquisition of E-Plus by Telefónica Deutschland. The Share Purchase Agreement was amended and supplemented on 26 August, 28 August and 5 December 2013, and 24 March, 7 August and 30 September 2014. The transaction was closed in the reporting year with effect as of 1 October 2013. For further information, see Note No. 7 Business Combinations.

Receivables from and liabilities to Telefónica, S.A. Group

Telefónica Deutschland Group reports the following receivables from and liabilities to the companies belonging to Telefónica, S.A. Group:

		As of 31 December
(Euros in millions)	2014	2013
Receivables from Telefónica, S.A. Group	**1,726**	**727**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Cash and cash equivalents (cash pooling)	1,673	701
Trade and other receivables	54	27
Liabilities to Telefónica, S.A. Group	**1,022**	**1,101**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Trade payables	254	220
Other payables	42	31
Interest-bearing debt	726	851

Cash and cash equivalents (cash pooling)

The receivables from Telefónica, S.A. Group as a result of cash pooling relate to the cash pooling agreement with Telfisa Global B.V.

Trade and other receivables

These receivables result mainly from transactions with goods and services between Telefónica Deutschland Group and Telefónica, S.A. Group. As of the reporting dates of 31 December, the line item contains receivables due from Telefónica, S.A. of EUR 7 million in 2014 and of EUR 2 million in 2013.

Trade payables

This item primarily relates to liabilities sold by the suppliers of Telefónica Germany GmbH & Co. OHG to Telefónica Factoring España, S.A., in which Telefónica, S.A. has an interest.

Other payables

The other payables result mainly from transactions with goods and services between Telefónica Deutschland Group and Telefónica, S.A. Group. As of the reporting dates of 31 December, the line item contains other payables to Telefónica, S.A. of EUR 6 million in 2014 (2013: EUR 6 million).

Interest-bearing debt

The interest-bearing debt relates to the loan agreement with Telfisa Global B.V.

Revenues, other income and expenses with Telefónica, S.A. Group

Telefónica Deutschland Group reports the following revenues, other income and expenses with companies belonging to Telefónica, S.A. Group:

	Revenues and other income		Expenses	
	1 January to 31 December		1 January to 31 December	
(Euros in millions)	2014	2013	2014	2013
Telefónica, S.A. Group	29	45	(104)	(151)

Revenues are generated primarily from the sale of goods and services. The figure also includes interest income from cash pooling amounting to EUR 2 million (2013: EUR <1 million).

Expenses include group fees totalling EUR 53 million in 2014 and EUR 71 million in 2013, together with expenses relating to the purchase of goods and services, as well as other expenses in connection with transactions with Telefónica, S.A. Group.

13.2. Transactions with KPN Group

Telefónica Deutschland Group has entered into a series of contractual relationships with KPN and with its direct and indirect subsidiaries that are considered to be transactions with related parties.

By contract dated 17 December 2013, KPN granted E-Plus Mobilfunk GmbH & Co. KG the right under a licence agreement to use the brands "Base" and "Freedom", "Freedom of Speech" and "Your mobile freedom" (plus all related brands) in Germany for free for a period of 20 years.

There are also agreements between E-Plus Mobilfunk GmbH & Co. OHG and various KPN Group companies regarding the mutual performance of services, especially for roaming, interconnection, voice and SMS.

For information on the acquisition of E-Plus by Telefónica Deutschland, Telefónica, S.A. and KPN, see Note No. 7 Business Combinations.

Receivables from and liabilities to KPN Group
As of 31 December 2014, Telefónica Deutschland Group reports the following receivables from and liabilities to the companies belonging to KPN Group:

(Euros in millions)	2014
Receivables from KPN Group	**14**
that are recognised in the following items in the Consolidated Statement of Financial Position:	
Trade and other receivables	14
Liabilities to KPN Group	**7**
that are recognised in the following items in the Consolidated Statement of Financial Position:	
Trade payables	7

Trade and other receivables
The trade and other receivables (EUR 9 million) result primarily from services between Telefónica Deutschland Group and KPN Group (roaming, voicemail hosting service, network usage fees).
As of 31 December 2014, the line item contains no receivables from KPN.

The other receivables (EUR 5 million) arose from the assumption of trade tax liabilities by KPN Group as part of the purchase agreement between Telefónica Deutschland Group and KPN and other services by Telefónica Deutschland Group for the KPN Group.

Trade payables
Trade payables of Telefónica Deutschland Group to KPN Group result chiefly from transactions with services (interconnection, roaming, infrastructure expenses, customer care). As of 31 December 2014, they amount to EUR 7 million.

Revenues, other income and expenses with KPN Group
Telefónica Deutschland Group reports the following revenues, other income and expenses with companies belonging to KPN Group for the period from 1 October to 31 December 2014:

	Revenues and other income	Expenses
	1 October to 31 December	1 October to 31 December
(Euros in millions)	**2014**	**2014**
KPN Group	2	(27)

Revenues are generated primarily from the performance of services.

The expenses are incurred due to the receipt of services.

13.3. Transactions with joint operations

Telefónica Deutschland Group reports the following receivables from and liabilities to the joint operation TCHIBO Mobilfunk GmbH & Co. KG as well as revenues, other income and expenses:

	As of 31 December	
(Euros in millions)	**2014**	2013
Receivables from TCHIBO Mobilfunk GmbH & Co. KG	0	3
Liabilities to TCHIBO Mobilfunk GmbH & Co. KG	6	1

	Revenues and other income		Expenses	
	1 January to 31 December		1 January to 31 December	
(Euros in millions)	**2014**	2013	**2014**	2013
TCHIBO Mobilfunk GmbH & Co. KG	7	8	22	20

Telefónica Deutschland Group reports no material transactions with the joint operation TCHIBO Mobilfunk Beteiligungs GmbH.

13.4. Transactions with other related persons

a) Management Board in 2014:
In the 2014 financial year, the members of Key Management Personnel comprise the following members of the Management Board:
— René Schuster (CEO) until 31 January 2014,
— Thorsten Dirks (CEO) since 9 October 2014,
— Rachel Empey (CFO),
— Markus Haas (COO since 1 October 2014, formerly CSO).

For further details see Note No. 2 Significant Events and Transactions in the Financial Year.

In the financial years to which the accompanying Consolidated Financial Statements relate, the members of the Management Board have not carried out any transactions with Telefónica Deutschland Group other than as part of the normal trading and business activity of Telefónica Deutschland Group.
For further details, see Note No. 14 Transactions with Management Board and Supervisory Board.

b) Salaries and other benefits paid to the Management Board in 2014 and 2013:
Salaries and other benefits according to IAS 24.17, that were granted to active Management Board members are made up as follows:

	1 January to 31 December	
(Euros in thousands)	**2014**	2013
Total remuneration	**6,873**	**3,740**
thereof:		
Short-term employee benefits	3,684	3,308
Other long-term employee benefits	164	295
Termination benefits	2,671	0
Share-based payments	287	115
Current service cost	67	22

The defined benefit pension obligation for Management Board members totalled EUR 3,074 thousand in the financial year 2014 and EUR 167 thousand in 2013. For further details of the pension obligations of Telefónica Deutschland Group, please refer to Note No. 5.12 Provisions.

