

Telefónica Deutschland  
Interim Group Report  
1 January to 30 June

2 0 1 6



**SHAPING  
THE LEADING  
DIGITAL  
TELCO**

*Telefónica*

Deutschland

# Portrait of Telefónica Deutschland\_



Thorsten Dirks (CEO), Rachel Empey (CFO), Markus Haas (COO)  
(from left to right)

Telefónica Deutschland is well on its way to becoming the Leading Digital Telco in Germany. As a future Onlife Telco, the company's aim is to enable customers to use the achievements of digitalisation in a way that caters to their desires, preferences and customs, while also retaining sovereignty over their data and remaining the masters of their own digital lives.

Having made significant progress with the integration of the E-Plus Group, Telefónica Deutschland is shifting its focus towards the digitalisation of its business and giving its customers and partners easier access to the digital world. This centres on the best experience in terms of network, products and services, combined with excellent value for money. With 43.4 million mobile connections<sup>1</sup>, Telefónica Deutschland is the German market leader. The company, which has also included the E-Plus Group since 1 October 2014, maintains 48.6 million customer connections<sup>1</sup> overall, making it one of the three leading integrated telecommunications providers in Germany. Revenues in 2015 amounted to EUR 7.89 billion. The company, which has been listed on the Frankfurt Stock Exchange since 2012, offers mobile and fixed services for private and business customers, including telephony, data and value-added services. The indirect majority shareholder is the Spanish company Telefónica, S.A. – one of the world's largest telecommunications providers.

The company's premium brand is O<sub>2</sub>. As part of its multi-brand strategy, Telefónica Deutschland also reaches additional customer groups through a wide range of secondary and

partner brands, including Blau, BASE, AY YILDIZ and Ortel Mobile as well as ALDI TALK and TCHIBO mobil. Thanks to its successful multi-brand strategy, the company is a leading provider of smartphone tariffs and products. Telefónica Deutschland is setting standards on the German telecommunications market with its innovative, customer-friendly solutions. Telefónica Deutschland is also one of the leading providers of wholesale services. Large multinational business customers can also make use of Telefónica's group-wide product and service offering.

These products and services build on a network infrastructure that is one of the most advanced in Europe. As part of the merger with the E-Plus Group, the company is making good progress in combining the two previously separate networks to create an even more powerful joint wireless communications network. A first milestone was reached in May 2015 with national roaming. Since then, the UMTS networks of O<sub>2</sub> and E-Plus have been interconnected and all customers have benefited from the pooled strength of both networks. Around 77% of the population had access to LTE technology by the end of June, thereby enabling significantly higher mobile data transmission speeds. A joint LTE network has also been under construction since summer 2016. In June 2015, Telefónica Deutschland invested EUR 1.2 billion in securing a valuable 60 MHz mobile spectrum at a frequency auction in June 2015. The acquired frequencies will allow the high-speed network to be expanded and the monetisation of the growing data business to be further improved. Following allocation, the total capacity of 358 MHz gives Telefónica an excellent starting point from which to continue offering its customers the best network experience. As an integrated

<sup>1</sup> as of 30 June 2016

provider, Telefónica Deutschland also sells wireline and DSL products. This includes high-speed VDSL connections, which the company provides under a long-standing partnership with Deutsche Telekom with a potential reach of more than 20 million German households.

Building on this strong infrastructure, Telefónica Deutschland brings technology to the people and helps to drive progress in society through digital products and services. To this end, Telefónica Deutschland is establishing two new business areas: Advanced Data Analytics (ADA) and Internet of Things (IoT). In the area of Advanced Data Analytics, Telefónica Deutschland is focusing on the considerable social and economic benefits that can be gained by

analysing large volumes of data. As the largest mobile communications provider in Germany by customers, Telefónica Deutschland's normal business processes give rise to a wide range of data whose analysis can deliver valuable insights. In the area of the Internet of Things, the company offers solutions for the intelligent networking of devices, machines and vehicles in cooperation with partners.

With its Think Big initiative, the company is championing young people in particular and has supported almost 3,500 projects in this area since 2010. As a socially responsible company, Telefónica Deutschland is also committed to shaping the future of mobile communications in Germany in a fair, ecologically responsible and forward-looking manner.

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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.

# Financial Highlights First Halfyear 2016\_

At the end of June 2016, Telefónica Deutschland's access base was 48.6 million driven by a 1.9% year-on-year increase in the mobile customer base, which stood at 43.4 million. Mobile postpaid continued to show good momentum in the market with 520 thousand net additions in the first six months and the customer base was up 2.5% year-on-year to 19.6 million accesses. Mobile prepaid customer base stood at 23.8 million accesses at the end of June (+1.3% year-on-year).

As expected, mobile service revenue performance (-1.5% year-on-year to EUR 2,694 million) was a reflexion of the increasing competitive dynamics across segments in German mobile and the associated strength of the partner business which resulted in a higher share of wholesale revenues. While we maintained our focus on the development of our customer base through retention and upselling mechanisms, we continued to see headwinds from regulatory and legacy base effects as well as OTT effects. In contrast, mobile data revenues continued to rise (+5.6% year-on-year to EUR 1,478 million).

OIBDA in the period up to June 2016 benefitted from a net capital gain of EUR 352 million from the sale of our passive tower infrastructure to Telxius S.A. in the second quarter of the year. Excluding exceptional and special effects<sup>1</sup> OIBDA grew by 3.5% year-on-year as result of in-year savings from integration activities (Opex and revenue) of approximately EUR 95 million and higher year-on-year Opex effects relating to transformation activities. As a result the OIBDA margin increased by 1.7 percentage points year-on-year to 23.3%

## Mobile Accesses

(in thousands)

### +1.9%



## Mobile Service Revenues

(Euros in millions)

### -1.5%



## OIBDA/OIBDA Margin (excluding exceptional and special effects)<sup>1</sup>

(Euros in millions)

### +3.5%



## Summary of the financial outlook for 2016

	Base line 2015 (EUR million)	Initial Outlook 2016 (year-on-year pct. growth)	Updated Outlook 2016 (year-on-year pct. growth)
MSR	5,532	Slightly negative to broadly stable	Slightly negative
OIBDA before exceptional and special effects	1,760	Low to mid-single-digit % growth	Low to mid-single-digit % growth
CapEx	1,032	% growth in the low tens	mid to high single-digit % growth

<sup>1</sup> As of 30 June 2016 exceptional effects include restructuring expenses of EUR 37 million and the net capital gain from the sale of passive tower infrastructure to Telxius S.A. amounting to EUR 352 million, while in the same period of 2015 a one-off gain from the sale of yourfone GmbH was registered. As of 30 June 2016 special effects consist of the impact which the Telxius deal had on OIBDA (EUR -6 million in the first six months of 2016) resulting primarily from higher operating lease expenses starting in May 2016.

## Financial Overview

(Euros in millions)	1 January to 30 June		
	2016	2015	% Change
<b>Revenues</b>	<b>3,691</b>	<b>3,849</b>	<b>(4.1)</b>
Mobile service revenues	2,694	2,735	(1.5)
<b>OIBDA before exceptional and special effects<sup>1</sup></b>	<b>860</b>	<b>831</b>	<b>3.5</b>
<b>Operating income before depreciation and amortisation (OIBDA)</b>	<b>1,170</b>	<b>845</b>	<b>38.3</b>
OIBDA margin	31.7%	22.0%	9.7%-p.
<b>Operating income</b>	<b>100</b>	<b>(188)</b>	<b>&gt;(100)</b>
<b>Profit for the period</b>	<b>83</b>	<b>(213)</b>	<b>&gt;(100)</b>
<b>Basic earnings per share (in Euros)<sup>2</sup></b>	<b>0,03</b>	<b>(0,07)</b>	<b>&gt;(100)</b>
<b>CapEx<sup>3</sup></b>	<b>(430)</b>	<b>(463)</b>	<b>(7.1)</b>
<b>Operating cash flow (OIBDA-CapEx)</b>	<b>740</b>	<b>383</b>	<b>93.3</b>
<b>Free cash flow pre dividends and payments for spectrum<sup>4</sup> and pre-acquisition of E-Plus net of cash acquired</b>	<b>599</b>	<b>102</b>	<b>&gt;(100)</b>
<b>Total accesses as of 30 June (in thousands)</b>	<b>48,605</b>	<b>48,041</b>	<b>1.2</b>
Mobile accesses (in thousands)	43,417	42,617	1.9
<b>Postpaid (%)</b>	<b>45.2%</b>	<b>44.9%</b>	<b>0.3%-p.</b>
<b>Total ARPU (in EUR)</b>	<b>10.4</b>	<b>10.7</b>	<b>(3.5)</b>
<b>Postpaid churn excl. M2M (%)</b>	<b>1.7%</b>	<b>1.7%</b>	<b>(0.0%-p.)</b>
<b>(%) non-SMS data over total data revenues</b>	<b>76.1%</b>	<b>71.0%</b>	<b>5.1%-p.</b>
<b>Employees as of 30 June</b>	<b>9,085</b>	<b>10,447</b>	<b>(13.0)</b>
	<b>As of 30 June 2016</b>	As of 31 December 2015	% Change
<b>Net financial debt<sup>5</sup></b>	<b>1,356</b>	<b>1,225</b>	<b>10.8</b>
Leverage <sup>6</sup>	0.8x	0.7x	9.3