In the reporting period, personnel costs of EUR 2,724 thousand were charged back to Telefónica, S.A. The difference between the termination payments made and the amount of personnel costs charged back mainly results from differences in exchange rates.

c) Share options held by members of the Management Board in 2014 and 2013:
The following changes have occurred in the Telefónica, S.A. share options for the Management Board members (for further information see Note No. 15 Share-Based Payments):

(In units)	**2014**	2013
Share options as of 1 January[1]	**159,292**	**160,023**
Forfeited share options	(48,344)	(54,095)
Addition of share options	168,340	53,364
Change in composition of Management Board	(66,652)	0
Share options as of 31 December	**212,636**	**159,292**

1 The share options disclosed in prior year financial statements were disclosed with a number of 271,176 as of 1 January 2013, and a number of 111,153 was disclosed in row "Change in composition of Management Board". For these financial statements, this was already included in the opening balance value as of 1 January 2013, aiming at a better comparability.

14. Transactions with Management Board and Supervisory Board

1. Management Board
According to the shareholders' resolution adopted on 5 October 2012, Telefónica Deutschland does not disclose the additional disclosures for listed stock corporations (Aktiengesellschaften) in accordance with section 314 (1) no. 6 a) sentence 5 to 8 German Commercial Code (*Handelsgesetzbuch* – HGB).

The current employment contracts of the members of the Management Board of Telefónica Deutschland Holding AG were concluded on 2 July 2014 and came into force on 1 October 2014. The employment contract of one of the Management Board members was amended by way of an amendment agreement on 22 January 2015. The employment contracts of the Management Board members basically expire on 30 September 2017.

In accordance with section 314 (1) no. 6a HGB, the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG for the financial year ended 31 December 2014 amounted to EUR 5,468 thousand. The total remuneration includes share-based payments with a fair value of EUR 1,680 thousand at grant date for 168,340 share options.

Currently, Telefónica Deutschland Group has not granted the members of its Management Board any security or loans and has not assumed any guarantees for them.

The total remuneration granted to the Management Board in accordance with section 314 (1) no. 6a HGB in 2013 amounted to EUR 4 million. The fair value of the share options included amounted to EUR 515 thousand at grant date for a quantity of 53,364.

In the 2014 and 2013 financial years, the total remuneration expenses for former directors and their surviving dependents was EUR 222 thousand in 2014 and EUR 117 thousand[1] in 2013. In addition, termination payments made of EUR 2,671 thousand relate to the board member resigning in 2014.

As of 31 December 2014 and 2013, the pension obligations for former directors and their surviving dependents were EUR 12,172 thousand and EUR 11,034 thousand, respectively[1].

For more details of the pension obligations of Telefónica Deutschland Group, please refer to Note No. 5.12 Provisions.

2. Supervisory Board

Name	Member of the Supervisory Board
Eva Castillo Sanz	since 5 October 2012
María Pilar López Álvarez	since 18 September 2012
Angel Vilá Boix	since 18 September 2012
Patricia Cobian González	since 18 September 2012
Michael Hoffmann	since 5 October 2012
Enrique Medina Malo	since 18 September 2012
Sally Anne Ashford	since 18 September 2014
Antonio Manuel Ledesma Santiago	since 18 September 2014
Imke Blumenthal	since 3 June 2013
Thomas Pfeil	since 3 June 2013
Jan-Erik Walter	since 3 June 2013
Marcus Thurand	since 3 June 2013
Christoph Heil	since 3 June 2013
Claudia Weber	since 3 June 2013
Joachim Rieger	since 31 October 2014
Jürgen Thierfelder	since 31 October 2014

The members of the Supervisory Board received remuneration for their activities of EUR 231 thousand in 2014 and EUR 162 thousand in 2013.

Members of the Supervisory Board who are also employees of Telefónica Deutschland Group also receive remuneration from their employment relationship, including entitlements from share-based payment agreements, subject to compliance with the requirements for participation in each individual case, and are

1 In order to ensure consistency, the disclosure only refers to the members of Management of former Telefónica Germany Verwaltungs GmbH, Munich.

entitled to pension schemes. This remuneration comprises the following with effect from appointment to the Supervisory Board:

(Euros in thousends)	1 January to 31 December 2014
Remuneration	**544**
thereof:	
Short-term employee benefits	483
Share-based payments	47
Service cost	14

As of 31 December 2014, Telefónica Deutschland Group has not granted the members of their Supervisory Board any securities or loans and has not assumed any guarantees for them.

15. Share-Based Payments

As of 31 December 2014, Telefónica Deutschland Group had made the following agreement regarding share-based payments:

Description of the share-based remuneration plans

"Performance and Investment Plan" 2011 and 2014 (equity-settled)
The plan is a long-term, defined benefit remuneration plan for the Management Board and senior executives of Telefónica S.A. Group companies, including Telefónica Deutschland Group.

The "Performance and Investment Plan" 2011 is divided into three phases, each three years long, whereby the first phase began on 1 July 2011, and ended on 30 June 2014, and the third phase began on 1 July 2013 and will end on 30 June 2016. The subsequent "Performance and Investment Plan" 2014 is likewise divided into three phases, each three years long, whereby the first phase began on 1 October 2014, and will end on September 30, 2017, and the third phase will begin on 1 October 2016, and will end on 30 September 2019.

At the beginning of each phase, the number of shares for each plan beneficiary is determined by dividing the amount that corresponds to a certain proportion of the fixed annual salary by the average share price of Telefónica, S.A. shares during the 30 days before the start of the phase. The shares are delivered no later than 90 days after each phase ends.

The shares are delivered by Telefónica, S.A. (this is the ultimate parent company which undertakes the settlement) if certain vesting conditions are fulfilled:

- The beneficiary is still actively employed by a company in Telefónica, S.A. Group at the end of the three-year phase period.
- The actual number of the shares awarded at the end of the phase is calculated by multiplying the maximum number of shares assigned to each beneficiary at the beginning of the phase by a roll-out-age that reflects the performance of the Telefónica, S.A. share. The performance is measured by comparing the total shareholder return for Telefónica, S.A. shareholders (comprising both share price and dividends) with the total shareholder return of the peer group. The peer group comprises several listed telecom companies.
  - The allocation amounts to 100% if Telefónica, S.A.'s total shareholder return is in the upper quartile of the peer group,
  - and 30% if Telefónica, S.A.'s total shareholder return corresponds to the median.