1 As of 30 June 2016 exceptional effects include restructuring expenses of EUR 37 million and the net capital gain from the sale of passive tower infrastructure to Telxius S.A. amounting to EUR 352 million, while in the same period of 2015 a one-off gain from the sale of yourfone GmbH was registered. As of 30 June 2016 special effects consist of the impact which the Telxius deal had on OIBDA (EUR -6 million in the first six months of 2016) resulting primarily from higher operating lease expenses starting in May 2016.

2 Basic earnings per share are calculated by dividing profit (loss) after taxes for the period by the weighted average number of ordinary shares of 2.975 m for the years 2016 and 2015.

3 Excluding investments in spectrum in June 2015 amounting to EUR 1,198 million and excluding capitalised cost on borrowed capital.

4 Free cash flow pre dividends and payments for spectrum is defined as the sum of cash flow from operating activities and cash flow from investing activities and does not contain payments for investments in spectrum amounting to EUR 978m as well as related interest payments.

5 Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents. Current and non-current financial assets include handset - receivables (current: EUR 327m in 2016 and EUR 321m in 2015; non-current: EUR 132m in 2016 and EUR 157m in 2015), positive Fair value Hedge for fixed interest financial liabilities (current: EUR 2m in 2016 and EUR 2m in 2015; non-current: EUR 15m in 2016 and EUR 12m in 2015) as well as loans to third parties (current: EUR 1m in 2016 and EUR 1m in 2015; non-current: EUR 0m in 2016 and EUR 1m in 2015). Current and non-current net financial debt include bonds, promissory notes and registered bonds issued (EUR 1,421m in 2016 and EUR 1,420m in 2015), other loans (EUR 598m in 2016 and EUR 501m in 2015), finance lease payables (current: EUR 73m in 2016 and EUR 180m in 2015; non-current: EUR 17m in 2016 and EUR 32m in 2015) as well as current interest bearing trade payables (EUR 0 in 2016 and EUR 119m in 2015).

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

Pending payments for spectrum amounting to EUR 221m (including capitalised costs of borrowed capital) are shown under trade payables against third parties in the Consolidated Statement of Financial Position and are therefore not included in the net financial debt calculation.

6 Leverage is defined as net financial debt divided by the OIBDA for the last twelve months before exceptional effects.

## Share price performance 2016

1 January to 30 June, rebased



## Economic and Capital Market Environment\_

Geopolitical events such as the Ukraine crisis and the upheaval in the Middle East were the main drivers of international capital markets in the first half of 2016. Above all, declines in share prices were driven by the economic weakness in Asia and the crisis in the international commodity markets with lows in oil prices. In addition, there were terrorist attacks in Paris, Brussels and Istanbul. To stimulate the economy and to respond to the low inflation in the euro area, the ECB in March for the first time reduced interest rate to zero percentage points and extended the bond purchase program. However, the most far-reaching turbulences on the international capital markets were led by the referendum in the United Kingdom for the so-called "Brexit".

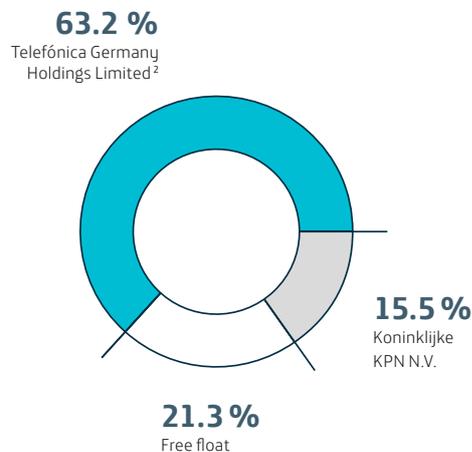
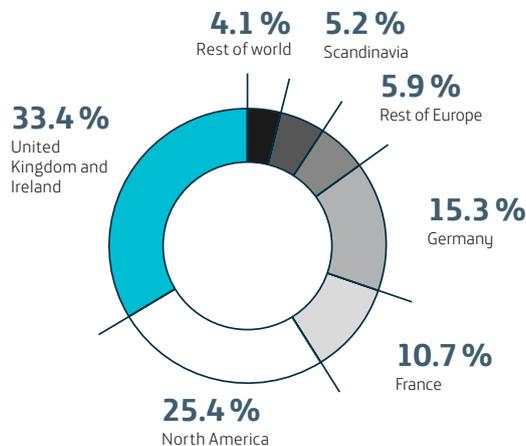
Regardless of the events, the German economy in the first six months of 2016 showed a moderate stable growth. After a low in early February, the DAX recovered, but dropped again after the Brexit-vote and ended the first half of the year with a decline of 9.9% to 9,680 points. The Stoxx 600 ended the half year with a loss of 9.8%. The European telecommunications registered a decline of 12.7%, slightly weaker than broader markets.

Telefónica Deutschland's share performed broadly in line with sector and markets in the first four months of the year. Upon release of the preliminary results for the first quarter of

2016, which were in line with expectations, the share price retreated significantly driven by short-term oriented investors. This is mainly due to growing uncertainties related to the currently dynamic market environment. The share ended the first half of 2016 at EUR 3.693; a decline of 24.5%.

### Share data

Share type	No-par value registered shares
Notional amount per share	EUR 1.00
German securities identification number (WKN)	A1J5RX
International securities identification number (ISIN)	DE000A1J5RX9
Ticker symbol	O2D
Segment	Prime Standard
Index	TecDAX
Sector	Telecommunications

**Shareholder structure<sup>1</sup>****Geographical distribution of free float<sup>3</sup>**

<sup>1</sup> According to shareholder register as of 30 June 2016.

<sup>2</sup> Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.

<sup>3</sup> According to shareholder ID, May 2016

## Shareholder Remuneration\_

We reiterate our general dividend policy, which includes a high payout ratio in relation to free cash flow. At the same time, we continue to place great emphasis on financial flexibility and a conservative financing policy; supported by a target leverage ratio of at or below 1.0x net debt/OIBDA for the medium term that will be continually reviewed.

On 27 July 2016, the Management Board of Telefónica Deutschland announced its intention for annual dividend growth over the next three years, starting with a dividend proposal to next Annual General Meeting of EUR 0.25 per share for the financial year 2016.

**Telefónica Deutschland Group fixed income**

Issue date	Currency	Volume	Tenor	Coupon	Instrument rating	Listing
22 November 2013	EUR	600,000,000	5 years	1.875%	BBB, stable outlook	Regulated market of the Luxemburg Stock Exchange
10 February 2014	EUR	500,000,000	7 years	2.375%	BBB, stable outlook	Regulated market of the Luxemburg Stock Exchange

Telefónica Deutschland has a long-term issuer credit rating by rating agency Fitch, which is subject to regular evaluation. On 26 January 2016, the agency confirmed the BBB rating with a stable outlook.

# Highlights January to June 2016\_

## Products & Brands\_

### 1 — New shop concept for O<sub>2</sub>

Telefónica is comprehensively redesigning its O<sub>2</sub> shops in Germany. The new concept focuses on customers and digitalisation. Surrounded by the new shop design, visitors will not only be inspired by new products and services in specially themed areas, but will also get to experience the possibilities of the digital world. In addition to workshops, specially trained O<sub>2</sub> gurus will provide customers with assistance and support. The rollout of the new shop concept is set to take place over the next three years. The process began at the start of the year in cities including Berlin, Frankfurt, Munich and Cologne.



### 2 — Mobile and DSL in one: O<sub>2</sub> Blue One

Simple, transparent, customised mobile and DSL bundles have been available to customers since 1 February in the form of the new product category O<sub>2</sub> Blue One. Under the motto "Alone is good, together is better", O<sub>2</sub> Blue One gives customers exactly the combination of mobile and DSL they require – while saving them money in the process. From entry-level customers to frequent users, O<sub>2</sub> Blue One offers the right combination for everyone with excellent value for money. Customers on the basic and medium tariffs are already benefiting from monthly savings of up to EUR 5, while customers on the higher-end tariffs are saving as much as EUR 10 per month.

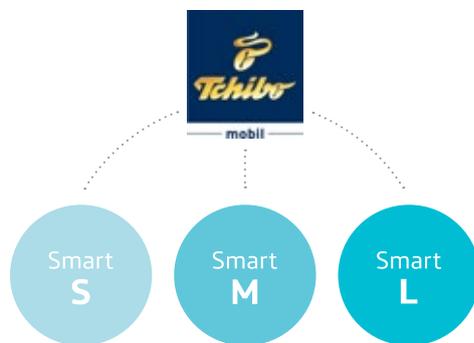
### 3 — Telefónica Deutschland transfers BASE and E-Plus tariffs to the O<sub>2</sub> brand family

Telefónica Deutschland is standardising its brand and tariff family as part of the integration of E-Plus. In the future, it will focus on the O<sub>2</sub> brand in the premium segment. In February, BASE and E-Plus customers therefore began being gradually transferred to O<sub>2</sub> over the following months. The tariff conditions and contract terms remain unchanged. Following the changeover to O<sub>2</sub>, all customers of both brands will receive the same services at the same price as in their previous BASE and E-Plus tariffs. With this move, Telefónica Deutschland is simplifying its product range in the premium segment and offering its customers uniform high-quality products and services under a single brand.



#### 4 — First smartwatch with eSIM from O<sub>2</sub>

Telefónica Deutschland is bringing the first smartwatch with eSIM to the market: The Samsung Galaxy Gear S2 classic 3G, as presented at the Mobile World Congress, will be available in selected O<sub>2</sub> shops from April. It has its own mobile communications unit and an embedded SIM on which the customer's SIM profile is installed electronically, meaning a physical SIM card is no longer required.



#### 5 — Brand enhancement: The new TCHIBO mobil

As part of the digitalisation process, the Hamburg-based coffee company Tchibo has extensively enhanced the joint prepaid brand TCHIBO mobil in terms of both image and product range. After all, mobile communication is not meant to rule your life, but rather to simplify and enrich it – in whatever way you choose. With this in mind, Tchibo is introducing new smartphone tariffs from 9 May. In addition to a revised brand image with newly designed packaging and a more well-defined brand positioning, the flexible smartphone tariffs selected by experts (Smart S, Smart M and Smart L) serve to combine telephony and surfing practically to reflect the customer's requirements and life situation.

#### 6 — Customer satisfaction: Top marks for ALDI TALK and Blau

Brands and partners in Telefónica Deutschland's networks are leading the way in terms of customer orientation. ALDI TALK and the Telefónica brands O<sub>2</sub>, BASE and Blau are winning over customers with fair prices, expert service and good tariff structures. This is underlined by the awards received from the German Institute for Service Quality, connect and FOCUS-MONEY in the spring of this year.



#### 7 — Attractive smartphones from O<sub>2</sub>

In March, the Samsung Galaxy S7 and the Samsung Galaxy S7 edge prompted long queues outside O<sub>2</sub> shops from the early hours of the morning. Best of all: The new super-smartphones with double storage capacity are only available from O<sub>2</sub>. On 31 March, this was followed by the release of the iPhone SE, the most powerful phone with a 4" display, at O<sub>2</sub> shops. The new Huawei P9 followed a few weeks later. The device stands out thanks to its unusual dual camera for capturing ultra-sharp images. In late May, the Sony Xperia X hit the shelves – marking the launch of the smartphone camera with an eye on the future.



### 8 — O<sub>2</sub> Banking – megabytes, not measly interest rates

Those who are bored of waiting at the bank counter or jumping through hoops with online banking now have a state-of-the-art digital alternative at their disposal: O<sub>2</sub> Banking. Following the announcement in the second quarter, Telefónica Deutschland will launch the first complete mobile bank account in the summer – with numerous benefits for O<sub>2</sub> customers. O<sub>2</sub> Banking can be used to make bank transfers using a mobile phone number and obtain small loans with immediate approval, as well as offering extensive security features and more besides. Depending on how they use O<sub>2</sub> banking, O<sub>2</sub> customers will receive an additional monthly data allowance of up to 500 megabytes (MB) – and, in the initial phase, of up to 1 gigabyte (GB).

### 9 — M2M with IoT Connect from Telefónica

M2M applications are entering more and more areas of life. They form the basis for Industry 4.0, in which interconnected machines configure and optimise themselves and automatically order components for their production runs via the Internet of Things. But rigid standard tariffs would only restrict the automatic communication from machine to machine (M2M). Companies need flexible offers that provide tailored support for the unique nature of their solutions. And this is precisely what they get from the new M2M tariff portfolio from Telefónica: IoT Connect.



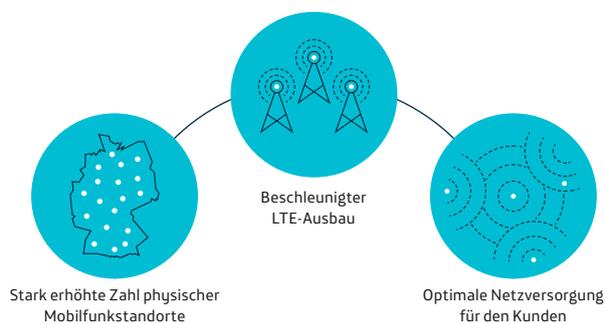
### 10 — Cooperation with TV Spielfilm: O<sub>2</sub> brings television to the smartphone

Ideally timed for Euro 2016, O<sub>2</sub> and TV Spielfilm are launching a new entertainment service on the market together. The O<sub>2</sub> TV & Video app gives O<sub>2</sub> customers free access to more than 50 TV channels. For EUR 9.99 a month, the premium package increases this to more than 70 channels, including 30 in HD quality. O<sub>2</sub> is bringing TV content to more than just customer's smartphones and tablets: Google Chromecast and AirPlay mean they can easily cast programmes to their television too, thereby eliminating the need for a cable or satellite package. One particularly practical feature is that the experts from TV Spielfilm provide editorial recommendations and make it easier to find the right programme thanks to an intuitive programme guide.

## Network\_

### 1 — Telefónica networks score well in network tests

The “Netzvetter” newsletter from connect magazine, which has been published for the second time, illustrates the development of the mobile networks in Germany on a monthly basis. “Netzvetter” is based on individual customer measurements, thereby allowing conclusions to be drawn about actual everyday network experience. The performance scores for Telefónica’s O<sub>2</sub> and E-Plus network were strong compared with the competition. According to the connect editorial team, Telefónica Deutschland’s continuous LTE network expansion in particular is now bearing fruit. The networks also did well at this year’s FLOQ Awards. Just like in 2014, the user-based network tests conducted using the FLOQ app served to confirm the high quality of the converging Telefónica networks.



### 2 — Innovative data analyses ensures efficient network expansion

Telefónica Deutschland is now using innovative data analysis techniques in its network planning. The company has developed an algorithm that is specifically aimed at ensuring that the expansion of the LTE network is geared towards actual customer requirements. This new algorithm for the best network experience ensures optimal investment management and the targeted improvement of the customer experience. Network planning is one of the first areas in which Telefónica is translating the analysis of large data volumes into new solutions. The new algorithm allows Telefónica Deutschland’s data specialists to predict mobile voice and data service usage right down to the level of the smallest regional areas. In addition to traditional wide-scale expansion, the new technique means the network expansion can be planned so that additional capacity is built up where customer demand is greatest.

### 3 — On-net launch for O<sub>2</sub> and E-Plus networks

From 14 March, customers of all Telefónica brands and many partner brands can make calls and sending SMS and MMS messages at on-net conditions. What this means: Telephone and messaging bills no longer make a distinction between the E-Plus and O<sub>2</sub> network, meaning no more fees for using the other network. With this move, Telefónica Deutschland is systematically pressing ahead with its integration process and continuing to grow together as a company to the benefit of its customers. The on-net launch involves selected tariffs from O<sub>2</sub> as well as other brands, such as AY YILDIZ and Ortel Mobile.