- On the basis of the “Performance and Investment Plan 2014”, members of the Management Board of Telefónica Deutschland, who are also ExComm (Executive Committee) members of Telefónica, S.A., receive an allocation of 125% if Telefónica, S.A.’s total shareholder return reaches at least the level of the total shareholder return for the upper decile of the comparison group.
- The roll-outage increases linearly for all points between the benchmarks.
- If the total shareholder return of Telefónica, S.A. is below the median, no shares are awarded.

In addition, all plan beneficiaries have the opportunity to co-invest. In accordance with the co-investment condition, the plan beneficiary must personally own 25% of the number of Telefónica, S.A. shares allocated to him or her under the Performance and Investment Plan.

These shares must be owned by the plan beneficiary at the first anniversary of the beginning of each cycle and the plan beneficiary must hold them up until the vesting date in order to be entitled to receive a further 25% of the number of the originally held Telefónica, S.A. shares.

Thus the plan beneficiary receives, conditional on the performance of the company, one free Telefónica, S.A. share for every co-invested Telefónica, S.A. share.

The first phase of the 2011 plan ended on 30 June 2014. The total shareholder return of Telefónica, S.A. was below the median for the peer group and included the following number of options that have forfeited:

Phase	No. of shares forfeited	Fair value per unit when granted	End date
First phase of 2011 plan: 1 July 2011	75,756	8.28	30 June 2014

Phase	No. of shares co-investment	End date
First phase of 2011 plan: 1 July 2011	13,168	30 June 2014

Phase	Total	End date
First phase of 2011 plan: 1 July 2011	88,924	30 June 2014

The second allocation of share options under the 2011 plan occurred on 1 July 2012. The maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was, as of 31 December 2014:

Phase	Maximum number of share options still to be granted	Fair value per unit when granted	End date
Second phase of 2011 plan: 1 July 2012	207,562	8.28	30 June 2015

Phase	No. of shares co-investment	End date
Second phase of 2011 plan: 1 July 2012	19,900	30 June 2015

Phase	Total	End date
Second phase of 2011 plan: 1 July 2012	227,462	30 June 2015

The last allocation of share options of Telefónica, S.A. shares as part of the 2011 plan occurred on 1 July 2013. The maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was, as of 31 December 2014:

Phase	Maximum number of share options still to be granted	Fair value per unit when granted	End date
Third phase of 2011 plan: 1 July 2013	172,910	6.40	30 June 2016

Phase	No. of shares co-investment	End date
Third phase of 2011 plan: 1 July 2013	15,511	30 June 2016

Phase	Total	End date
Third phase of 2011 plan: 1 July 2013	188,421	30 June 2016

The first allocation of share options of Telefónica, S.A. shares as part of the 2014 plan occurred on 1 October 2014. The maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was, as of 31 December 2014:

Phase	Maximum number of share options still to be granted	Fair value per unit when granted	End date
First phase of 2014 plan: 1 October 2014	314,280	8.60	30 September 2017

Phase	No. of shares co-investment	End date
First phase of 2014 plan: 1 October 2014	79,291	30 September 2017

Phase	Total	End date
First phase of 2014 plan: 1 October 2014	393,571	30 September 2017

The fair values of the equity instruments granted to plan beneficiaries is determined using the share price of the shares of Telefónica, S.A. at grant date of the grant under consideration of market conditions.

The plan is valued using the Monte Carlo method, thereby incorporating the performance target as a market condition. This method involves generating share prices and Telefónica, S.A. total shareholder return for each company, based on dividend yield and volatility, taking into account the cross correlations between stocks. The model is used to define the probability for the shares to vest and establish share price growth associated with different ranking positions.

The service condition which requires that the plan beneficiary must be employed by a Telefónica, S.A. group company until the end of the vesting period is considered in determining the number of equity instruments to be taken into account at the grant date. The amount to be recognised is thus based on the number of ultimately exercisable equity instruments.

The co-investment condition, being a non-vesting condition, is taken into account in determining the number of equity instruments to be considered. In addition, in determining the fair value, a further non-vesting condition is taken into account, which provides that the shares must be held until the vesting date.

No compensation is paid for expected dividends from the shares that the employees do not receive before physical delivery of the shares. This fact is taken into account in determining the fair value.

Because this is a plan with settlement by equity instruments and because Telefónica, S.A. undertakes the settlement, the personnel expenses are recognised on a pro rata temporis basis over the vesting period with a corresponding entry in the equity of Telefónica Deutschland Group.

There is a recharge agreement in place between Telefónica, S.A. and Telefónica Deutschland Group in relation to the shares that are delivered to employees in Germany. This recharge is done by reducing equity and a corresponding increase of the liabilities to Telefónica, S.A.

(In units)	**2014**	2013
Share options as of 1 January	**528,074**	**400,068**
Addition of share options	393,571	206,350
Change in Employees	(23,268)	(78,344)
Forfeited share options	(88,924)	0
Share options as of 31 December	**809,453**	**528,074**

“Talent for the Future Share Plan” (equity-settled)
The plan is a long-term, defined benefit remuneration plan of Telefónica, S.A., also applicable for the Telefónica Deutschland Group and implemented for employees with persistently outstanding performance, high potential and key qualifications who are expected to take leading roles in the future.

The “Talent for the Future Share Plan” is divided into three phases, each three years long, whereby the first phase began on 1 October 2014, and will end on 30 September 2017, and the third phase will begin on 1 October 2016, and will end on 30 September 2019.

The number of shares to be assigned no later than 90 days after the end of each phase is determined at the beginning of each phase.

Phase	Maximum No. of shares granted	Grand-date fair value per unit	End date
First phase 1 October 2014	45,000	8,60	30 September 2017

The method of calculation for determining the Telefónica, S.A. shares that must actually be delivered is similar to the method used for the “Performance and Investment Plan”. The vesting condition for this plan that every plan beneficiary must be employed with Telefónica, S.A. Group at the delivery date of each phase also applies.

No compensation is paid for expected dividends from the shares that the employees do not receive before physical delivery of the shares. This fact is taken into account in determining the fair value.

Because the “Talent for the Future Share Plan“ is a plan with settlement by equity instruments and because Telefónica, S.A. undertakes this settlement, the personnel expenses are recognised on a pro rata temporis basis over the vesting period with a corresponding entry in the equity of Telefónica Deutschland Group.

There is a recharge agreement in place between Telefónica, S.A. and Telefónica Deutschland Group in relation to the shares that are delivered to employees in Germany. This recharge is done by reducing equity and a corresponding increase of the liabilities to Telefónica, S.A.

(In units)	2014
Share options as of 1 January	**0**
Addition of share options	45,000
Share options as of 31 December	**45,000**

"Restricted Share Plan" (equity-settled)

The "Restricted Share Plan" ("RSP" or "the plan") is a long-term remuneration plan of Telefónica, S.A. Group, also applicable for the Telefónica Deutschland Group and implemented for top talents and employees with key qualifications and optimally maintaining the motivation of employees in key positions and employees with high potential.

A restricted share option can be granted under the plan only between 2011 and 2015. Within Telefónica Deutschland Group, only one member of the Managing Board of Telefónica Deutschland Holding AG is currently participating in the plan.

The Supervisory Board has set the level of the Restricted Share Plan at a fixed annual salary of the plan beneficiary. The shares are assigned no later than 90 days after the vesting period ends.

No compensation is paid for expected dividends from the shares that the participant does not receive before physical delivery of the shares.

The shares are allocated in three equal tranches over a period of three years, provided the plan beneficiary is in employment at Telefónica Deutschland Holding AG at the relevant allocation date (if applicable, for each of the tranches).

	Maximum No. of shares granted	Grant-date fair value per unit	End date
1 October 2014	65,990	12.12	
First Tranche	21,997	0	30 September 2015
Second Tranche	21,997	0	31 January 2016
Third Tranche	21,997	0	31 January 2017

(In units)	2014	2013
Share options as of 1 January	**0**	**0**
Addition of share options	65,990	0
Share options as of 31 December	**65,990**	**0**

"Performance Cash Plan" (cash-settled)

The plan is operating under the same vesting conditions as the Performance and Investment Plan. The plan involves the delivery of a certain number of theoretical shares in Telefónica, S.A. to key personnel that are, if applicable, settled in cash at the end of each phase. The payment is equivalent to the market value of Telefónica, S.A. shares on the settlement date up to a maximum of three times the notional value of the shares on the delivery date.

The payment is made by the respective legal entity of Telefónica Deutschland Group, which undertakes the settlement.

The value of the theoretical shares is established as the average share price in the period of 30 days immediately before the start of a phase; except for the first phase, where the average share price during the 30 days before 11 May 2006 (EUR 12.83) was used as the reference.

The duration of the plan is seven years, with six phases, each of three years, beginning in 2006, whereby the first phase began on 1 July 2006, and ended on 30 June 2009. The sixth and last phase began on 1 July 2011, and ended on 30 June 2014.

Like the "Performance and Investment Plan", the basis for the performance-based rate for the payments is the total shareholder return of Telefónica, S.A. compared to the total shareholder return of the peer group, in line with the same criteria.

As of 30 June 2014, the fair value of the shares that were delivered in each phase in force at that time was EUR 12.52 per share. The value is calculated by using the price of a Telefónica, S.A. share as the basis and in addition taking into account the estimated total shareholder return. This value is updated in each case at the end of the year.

The market condition that requires the Telefónica, S.A. shares to reach a prescribed performance goal was incorporated by means of the Monte Carlo method described above in determining the fair value.

The service condition which requires that the plan beneficiary must be employed by a Telefónica, S.A. company until the end of the vesting period is considered in determining the number of equity instruments to be taken into account at the grant date.

Because this plan is a cash-settled plan, it is accounted for by recording personnel expenses and a corresponding liability.

The total shareholder return of Telefónica, S.A. is below the median for the peer group and included the following number of cash-settled options that have forfeited:

(In units)	2014	2013
Share options as of 1 January	**91,740**	**200,431**
Change in Employees	(3,170)	(13,640)
Forfeited share options	(88,570)	(95,051)
Share options as of 31 December	**0**	**91,740**

"Global Employee Share Plan" (equity-settled)
This plan was a share incentive plan for all employees of Telefónica, S.A. Group, also applicable for the Telefónica Deutschland Group with certain exceptions. Under this plan, participants who met the qualifying requirements were offered the opportunity to acquire shares of Telefónica, S.A. and to receive the same number of shares free of charge at the end of the period.

The shares were delivered by Telefónica, S.A. This is the ultimate parent company which undertook the settlement.

The duration of the plan was two years. Employees who participated in the plan could acquire Telefónica, S.A. shares through monthly instalment payments of up to EUR 100 and up to a maximum of EUR 1,200 for a twelve-month period (acquisition period). The shares were purchased at fair value on the acquisition date. The employees who participated in the plan were entitled to dividend payments with respect the acquired shares. The shares were delivered on 1 December 2014, whereby the following vesting conditions had to be fulfilled:
— The beneficiary had to be continuously employed during the two-year duration of the plan with a Telefónica, S.A. company (consolidation period), with the exception of employees leaving for a good cause.
— The beneficiary had to retain the acquired shares for an additional twelve months after the end of the acquisition period.

The vesting period for this plan ended on 30 November 2014. 144,272 shares were delivered to 1,605 plan participants:

As of 31 December	No. of shares delivered	Weighted average of grant date fair value per unit
2014	144,272	11.01

The fair value of the equity instruments granted to employees was determined by means of the share price of the Telefónica, S.A. shares at grant date.

The non-market-related vesting condition which required that the beneficiary had to be employed by a company of the Telefónica, S.A. Group until the end of the vesting period was taken into account in determining the number of the equity instruments under consideration at grant date. The amount to be recognised was thus based on the number of ultimately exercisable equity instruments.

In determining the fair value, the holding condition was taken into account, which is a non-vesting condition.

No compensation was paid for expected dividends from shares that the employee did not receive before physical delivery of the shares. This fact was taken into account in determining the fair value.

The Global Employee Share Plan was an equity-settled plan and was accounted for by a debit to personnel expenses and a credit to equity.

There was a recharge agreement in place between Telefónica, S.A. and Telefónica Deutschland Group in relation to the shares that were delivered to employees in Germany. This recharge was recognised with a reduction in equity and a corresponding liability to Telefónica, S.A.

(In units)	**2014**	2013
Share options as of 1 January	**150,417**	**14,438**
Addition of share options	0	135,979
Change in Employees	(6,145)	0
Exercise of share options	(144,272)	0
Share options as of 31 December	**0**	**150,417**

Personnel expenses resulting from share-based payment transactions

In the financial year ending December 31, the following personnel expenses resulting from share-based payment transactions were recorded:

	As of 31 December	
(Euros in millions)	**2014**	2013
Personnel expenses arising from share-based payment transactions	2	2
Thereof from cash-settled plans	*0*	*0*
Thereof from equity-settled plans	*2*	*2*

16. Information Regarding Employees

The following table presents the breakdown of Telefónica Deutschland Group's average headcount in 2014 and 2013 grouped with respect to their status under labour law:

Average headcount[1]	**2014**	2013
Office staff	6,609	5,461
thereof from joint operations	10	9
Temporary staff	613	521
Total	**7,222**	**5,982**

1 The employees of the E-Plus group are included from 1 October 2014 (for further information refer to Note No. 2 Significant Events and Transactions in the Financial Year).