## Company\_

### 1 — Innovative processes thanks to digital transformation

Telefónica is successively rolling out new digital technologies in order to simplify processes, both externally and externally, and achieve better results more quickly. At Telefónica Deutschland, the new internal knowledge tool DigitalBrain on the employee portal is making day-to-day life easier. This intelligent network allows employees to ask questions, identify the right experts within the company and make the answers available to all colleagues. Meanwhile, the Digital Command Center allows us to respond to changes on the market in real time. This makes Telefónica Deutschland one of the first telecommunications companies in the world to be able to analyse all significant company and market data in real time. Which products are especially sought-after, and in which regions? Which tariffs attract the most enquiries? What are users writing on social media? Most pieces of data are at most 20 seconds old when they appear on the screens. Employees can now react to developments immediately on this basis.



### 2 — Telefónica Deutschland sells masts to Telxius

Telefónica Deutschland used the attractive market prices for network infrastructure to sell almost all of its mobile masts in April 2016. The proceeds increase the company's financial flexibility for investments in network quality and new growth areas. Telefónica Deutschland received EUR 587 million in cash for the sale of around 2,350 steel and concrete masts to the telecommunication infrastructure specialist Telxius, a subsidiary of Telefónica S.A. The transmission and receiving equipment installed on the masts is not affected.

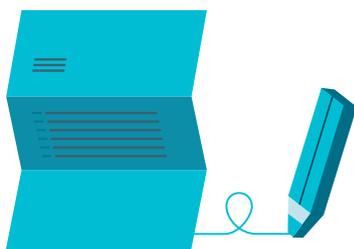


### 3 — New business areas get the freedom of a start-up

According to Chief Operating Officer Markus Haas, Telefónica Deutschland's objective of becoming the Leading Digital Onlife Telco includes a new, streamlined, data-driven business model. Two key materials form the basis for this vision: connectivity and data. This will enable Telefónica Deutschland to enter into new business areas, combining a start-up mentality with the experience of the corporate environment. According to Haas, the business areas of the future, Advanced Data Analytics and Internet of Things, will be deliberately kept separate from the company's core business in small, agile teams so that they can develop and grow freely. The teams will be given considerable creative freedom while simultaneously enjoying the full support of the Management Board. The aim is to encourage colleagues to try out ideas even if some of them fail to work.

### 4 — Annual General Meeting informs shareholders about successful integration and transformation

At its Annual General Meeting on 19 May, Telefónica Deutschland reported in detail on the successes of the first full financial year following the merger with E-Plus. The Management Board discussed the company's operating performance and the progress made in terms of its integration and digital transformation. The shareholders who attended the event at the Kongresshalle in Theresienhöhe in Munich approved the management's proposals with a large majority. As in the previous year, shareholders will receive a dividend of EUR 0.24 per share for the financial year 2015.



### 5 — Telefónica optimises financing structure

On 13 June 2016, Telefónica Deutschland signed its first financing agreement with the EIB in the amount of EUR 450 million via its subsidiary Telefónica Germany GmbH & Co. OHG. The funds will be used to finance the consolidation, modernisation and expansion of the Telefónica Deutschland Group's mobile network after the acquisition of the E-Plus Group. The funds provided by the EIB have terms of up to eight years. Following the conclusion of a syndicated credit facility with a volume of EUR 750 million in March 2016 and the repayment of the remaining intercompany loans to Telefónica S.A. in April 2016, the financing agreement with EIB represents another key milestone in Telefónica Deutschland's development towards a diversified, independent and cost-effective financing structure.

Condensed  
Interim Group  
Management Report\_  
for the period 1 January  
to 30 June 2016

# Basic Information on the Group\_

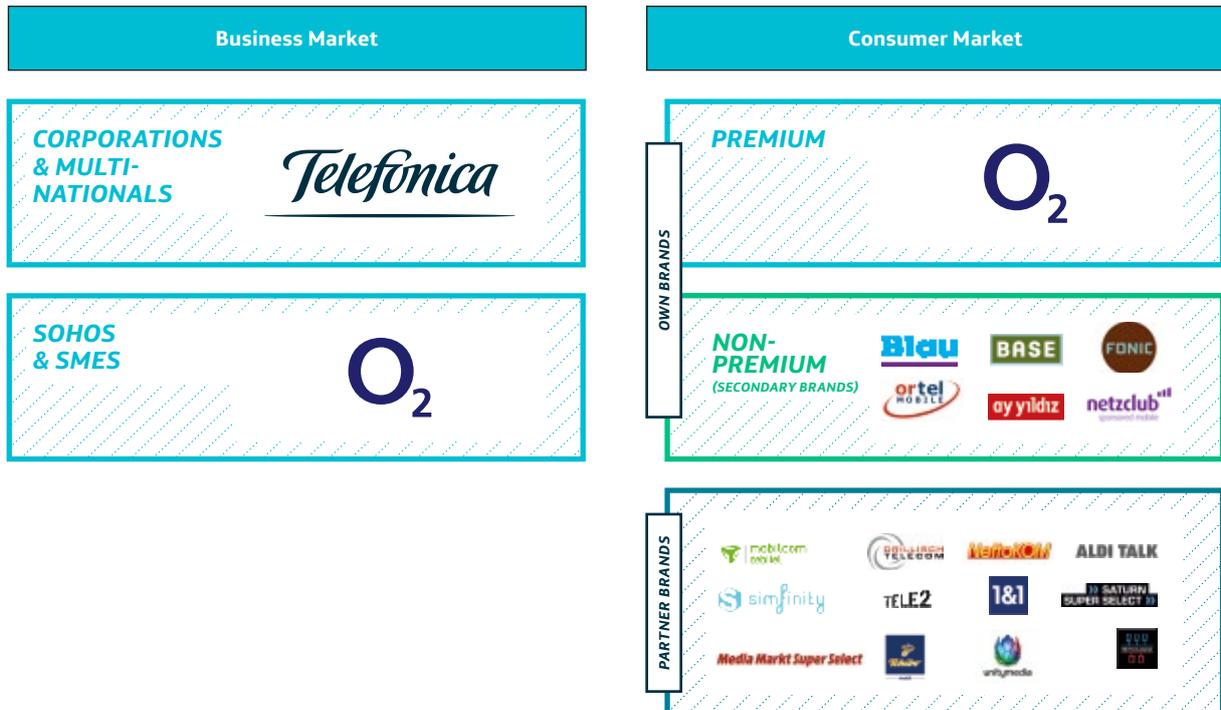
## Business activity

*Telefónica Deutschland Group is one of the leading integrated network operators in Germany./We successfully approach all market areas with a multi-brand strategy./Telefónica Deutschland offers a state-of-the-art mobile network especially in urban and suburban areas./We are a data-driven and data-focused company./We lead the mobile consumer and wholesale market in Germany.*

With almost 49 million customer accesses as of 30 June 2016, Telefónica Deutschland Group is one of the three integrated network operators in Germany. We are leading the German mobile telecommunications market with a total of over 43 million mobile customer accesses as of 30 June 2016. We are a part of Telefónica, S.A. Group, one of the biggest telecommunications companies in the world.

## Our brands: covering all market areas & needs

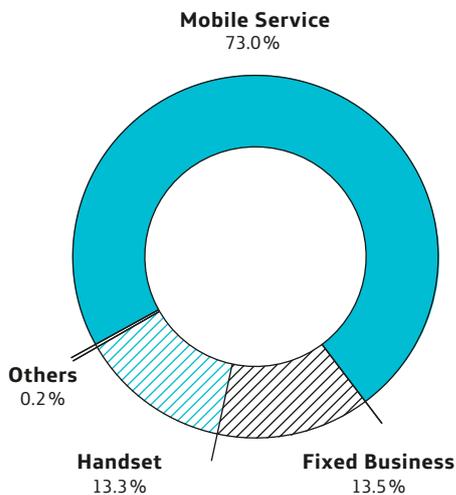
### G01 — Our brands



Our marketing and sales approach follows a consistent and focused multi-brand strategy in order to address a broad range of customer types with our products and services. With our premium brand O<sub>2</sub> we offer a broad range of high-value mobile and fixed-line communications products for both consumer and business customers. Large international businesses are addressed through the Telefónica brand.

With our secondary and partner brands and through our wholesale channels, we reach further groups of customers that we do not target with our O<sub>2</sub> brand. Our secondary brands include Blau, BASE, Fonic, netzclub, AY YILDIZ and Ortel Mobile. We also count on brands from joint operations and strategic partnerships such as TCHIBO mobil. Our multi-brand approach enables us to address a broader spectrum of customers with tailored product offerings, sales and marketing, thereby increasing our potential revenue.