17. Financial Instruments and Risk Management

General financial market risks

The Telefónica Deutschland Group is exposed to various financial market risks as part of its business activity. Due to Telefónica Deutschland Group's regional focus of its activities, however, it is not significantly affected by e.g. foreign currency risks. The Telefónica Deutschland Group is exposed to the risk of default from operative business (trade receivables). Related parties receivables are mainly related to a subsidiary of Telefónica, S.A. Group.

In addition there are liquidity risks for the Telefónica Deutschland Group that are connected with credit risks, market risks, a weakening of operative business or disruptions of the financial market.

If such financial risks occur, they may lead to negative impacts 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 solely 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 monitoring with regards to the use of financial derivatives.

Market risk

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

Currency risk

The underlying currency of the financial reports of the Telefónica Deutschland Group is the Euro. All financial statements of all subsidiaries of Telefónica Deutschland Group are also prepared in Euro; thus the Telefónica Deutschland Group is not subject to any translation risk. However, aside from the translation risks there is a transaction risk that primarily arises from the business relationship of the Telefónica Deutschland Group with its suppliers or business partners in countries with a different national currency than the Euro. Because the Telefónica Deutschland Group finances itself exclusively through self-generated cash in Euro as well as Euro-denominated equity and debt, there is no exchange rate risk through debts that are denominated in a different currency than the Euro. The net risk position from foreign currency risks in the statement of financial position is comprised of non-derivative and derivative financial instruments denominated in foreign currencies, as well as future positions in foreign currencies in the following year.

Derivatives are contracted with Telefónica, S.A. Group Treasury to hedge against identified key currency risks.

The effects before taxes on the Consolidated Income Statement and thus equity of a simultaneous, parallel increase in the Euro of 10% as against all foreign currencies in the financial years 2014 and 2013 would have been as follows:

	1 January to 31 December			
	2014		2013	
(Euros in millions)	**Risk**	**+ 10%**	Risk	+ 10%
USD	(14.1)	1.3	0.0	0.0
GBP	0.2	0.0	0.0	0.0

Because Telefónica Deutschland Group did not use cash flow hedge accounting, the effect of the sensitivities would only have affected the Consolidated Income Statement.

Interest rate 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. The Telefónica Deutschland Group deposits cash surpluses almost exclusively in cash pooling and deposit accounts with Telfisa Global B.V., Netherlands. These accounts and the bank accounts pay a variable interest rate. The loan agreements where the Telefónica Deutschland Group is the borrower carry a variable interest rate. In November 2013 and February 2014, interest rate swaps were signed in each case in connection with the issue of bonds for a partial amount of the bonds' nominal values. On the basis of these interest swaps 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. These interest rate swaps compensate, to the level of their nominal amounts, the effects of future market interest rate changes on the fair value of the underlying fixedinterest financial liabilities from the bond issues (fair value hedge). Hedge accounting for these hedge relationships complies with IAS 39. At the start of each hedge relationship,both the relationship between the hedge instrument and the underlying transaction as well as the goal and strategy of the hedge were documented. A specific allocation of the hedging instrument to the corresponding liability took place and an estimate of the degree of effectiveness of the hedging relationship was made. The existing hedging relationship is continuously monitored for effectiveness.

The net risk position for variable interest for Telefónica Deutschland Group as of the reporting dates 31 December 2014 and 2013, was EUR 643 million and EUR –341 million respectively, which is essentially attributable to the loan, the interest swap and the cash and cash equivalents deposited with Telfisa Global B.V.

In the reporting periods, Telefónica Deutschland Group concluded two interest rate swaps as a hedging instrument in the financial years 2014 and 2013 (see Interest rate risk management below).

The effects before taxes on the Consolidated Income Statement of a change in the interest rates of variable interest-bearing financial instruments of +/- 100 basis points as of the reporting dates 31 December 2014 and 2013, are shown below. There is no impact recognised directly in equity. This analysis assumes that all other variables remain unchanged.

	1 January to 31 December	
(Euros in millions)	2014	2013
+ 100 bp	6	(3)
– 100 bp	5	8

Credit risk

Credit risk describes the risk of financial losses from the inability of contractual partners to repay or service debts in accordance with the contract. The Telefónica Deutschland Group's maximum credit risk corresponds with the carrying amount of the financial assets (without considering any guarantees or securities).

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. Suitable processes have been established for the management and the monitoring of the credit risk.

This approach for credit risk management is based on the ongoing monitoring of the expected risks and the level of default. Here, particular attention is paid to customers who can have a significant effect on the Consolidated Financial Statements of Telefónica Deutschland Group and for whom, depending on the business area and the type of relationship, appropriate credit management instruments are used such as credit insurance or security to limit the credit risk. To control the credit risk, the Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and only reports adjustments for doubtful receivables with a credit risk. The Telefónica Deutschland Group has concluded cash pooling and deposit agreements with Telfisa Global B.V. with regards to its cash surpluses in accordance with Telefónica corporate policy, and it deposits the majority of its cash surpluses there. The majority of cash surpluses of the Telefónica Deutschland Group are thus concentrated in Group companies of the Telefónica, S.A. Group. Telefónica, S.A. is rated by international rating agencies with an investment grade rating. The remaining cash surpluses are distributed across several German banks that have been rated by international rating agencies with investment grade.

The financial assets for which Telefónica, S.A. Group was a counterparty amounted to EUR 1,726 million as of 31 December 2014, and EUR 727 million as of 31 December 2013. There are financial liabilities to KPN Group of EUR 14 million as of 31 December 2014, and EUR 0 million as of 31 December 2013.

Liquidity risk

Liquidity risk includes the risk that a business cannot comply with its financial obligations, which are processed either in cash or with other financial assets. To manage liquidity risk, the Telefónica Deutschland Group ensures that it has sufficient liquidity at all times to fulfil its obligations, both under normal and under demanding circumstances. The Telefónica Deutschland Group works on its liquidity management closely with Telefónica, S.A. Group and, in accordance with the corporate policy, has concluded cash-pooling and deposit agreements with Telfisa Global B.V., Netherlands. It deposits the majority of its cash surpluses there. Liquidity risk is reduced by the inflowing funds generated by the operative business of the Telefónica Deutschland Group, by the opportunity to factor receivables and by maintaining (currently unused) credit facilities.

In August and September 2012 Telefónica Germany GmbH & Co. OHG concluded agreements with various banks for revolving credit facilities. As a result, Telefónica Germany GmbH & Co. OHG has, as of the reporting date 31 December 2014, undrawn committed credit lines in a total amount of EUR 710 million with a maturity beyond one year. In all agreements the interest corresponds to the sum of margin and Euribor.

Telefónica Deutschland Holding AG has authorised capital which allows the Management Board, upon approval of the Supervisory Board, to increase the share capital up until September 2017 for cash and/or contributions in kind once or several times by a total of up to EUR 558,472,700 by issuing new registered shares with no-par value (authorised capital 2012/I) and to carry out a cash increase for contributions in kind of up to EUR 475 million (authorised capital 2014/I).

In 2014, Telefónica Deutschland's share capital was increased by EUR 1,117 million by way of a capital increase for cash, entered in the commercial register on 18 September 2014, and by EUR 741 million by way of a capital increase for contributions in kind, entered in the commercial register on 7 October 2014, to a total of EUR 2,975 million (see Note No. 5.9 Equity and Note No. 21 Events after the Reporting Period).

Cash and cash equivalents amounted to EUR 1,702 million as of 31 December 2014, and EUR 709 million as of 31 December 2013).

The following table shows the maturity profile of the financial liabilities of Telefónica Deutschland Group on the basis of the contractual undiscounted payments:

	As of 31 December 2014				
			remaining term		
(Euros in millions)	**Total carrying amount**	**Gross cash outflow**	**< 1 years**	**1–5 years**	**> 5 years**
Non-current interest-bearing debt	1,800	1,951	26	1,401	524
Non-current trade and other payables	19	19	0	18	1
Current interest-bearing debt	615	636	636	0	0
Current trade and other payables	2,283	2,283	2,283	0	0
Financial liabilities	**4,717**	**4,889**	**2,945**	**1,419**	**525**

	As of 31 December 2013				
			remaining term		
(Euros in millions)	Total carrying amount	Gross cash outflow	< 1 years	1–5 years	> 5 years
Non-current interest-bearing debt	1,344	1,447	0	1,447	0
Non-current trade and other payables	3	3	0	3	0
Current interest-bearing debt	104	120	120	0	0
Current trade and other payables	1,271	1,271	1,271	0	0
Financial liabilities	**2,722**	**2,841**	**1,391**	**1,450**	**0**

Capital management

The Telefónica Deutschland Group strives to guarantee the sustainability of its business and to maximise the business value. It monitors its capital costs with the goal of an optimal capital structure. In particular, the Telefónica Deutschland Group monitors its equity ratio and OIBDA.

As of 31 December 2014, the equity ratio was 63.7% and 66.5% in 2013. OIBDA from continuing operations was EUR 679 million in 2014 and EUR 1,237 million in 2013.

Interest rate risk management

The interest rate risk results from the sensitivity of financial assets and liabilities in relation to changes on the market interest rates. The corporation strives to limit such risks by using interest rate swaps.

Fair value hedge for fixed interest financial liabilities

In November 2013 and February 2014, interest swaps of EUR 200 million and EUR 150 million were signed in connection with the issue of one bond in each case. On the basis of the existing interest swap contracts, Telefónica Deutschland Group pays a variable interest rate on a nominal amount and in return receives a fixed interest rate on the same amount as consideration. The interest swaps compensate for the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities. Telefónica Deutschland Group records the interest swaps in the Consolidated Statement of Financial Position at fair value. The company recognises the corresponding portion of the fixed-interest financial liabilities that are thereby hedged as the sum of their carrying amount and a value adjustment. The value adjustment corresponds to the change in the fair value of the financial liabilities on the basis of the relevant hedged interest risk. Changes in the fair value of the interest swaps as well as the changes in the adjustment to the carrying amount of the hedged portion of the fixed-interest financial liabilities are recognised in the financial income/(loss) in the Consolidated Income Statement.

18. Contingent Assets and Liabilities

Apart from the suit by Airdata AG, all cases against the frequency shift decisions of the German Federal Network Agency of 3 February 2006, which allocated Telefónica Deutschland Group frequencies in the E-GSM range (900MHz), have been dismissed without possibility of appeal, i.e. these proceedings ended in favour of Telefónica Deutschland Group. The suits from Airdata AG were dismissed by the Cologne Administrative Court. Airdata AG's subsequent appeals were likewise dismissed. In respect to the denial of leave to appeal, Airdata AG filed complaints against the denial of leave to appeal with the Federal Administrative Court. The Airdata AG appeals then filed were rejected by judgements of the Federal Administrative Court dated 26 January 2011. Therefore, the legal disputes before administrative courts have ended in favour of Telefónica Deutschland Group. Against this, Airdata AG has brought constitutional complaints to the Federal Constitutional Court. The chances of success are rated as very low.

Indirect claims against the frequency allocation at 800MHz, 1.8GHz, 2.0GHz and 2.6GHz could result in the reassignment of the 800MHz, 1.8GHz 2.0GHz and 2.6GHz frequencies purchased at the 2010 frequency auction. The above frequencies were (indirectly) contested, as there was pending litigation from several cable network operators, broadcasting companies and Airdata AG against the terms and conditions, on which the frequency allocation was based. This litigation was primarily aimed at the allocation conditions for 800MHz, but also alternatively involved the rescission of the entire allocation decision (i.e. also affecting 1.8GHz, 2.0GHz and 2.6GHz). Apart from the suit by Airdata AG, all cases have since been dismissed at the court of last instance. The legal disputes therefore ended before the administrative court. It is not known whether constitutional complaints were filed. Airdata AG's case was remitted to the Cologne Administrative Court for a new heading in respect to formal irregularities of the frequency allocation decision. The case has since been dismissed again by the Cologne Administrative Court. It is not known whether Airdata AG has lodged an appeal. If Airdata succeeds at the last instance, this could result in the reassignment of the frequencies acquired at the 2010 frequency auction.

On 16 October 2013, the Federal Fiscal Court (Bundesfinanzhof) passed a judgement regarding the free-of-charge provision of wireless communications devices by intermediaries, with a circular published subsequently by the Federal Ministry of Finance (BMF) on the application of the judgement. The current standard sales model of Telefónica Deutschland Group deviates from the situation covered in the judgement, as no IMEI commission is paid. Due to the complex and heterogeneous commission structure on the mobile telephone market, it is not certain that this judgement would have applied to Telefónica Deutschland Group for past situations. It is thus not yet possible to quantify any theoretical effects on taxation and potential recourse claims against retailers.

Proceedings are pending at first instance before the finance court in connection with the VAT treatment of roaming revenues in third countries. They relate to the assessment whether telecommunications services to private customers are subject to German VAT, even if these services are agreed on and billed separately for telephone calls to third countries. The potential amount of additional tax resulting is not material.

It is deemed highly probable that the judgement and the pending proceedings will have no negative impact on VAT for Telefónica Deutschland Group.

Additional contingent liabilities were incurred in connection with the acquisition of E-Plus (for further information see Note No. 2 Significant Events and Transactions in the Financial Year) with effect as of 1 October 2014. For further information, see Note No. 7 Business Combinations.

Telefónica Deutschland Group is, as part of its ordinary business, involved in various proceedings both in court and out of court. Possible effects are of minor significance for the net assets, financial and earnings.