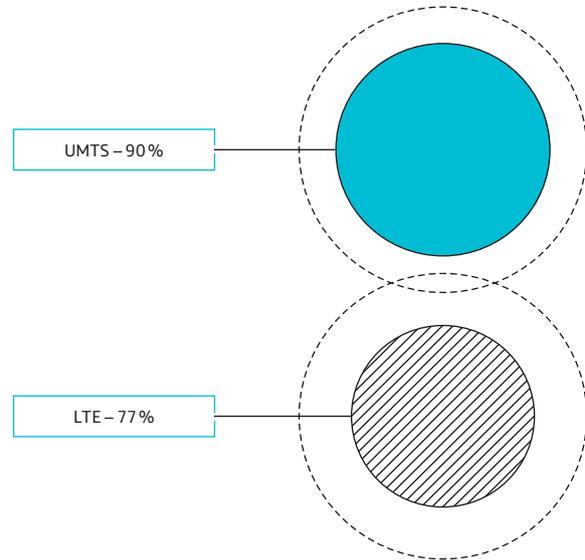
## G02 — Revenue Structure H1 2016



### Mobile Business is the main revenue stream

As the market leader for mobile services in Germany we operate a state-of-the-art network. We provide a high-quality network experience particularly in urban and suburban areas. We are rapidly improving in rural areas especially driven by the deployment of our LTE network. During the first half of 2016, the mobile service has been the main revenue stream for Telefónica Deutschland Group with EUR 2,694 million (73,0% over total).

## G03 — Network Coverage



The combined UMTS network infrastructure now reaches around 90% of the population in Germany. Our customers benefit from the combined strength of the O<sub>2</sub> and E-Plus network and can make even better use of mobile data applications.

In order to improve the network experience beyond using mobile data on UMTS, Telefónica Deutschland Group is also constantly driving forward the expansion of its LTE network. By the end of June 2016, the company achieved a nation-wide LTE coverage rate of approximately 77%.

### Fixed Business: Future proof infrastructure & full service offers

We offer nationwide fixed services to complement our mobile services. The offer is based on our strategic partnership with Telekom Deutschland GmbH, Bonn. It grants us long-term access to future proof next generation fixed infrastructure, currently covering over 22 million households with high-speed VDSL internet access.

In addition, Telefónica Deutschland Group benefits from all future network improvements such as an increase in VDSL coverage and higher speeds based on vectoring.

With these assets, Telefónica Deutschland Group is in an excellent position to provide full service offerings to consumer as well as business customers.

### **Handset business: state-of-the-art products, services & financing offers**

We sell a large variety of mobile phones and other hardware to our customers independently of mobile communications contracts. The best example is our successful "O<sub>2</sub> 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 regard to the cost of both the mobile phone and the telecommunication services contract. Customers can choose from a large variety of mobile phones including the latest premium devices and benefit from attractive payment conditions and the possibility to replace their device outside the 24 months cycle of a mobile service contract.

Our main suppliers of mobile phones are the manufacturers Samsung, Apple, Microsoft, HTC, Sony and Huawei. We focus on the sale of LTE-enabled smartphones, and as a result, smartphone penetration continues to grow, reaching more than 56% of our customer base. We are serving the growing demand for mobile data services among customers of our secondary brands via a large range of affordable entry-level smartphones. In the first half 2016, sales of smartphones and tablets slowed down from a strong year-earlier period.

In order to enhance our propositions around smartphones, we have expanded our portfolio with additional services and products such as smartphone insurance services, antivirus protection or state-of-the-art complements such as the latest digital lifestyle devices like smartwatches or TV extenders as well as protection cases or selfie sticks. A good example is the commercialisation of virtual reality glasses (Samsung Gear VR) and the first device supporting the new eSIM standard (smartwatch Samsung Galaxy Gear 2 classic 3G) during the first months of the year 2016. This standard, developed by the GSMA (Global System for Mobile Communications Association) in cooperation with Telefónica S.A. Group and other telecommunications companies, enables smaller device sizes and lower energy consumption. Furthermore the eSIM standard increases flexibility for consumers and is an enabler for the future development of the Internet of Things (IoT) business.

### **Our market areas**

We continually strive for an improvement of the market positioning of our premium brand O<sub>2</sub>, particularly in order to gain high-value customers in the consumer and business customer market areas. In addition, Telefónica Deutschland Group is the leading wholesale provider in Germany. We offer our wholesale partners access to our infrastructure and to our services.

In order to maximise the advantage from scale, we market our products using a diversified sales platform. This includes direct sales channels such as our own shops, a nation-wide network of independently operated franchise and premium partner shops, online and telesales plus indirect sales channels such as partnerships and cooperations with retailers in physical or online channels.

### **Value management & sustained leadership in consumer retail**

The O<sub>2</sub> brand is market leader in the consumer postpaid market according to accesses in Germany. As a trailblazer in the German market, our strategic focus has been on the sale of data-centric mobile telecommunications contracts to smartphone users. On the back of their use of mobile data services, together with an increasing uptake of LTE-capable devices, these customers generate higher revenues compared to users without a smartphone. We are also seeing rising interest in smartphones and the use of mobile data in the prepaid area, where we offer special prepaid tariffs for smartphone users.

A relevant market trend is the appearance of digital applications that make our customers' lives easier and more secure in many areas. We enable our customers to handle important elements of everyday life via their mobile phones, such as mobile paying, music and video streaming, playing games, monitoring the condition and location of their cars or controlling power usage in their homes. New additions to our product portfolio are the recently launched O<sub>2</sub> TV & Video App, the new O<sub>2</sub> Banking proposition, as well as a partnership with Sky, which will give O<sub>2</sub> customers affordable access to exclusive sports events, movies and series starting in January 2017 (▶ GOALS AND STRATEGY, P. 20).

### **Business customers: focus on small and medium-sized enterprises (SMEs)**

We address SMEs as well as small office/home office (SoHo) through our premium brand O<sub>2</sub>, for example with our innovative product "O<sub>2</sub> Unite". "O<sub>2</sub> Unite" offers our customers a drastic cost reduction by pooling SMS, minutes and data for all employees of a company.

Another example of products that meet the needs of our business customers is the "Digital Phone". This is a cloud-based telephony system that offers the customer flexible usage (e.g. single telephone number independent of the location and hardware of the employee), high-quality service (e.g. secure communications through German data centres) and savings (e.g. low infrastructure requirements, flat rates and flexible adaptation of number of licences needed).

Our aim to increase our market share among business customers is based on the right products and services as well

as the continuous improvement of our network quality. Following the optimisation of our product portfolio and our organisation in 2015, we have finalised the preparations in the first half of 2016 to initiate the business customer migration from BASE to O<sub>2</sub> during the second half of the year. This will enable us to continue our focus in growth, especially among SME customers.

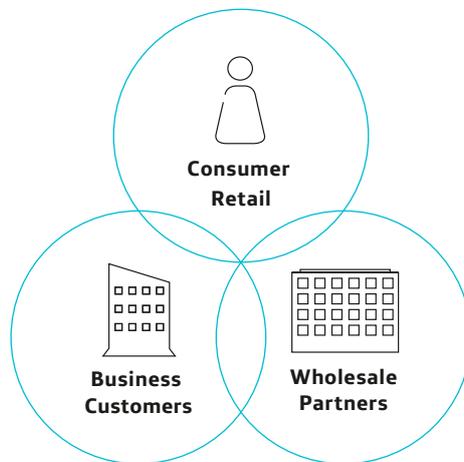
**Wholesale partners: maintain leadership**

As part of the wholesale business, we offer mobile services for customers such as MEDIONmobile (ALDI TALK), United Internet (1&1), mobilcom/debitel, WhatsApp and cable providers. In addition, we have committed to selling 20 % of our mobile network capacity via mobile bitstream access (MBA) to MS Mobile Service GmbH (Drillisch) as part of the merger remedies. Drillisch also has the option to acquire up to 10 % of additional network capacity.

In the fixed line business, we offer our existing wholesale partners a range of “unbundled local loop” (ULL) services, including fixed line telephony and high-speed Internet.

Furthermore, we offer value added 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 consumers and, at the same time, gives us the opportunity to increase our range and leverage economies of scale. However, we will phase out this model by 2019 as part of the transition to the next generation fixed network of Telekom Deutschland GmbH.

**G04 — Main Market Areas**



## Goals and strategies

*We want to further improve our leading position in the German mobile market./We strive for the best customer and network experiences and the best price-performance ratio./We focus on the monetisation of data usage and cost leadership./Our vision is to become the leading digital Onlife telecommunications company in Germany./To achieve this, we have three main strategic priorities: Keep the momentum, Integrate quickly and Transform effectively.*

During the first half 2016, we further progressed to build the solid foundation for the leading digital telco in Germany. We made that possible with our multiple and ambitious actions around our strategic priorities: Momentum, Integration and Transformation (MIT). As a leading digital telco, we strive for the best network experience, the best customer experience and most attractive offers thanks to our focus on cost leadership (efficient processes and organisational structure, leverage economies of scale).

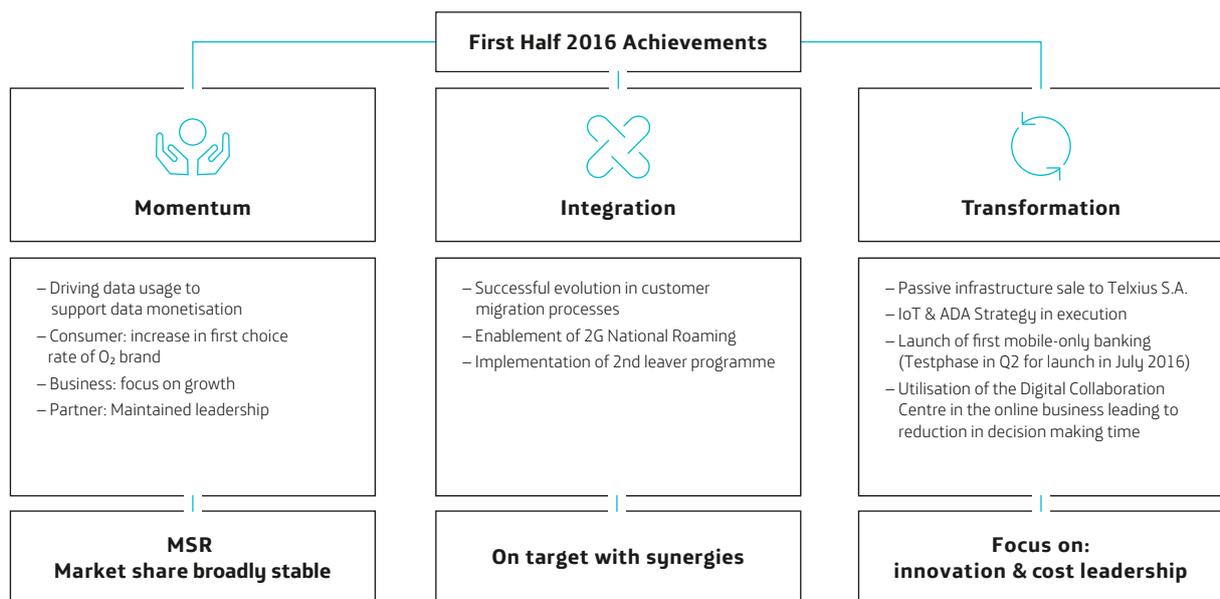
### Momentum: We drive the German market

Telefónica Deutschland Group is driving the German mobile market through excellent customer experience, first-class

connectivity and good value for money. Thanks to the focus on customer retention rather than acquisition for the consumer market area, Telefónica Deutschland Group remained the market leader by customer base while our share of mobile service revenue remained broadly stable. In the business market area, we have successfully approached the market with innovative products and we have increased our focus on SMEs and SoHos.

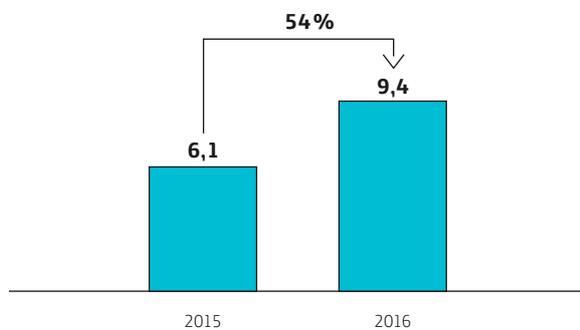
Data monetisation has been at the centre of our strategic priorities. Thanks to the use of data as a product differentiator in a context of growing data demand, we have partially mitigated the adverse effect of aggressive pricing of non-premium players and headwinds from repricing, regulatory effects and the decline of revenues from SMS driven by OTT services substitution. Example of data monetisation measures which we have successfully implemented in 2015 are our data automatic and data upselling mechanisms. In the first half of 2016, we are also experiencing an improvement in revenues from both data automatic and data upselling. The data automatic mechanism offers our customers an automatic increase in their data allowance ("data snack") if the latter has been exhausted without having to experience the effects of throttling. Data upselling mechanisms give the customers the option to increase their regular monthly data allowance upon request.

## G05 — First Half 2016 Achievements



The result of these innovative customer propositions is a continued and significant increase in data usage and the improvement of our ability to monetise it. In addition, LTE active customers grew around 54 % as against the previous year (↪ **GRAPH 06: LTE ACTIVE CUSTOMER BASE**). All in all, a clear example of Telefónica Deutschland Group supporting the digital lifestyle of consumers.

**G06—LTE Active Customer Base (as of 30 June)**  
(in millions)



Furthermore, during the first half of 2016 we have seen an improvement in the first choice rate for O<sub>2</sub> among consumers. This is the result of a successful image campaign that has accompanied our significant network improvements and our excellent retail services. Our advisers and shops were awarded the highest score by the consumer organisation “Stiftung Warentest” in their test released in May 2016.

Our leadership position in the wholesale market complements our activities. We are the partner of choice for most relevant MVNO (Mobile Virtual Network Operator) players. With the coverage of the three areas consumer, business and partners, Telefónica Deutschland Group approaches the market with a competitive and integrated portfolio. Our mobile/fixed convergent offer, relaunched under the branding O<sub>2</sub> Blue One since February 1<sup>st</sup> 2016, gives customers the option to combine mobile and fixed services from a single provider at a promotional price. Next to the clear focus on customer retention and the development of the customer base this contributed to the reduction in the consumer post-paid churn rate during the first half of 2016.

All the above is supported by our multi-brand strategy which we continue to optimise. This enables us to cover all market areas and to address the different needs of the

customer. Within our portfolio the O<sub>2</sub> brand is positioned as the flagship brand for Telefónica Deutschland Group (↪ **BUSINESS ACTIVITY, P. 16**).

#### **Integration: within the synergy plan**

Our strategy is to integrate quickly. We continue to successfully execute according to plan and are now moving the focus from integration to transformation. During the first half of 2016, incremental synergies of approximately EUR 95 million have been generated, mainly as we continue to benefit from the roll-over effects of the successful integration initiatives in 2015, as well as pushing ahead with employee restructuring, customer migration and network integration efforts in 2016. We thus continue to expect incremental OpEx and revenue-related in-year savings from synergies to kick in in the second half of the year and an accumulated savings level of approximately EUR 430 million (>50 % of total Operating Cash flow target of EUR 800 yearly) by year-end 2016.

We achieved key milestones to make this possible. Firstly, we started the network optimisation in 2015. Telefónica Deutschland Group is selecting the best locations from the two networks, meaning that the joint network will reach approximately 25,000 sites once the integration is completed. This will ensure improved coverage, service quality and operational efficiency. Part of the site reduction has been achieved by means of the agreement with Deutsche Telekom for the transfer of around 7,700 sites that entered into force in October 2015 (↪ **OVERVIEW OF THE FIRST HALF 2016 — SIGNIFICANT EVENTS, P. 32**).

Telefónica Deutschland Group has access to 357.5 MHz of spectrum including 60 MHz (2x10 MHz at 700 MHz, 900 MHz and 1800 MHz of paired spectrum) obtained during the last spectrum auction that finalised in June 2015.

Among the frequencies obtained, the spectrum at 700 MHz and 1.8 GHz will lead to a larger and denser LTE network both in major cities and in the countryside and enables us to offer our customers all over Germany outstanding connectivity to use mobile data services. The spectrum at 700 MHz will complement the frequencies at 800 MHz already obtained in 2010, thus favouring the extension of LTE coverage in suburban and rural areas.

The auctioned blocks in the 1.8 GHz range also allow us to establish an even stronger high-performance network with more capacity in the cities. Our customers will thus benefit significantly from higher LTE speeds. The blocks in the 900 MHz range will also ensure the high quality of the nationwide GSM network for voice, SMS and narrowband internet connections in the future.