19. Operating Leases and Sublease Agreements

19.1. Operating leases

The following expected maturity dates apply for the obligations from operating leases, purchase and contractual obligations:

	As of 31 December	
(Euros in millions)	**2014**	2013
Less than 1 year	549	316
1 to 5 years	1,396	804
Over 5 years	1,031	790
Total operating lease obligations	**2,976**	**1,910**

	As of 31 December	
(Euros in millions)	**2014**	2013
Less than 1 year	710	185
1 to 5 years	265	46
Over 5 years	710	81
Total purchase and other contractual obligations	**1,685**	**313**

The following amounts are recognised in the Consolidated Income Statement:

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Operate lease expense	418	341

The expenses for operating leases include essentially rental expenses (i.e. office building and shops), antenna sites, cars and network equipment (i.e. leased lines and cell sites).

Telefónica Deutschland Group provides guarantees to secure rental obligations primarily for antenna sites. These guarantees are granted by external financial counterparts and are offered in the course of normal commercial activity.

The guarantees amount to EUR 66 million as of 31 December 2014, and EUR 37 million as of 2013.

19.2. Subleases of operating leases

Telefónica Deutschland Group entered into various sublease agreements for office buildings, cell sites and shops. The estimated payment schedule for subleases is as follows:

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Less than 1 year	35	26
1 to 5 years	86	77
Over 5 years	50	39
Sublease income	**171**	**142**

The following amounts are recognised in the Consolidated Income Statement:

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Total sublease income	28	24

20. Total Auditor's Fees

In the financial years 2014 and 2013, the services listed below performed by the Group's auditor, Ernst & Young GmbH, are recognised in the Consolidated Income Statement.

Because Telefónica Deutschland Group conducts all of its business in Germany, the entire amount is incurred in Germany.

	1 January to 31 December	
(Euros in millions)	**2014**	2013
Type of fees:		
Audit fees	3	2
Other audit-related services	1	0
Total fees	**4**	**2**

The audit fees include primarily the fees for auditing the Consolidated Financial Statements of Telefónica Deutschland Holding AG and fees for auditing separate financial statements. The other audit-related services comprise fees for services relating to the issuance of comfort letters.

21. Events after the Reporting Period

Integration and transformation
The change in the legal form of E-Plus Mobilfunk into a limited liability company (GmbH) was entered in the Commercial Register on 26 January 2015. On 4 February 2015, a profit and loss transfer agreement was concluded with Telefónica Germany GmbH & Co. OHG with effect from 1 January 2015 so that, with effect from 1 January 2015, the E-Plus Mobilfunk GmbH including its income tax group subsidiary companies are integrated in the income tax group of Telefónica Deutschland Group.

Yourfone
The sale of yourfone GmbH to Drillisch AG was closed on 2 January 2015.

Framework redundancy plan
The Management Board and Works Councils of the Telefónica Deutschland Group have agreed in February 2015 on a framework redundancy plan that will apply until the end of 2018. Based on the regulations set out in this plan, the implementation of the redundancy programme announced in autumn 2014 could begin in the first quarter 2015 as planned. In this way, Telefónica Deutschland Group is ensuring clarity for the employees and pressing ahead at full steam with the integration in the context of the acquisition of the E-Plus Group completed at the beginning of October 2014.

Private Placement transaction
On 13 March 2015, Telefónica Deutschland Group closed its inaugural private placement transaction in the form of promissory notes (Schuldscheindarlehen) and registered bonds (Namensschuldverschreibung). The transaction was announced on 2 February 2015, with a target volume of EUR 250 million but closed with a volume of EUR 300 million due to the high oversubscription achieved.

In the promissory note format, unsecured tranches with tenors of 5, 8 and 10 years were issued with both fixed and floating interest rates. In the registered bond format, unsecured tranches with tenors of 12, 15 and 17 years with fixed interest rates were issued. All tranches were issued by Telefónica Germany GmbH & Co. OHG, Munich.

The EUR 52 million sized fixed rate tranche with a 5-year tenor yields 0.961%, the EUR 60.5 million sized floating rate tranche yields an interest of the 6-months Euribor + 65 bps margin.

The EUR 19.5 million sized fixed rate tranche with a 8-year tenor yields 1.416%, the EUR 1.5 million sized floating rate tranche yields an interest of the 6-months Euribor + 85 bps margin.

The EUR 29.5 million sized fixed rate tranche with a 10-year tenor yields 1.769%, the EUR 9 million sized floating rate tranche yields an interest of the 6-months Euribor + 105 bps margin.

The volume of the 12, 15 und 17 year tenor tranches amounts to EUR 3 million, EUR 33 million and EUR 92 million, with respective yields of 2.000%, 2.250% and 2.375%.

All tranches were issued at par.

The promissory notes and registered bonds can be transferred in a minimum amount of EUR 500 thousand.

The proceeds of the transaction will be used for general corporate purposes.

Changes in the Supervisory Board of Telefónica Deutschland
María Pilar López Álvarez resigns from her function as member of the Supervisory Board of Telefónica Deutschland with effect of the end of the Annual General Meeting in which her successor shall be elected.

Declaration of Telefónica Germany on authorisation application of Telefónica Germany GmbH & Co. OHG to award spectrum under "Project 2016" by the Federal Network Agency
As part of the allocation of frequencies under "Project 2016" by the Federal Network Agency in the fields at 700MHz, 900MHz, 1,800MHz and 1.5GHz for mobile access for the supply of telecommunications services, the Telefónica Germany is obligated as parent company of Telefónica Germany GmbH & Co. OHG to ensure unlimitedly that Telefónica Germany GmbH & Co. OHG is equipped in such a way that all funds necessary for the fulfillment of a submitted bid to acquire a frequency in the auction process and all resources needed for the planned investments in the development and expansion as well as the operation of the mobile network will be permanently available. These obligations are based on the specified supply obligations and their time frame.

Procedure on the allocation of frequencies in the ranges 700MHz, 900MHz, 1,800MHz and 1.5GHz
The Federal Network Agency published on 28 January 2015, the presidential chamber's decision on the arrangement and selection of the allocation procedure and on the allocation conditions and auction regulations for the allocation of frequencies in the ranges 700MHz, 900MHz, 1,800MHz and 1.5GHz was finally made and published. With the publication of the decision, the admission procedure for the auction was opened. Telefónica Deutschland Group submitted the applications for admission to the auction to the Federal Network Agency as of 5 March 2015. The auction is scheduled to be held in the second quarter of 2015. Telefónica Deutschland Group has filed an action against the decision of the presidential chamber in the first instance purely in a timely manner, on which has not yet been decided.

Dividend proposal for the 2014 financial year
Management Board of Telefónica Deutschland proposed to the supervisory to suggest to the Annual General Meeting (scheduled on 12 May 2015) the distribution of a dividend in the amount of approximately EUR 714 million respectively EUR 0.24 per share.