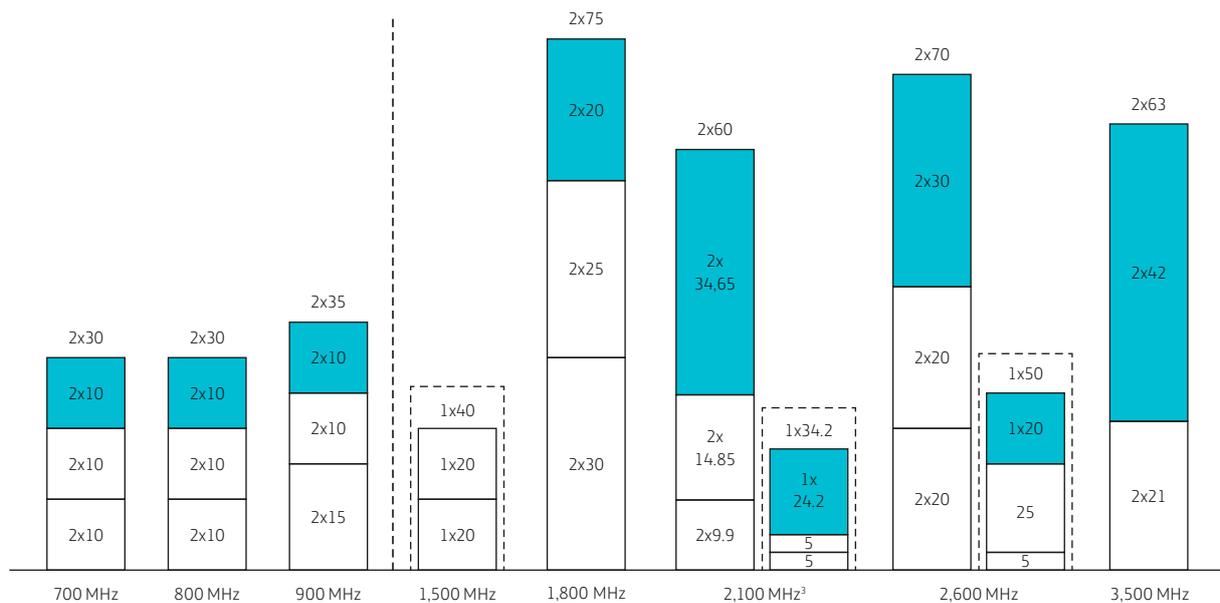
With its existing and newly acquired frequencies, Telefónica Deutschland Group holds a balanced share in the frequencies

## G07 — Results of the Spectrum Auction in 2015

- Telefónica Deutschland Group
- Competitors
- FDD<sup>1</sup> spectrum
- TDD<sup>2</sup> spectrum

Frequencies for coverage: a level playing field

Frequencies for high capacity: Telefónica Deutschland Group keeps a strong positioning



1 FDD = Frequency Division Duplex

2 TDD = Time Division Duplex

3 So called "UMTS core band" also referred as 2 GHz band by the Federal Network Agency

below 1 GHz (area coverage) and a strong position the frequencies above 1 GHz (capacity coverage). The investment of EUR 1.2 billion (23.5 % of total auction costs in 2015) in this valuable frequency package is therefore an important building block for further network expansion and focused data business. We want to point out our efficient capital allocation which ensures our leadership position in the high-frequency spectrum while, at the same time, investing the least among the German network operators during the auction.

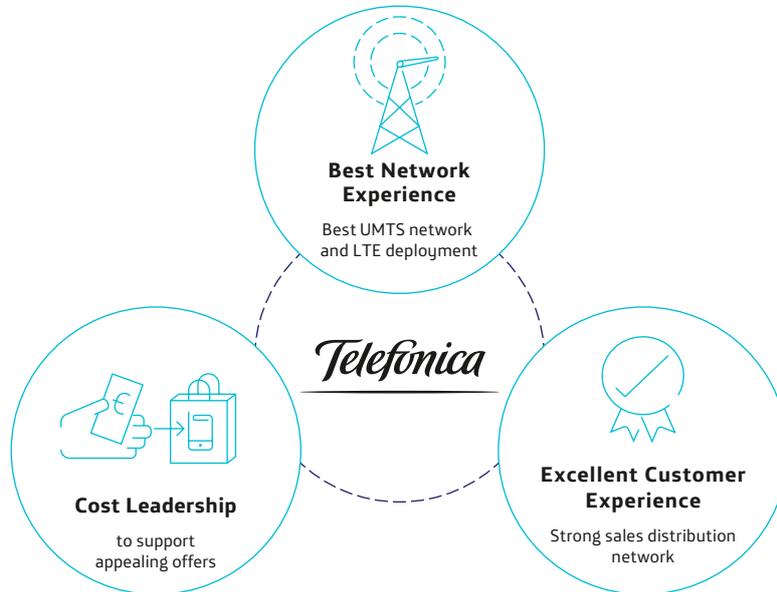
Secondly, we activated national roaming between the UMTS networks of the former Telefónica Deutschland Group (O<sub>2</sub>) and the E-Plus Group (E-Plus) in 2015, combining for the first time the strength of both our networks. This milestone supports a positive network experience for our customers. As a result, we offer the customers of all our brands and partner brands the densest UMTS network infra-structure in urban and suburban areas and considerably expanded coverage in rural areas. This step improves the user experience for mobile data services even in areas where our customers do not yet have LTE, and thus it demonstrably improves customer experience and satisfaction as shown in the Connect-“Netzwerker” test from February 2016, based on direct customer experiences. During

the first half of 2016 we have also extended national roaming. This improves coverage especially for calls and M2M devices.

Thirdly, we have advanced in the optimisation of our retail distribution network, one of the biggest strengths of Telefónica Deutschland Group, to keep momentum and achieve our strategic goals. We have harmonised the branding of our shops. Since the end of the year 2015, almost all shops have been operating under the O<sub>2</sub> brand.

Key milestones in the integration process in the first half 2016 were, on the one hand, the successful execution of customer migration plans from BASE to our premium brand O<sub>2</sub> which is on track to achieve the year-end targets and is meant to be accomplished in the third quarter 2016. On the other hand, Telefónica Deutschland Group has significantly advanced in the integration and its transformation as within the second wave of the leaver programme 500 FTE have been given clarity about their employment situation. Thus, already more than 80 % of the total company target (a reduction of 1,600 FTEs by 2018) is executed (OVERVIEW OF THE FIRST HALF 2016 — SIGNIFICANT EVENTS, P. 32). As a result we continue to support our focus on cost leadership as well as the transformation of the company.

## G08—Our Focus



### Transformation: shaping the leading digital Onlife Telco

The third strategic priority has been an effective transformation of the whole company with the target of becoming the leading digital telco in Germany.

In order to achieve this we have focused on initiatives to simplify, digitalise and adapt the business models and day-to-day business activities. Simplification and digitalisation are core levers to increase customer loyalty and satisfaction while sustaining our focus on cost leadership.

One important enabler for our transformation in the context of digitalisation is applying Advanced Data Analytics across our customer data to increase the efficiency of our internal processes. A prerequisite for the use of our customer data is ensuring data privacy and security, both core beliefs of our company. We ensure data security and privacy by different means such as our newly developed Data Anonymisation Platform. Furthermore, we let our customers choose what data to share and ensure the highest possible transparency for the use of our customer data. Customers can choose whether to participate in the O<sub>2</sub> More Local service, for example, through which they receive special offers based on their location.

Advanced Data Analytics leads to better business decisions, optimised capital allocation and increased revenues

due to better insight-driven propositions and higher efficiency of upselling campaigns as well as a reduced churn as a result of the early identification of potential switchers. In addition, we increase the return of our network investments by optimising site and roll-out area selections through demand analysis using multiple information sources within our data warehouse.

Ensuring a seamless digital experience for our customers is also part of the transformation process. We are proactively increasing the share of digital customer contacts by improving our digital channels. As a result, we plan to significantly reduce our customer services cost over the next years. During the first half of 2016, we experienced a considerable increase in the share of new postpaid consumer customers acquired via digital channels.

The digital channels are complemented by a large variety of alternative contact possibilities, and it is our goal to ensure that all channels are closely interconnected. This will also ensure that customers can, for example, choose a smartphone or tablet online, and then have it set up and collect it from the store. New types of concept stores will increase customer loyalty to the O<sub>2</sub> brand. We continue to increase our number of concept stores including the opening of the O<sub>2</sub> Live store in Frankfurt in June 2016.