There were no material transactions that have an impact on the Consolidated Financial Statements as of 31 December 2014 beyond the above mentioned ones.

22. Declaration of Compliance with the German Corporate Governance Code

On 13 and 14 October 2014, and on 19 December 2014, the Management Board and Supervisory Board of Telefónica Deutschland Holding AG issued the latest declaration of compliance in accordance with section 161 of the German Stock Corporation Act (*Aktiengesetz – AktG*) that is made available for the shareholders on the company's website.
WWW.TELEFONICA.DE/INVESTOR-RELATIONS/CORPORATE-GOVERNANCE/ENTSPRECHENSERKLAERUNG

Munich, 9 March 2015

Telefónica Deutschland Holding AG

The Management Board

Thorsten Dirks   Rachel Empey   Markus Haas

Telefónica Deutschland Holding AG
Declaration of the Statutory Representatives

To the best of our knowledge, and in accordance with the applicable reporting principles, the Consolidated Financial Statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Munich, 9 March 2015

Telefónica Deutschland Holding AG

The Management Board

Thorsten Dirks   Rachel Empey   Markus Haas

Audit opinion

We have audited the consolidated financial statements prepared by Telefónica Deutschland Holding AG, Munich, comprising the consolidated statement of financial position, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flows and the notes to the consolidated financial statements, together with the group management report for the fiscal year from 1 January 2014 to 31 December 2014. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB ["Handelsgesetzbuch": "German Commercial Code"] are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with Sec. 317 HGB 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 consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group 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 consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the group 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 consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, 23 March 2015

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Dahmen	Vogel
Wirtschaftsprüfer	Wirtschaftsprüferin
(German public auditor)	(German public auditor)

Further Information_

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Glossary_

The glossary also contains abbreviations as used in the Group Management Report.

3G	Third generation mobile communications standard (see UMTS)
4G	Fourth generation mobile communications standard (see LTE)
ADSL	Asymmetrical Digital Subscriber Line (see DSL)
ARPU	Average Revenue per User
BKartA	Bundeskartellamt
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
CapEx	Capital Expenditure: Additions in fixed and intangible assets
Carrier	Telecommunication network operator authorized by the federal network agency
CF	Cash flow
Cloud Service	Cloud services are dynamic infrastructure, software or platform services provided online
Convergence	Signifies the bundling of different digital services, which to some extent use different transmission technologies, into one product, e.g. wireless and wireline
Cross-selling	Marketing term denoting the sale of related or complementary products or services
DLD	Digital-Life-Design
DSL	Digital Subscriber Line: technology to transmit data in the local loop to private end-customers
EasT	Experts as Trainers: programme for training and continuing education
EC	European Commission
E-Plus	E-Plus Mobilfunk GmbH & Co. KG
E-Plus Mobilfunk	E-Plus Mobilfunk GmbH & Co. KG
EPM	E-Plus Mobilfunk GmbH & Co. KG
EU	European Union
Euribor	Euro Interbank Offered Rate
FCF	Free cash flow
FNA	Federal Network Agency: Bundesnetzagentur
FTR	Fixed network Termination Rates
GDP	Gross Domestic Product
GfK	Consumer research association (Gesellschaft für Konsumforschung)
GPS	Global Positioning System

GSM	Global System for Mobile Communications: this is the global standard for digital mobile communications
HSPA	High-Speed Package Access
Hosting	Providing storage capacity via the internet
IDR	Issuer Default Rating
Internet	Worldwide network of computers on the basis of an IP (Internet Protocol) without any central network management
IPO	Initial public offering
IT	Information Technology
Joint Venture	Two or more companies founding a new enterprise for cooperation
KPN	Koninklijke KPN N.V., Den Haag, Niederlande
LAN	Local Area Network: a group of computers and associated devices that share a common communications line or wireless link
Libor	London Interbank Offered Rate
Live Check	Website and app which customers can use to get location-based information on the current quality of the O_2 mobile communications network
LTE	Long Term Evolution: further development of the UMTS/HSPA mobile communications standard
M2M	Machine-to-Machine communication, automatic exchange of information between machines
MMS	Multimedia Messaging Service
mpass	Mobile payment service
MTR	Mobile termination rates
Multi-brand strategy	Enables Telefónica Deutschland to provide customers in all segments offers that suit their exact needs through various own and partner brands
MVNO	Mobile Virtual Network Operator
NFC	Near Field Communication: a short-range wireless connectivity standard
NGO	Non Governmental Organisation
n.m.	not measured
NRA	National Regulatory Authority
O2 (Europe) Limited	O2 (Europe) Limited, Slough, Vereinigtes Königreich
O_2 My Handy	Monthly payment model for mobile phones and other devices
OHG	Telefónica Germany GmbH & Co. OHG, München
OIBDA	Operating Income before Depreciation and Amortisation
OTT	Over The Top
PBX	Private Branch Exchange: a telephone system within an enterprise that switches calls between enterprise users on local lines while allowing all users to share a certain number of external phone lines
PIP	Performance and Investment Plan

POS	Point of Sale
Prepaid/Postpaid	In contrast to postpaid contracts, prepaid communication services are services for which credit has been purchased in advance with no fixed-term contractual obligations
Retail	Sale of goods and services to end users; as opposed to resale or wholesale business
Roaming	Using a communication device or subscriber identity in a different network other than one's home network
SIM	Subscriber Identity Module: a chip card to insert into a mobile phone and identifies the user within the network
SIP	Session Initiation Protocol: an Internet Engineering Task Force (IETF) standard protocol for initiating an interactive user session that involves multimedia elements such as video, voice, chat, gaming, and virtual reality
Smartphone	Mobile handset that can be used as a wireless phone, a web browser, and an e-mail reader simultaneously
SME	Small and Medium-sized Enterprises
SMS	Short Message Service
SoHo	Small and Home offices
Tablet	A wireless, portable personal computer with a touch screen interface
Telefónica	Telefónica, S. A., Madrid/Spain
Telefónica Deutschland	Telefónica Deutschland Holding AG (former: Telefónica Germany Verwaltungs GmbH), Munich
Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telefónica Group	The companies included in the Consolidated Financial Statements of Telefónica
ULL	Unbundled Local Loop: bridges the distance between the local exchange and the termination point on the customer's premises or in their home, so it is also known as the "last mile"
UMTS	Universal Mobile Telecommunications Service: international mobile communications standard of the third generation which unites mobile multimedia and telematics service under the frequency spectrum of 2GHz.
VAT	Value Added Tax
VDSL	Very High Data Rate Digital Subscriber Line (see DSL)
VPN	Virtual Private Network
WAN	Wide Area Network: a geographically dispersed telecommunications network
Wholesale	Selling services to third parties who sell them to their own end customers either directly or after further processing

Imprint_

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