A key achievement in the management of Advanced Data Analytics in conjunction with digital and offline channels has been the development and the building of our Digital Collaboration Centre (DCC). This provides real-time information for faster decision making and for anticipating our customer needs. As a consequence, we will consequently improve our customer experience. The system will cover all aspects of our interaction with the customer, from the first contact to customer care and retention. Furthermore, it will transform the way we work and cooperate by enabling, when completed, the full digitalisation across the organisation. This will help to continuously improve our offers and the way we communicate with our customers.

As part of the Telefónica, S.A. Group, leading in R&D investments among European communications providers, innovation is at the heart of our core values. Both former companies merged in the new Telefónica Deutschland Group were known for innovations and for setting new trends in the market. These included establishing multi-brand strategies and new types of tariff models, in addition to introducing and operating brands for partners from other industries. We expect to reinforce the role of innovation in our organisation, as we have already shown with the launch of Voice over LTE (VoLTE) in 2015 as the first operator in Germany. This new technology significantly improves the quality of the voice service with the reduction of call set-up times, better speech quality and longer handset battery duration.

We also advanced in evolving towards a more digital lifestyle focused product portfolio. During the first half of 2016, we launched our new application O<sub>2</sub> TV & Video. This offers our customers access to live TV content from over 70 channels and to video-on-demand services from public broadcasters. Furthermore, the service includes HD channels as well as the recommendations and TV guide from TV Spielfilm, the leading electronic programme guide in Germany. This way we cover our customers' need for access to TV content independently of their location in the country.

In addition, we have worked on the conclusion of a cooperation agreement with Sky. This cooperation will open the Sky Ticket offer to O<sub>2</sub> customers from January 2017 under top conditions. O<sub>2</sub> customers will gain access to live sport events including football, Formula1 and tennis (with the Supersport daily, weekly or monthly tickets), exclusive series (with the Entertainment monthly ticket) and the latest movies (with the Cinema monthly ticket). All in all, the cooperation with Sky will be an excellent complement to our mobile content offer.

Another highlight was the launch of O<sub>2</sub> Banking in July 2016 after the conclusion of the test phase initiated in the first half 2016. O<sub>2</sub> Banking is the first mobile-only banking in Germany and an outstanding digital bank experience. O<sub>2</sub> Banking enables the full usage of the smartphone as a bank account, for instance, with the enablement of money

transfers using only the mobile number of the recipient instead of the IBAN. Further advantages are the quick and secure sign-up process, a free contactless MasterCard for ATM withdrawals and payments in shops or online, security features (e.g. deactivation of the MasterCard card via app) or a financial planner. In addition, O<sub>2</sub> customers who use O<sub>2</sub> Banking as their salary account or pay with the linked MasterCard regularly will be rewarded with additional data volume. This banking product has been launched in cooperation with Fidor Bank AG, a direct bank registered in Germany that specialises in providing financial services for millennials and awarded by the World Economic Forum as a "Global Growth Company".

Supporting our transformational plans, we have concluded the sale of our passive tower infrastructure to Telefónica S.A.'s infrastructure management company Telxius S.A. Group, generating resources that contribute to our network roll-out plans and the development of new business activities  
([OVERVIEW OF THE FIRST HALF 2016 - SIGNIFICANT EVENTS, P. 32](#)).

#### **Our ambitions in 2016**

The Telefónica Deutschland Group will continue to drive the German market, advance its integration and complete some major projects in this context. Moreover, the company focusses on the digital transformation and aims to take shape as the leading digital telco and become the Onlife Telco by 2020. This is a digital telco that goes beyond the provision of connectivity and instead plays a central role in the digital life of its customers.

We continued to move in that direction in the first half 2016, as shown by the above-mentioned achievements, and will continue to focus on our ambitions accordingly during the rest of 2016.

To accomplish our ambitions we will continue to intensively develop our network towards outstanding connectivity. This is shown in the key achievements such as the launch of 2G national roaming, a necessary step before the launch of 4G national roaming. In parallel, we continue to work on the full integration of networks which includes the optimisation of the number of sites in 2016. The continuous improvement of our network is without doubt a key strength of our company and of our value propositions to the customers.

The use of Advanced Data Analytics in innovative ways will significantly increase in 2016 thanks to the intensified deployment and utilisation of our DCC. So far we have successfully implemented the DCC in our online business, significantly reducing our decision-making times. Moreover, we continue to further develop the capabilities of the DCC and its scope of application. In 2016, we will continue to expand digital lifestyle propositions for our customers such as O<sub>2</sub> TV & Video, O<sub>2</sub> Banking, smart home services or the WLAN calling application as part of our integrated offerings.

As a complement to a state-of-the-art telecommunications infrastructure and digital lifestyle propositions, our ambitious plans also include the expansion of new concept stores during 2016. This, supported by enhancements of the online channels, will ensure an improvement in customer experience and their digital lifestyle.

During 2016, we are markedly increasing our focus on the IoT, the evolution of our M2M business. This market is expected to grow at double-digit rates until 2024, from around 6 billion connections worldwide to 27 billion<sup>1</sup>. Telefónica, S.A. Group is among the global leaders in the provision of M2M services, a core element in the IoT ecosystem. These will serve as a base for the development of end-to-end solutions for selected use cases, such as fleet management. We have already successfully gained expertise and major clients such as Sixt Leasing for smart mobility services. Telefónica Germany Group benefits from the global capabilities of the Telefónica, S.A. Group such as the Global SIM IoT platform. Thanks to the scale of Telefónica,

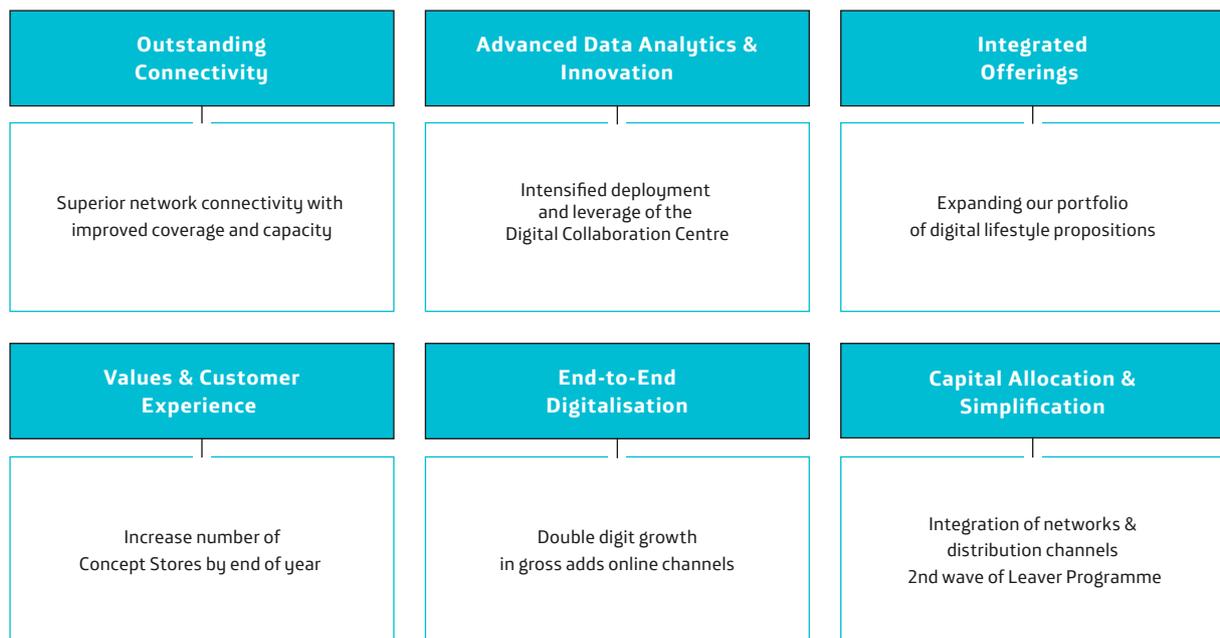
S.A. Group and its extensive network of data centres and roaming partners this platform provides secure worldwide coverage for any cellular IoT device.

With regard to the monetisation of Advanced Data Analytics, we have started the commercialisation of Mobility Insights. This product offers anonymised and aggregated analysis of people's mobility behaviour with privacy ensured by Telefónica Deutschland Group's Data Anonymisation Platform. Furthermore, we are engaged in a pilot project in Nuremberg that will improve the measurement of air pollution based on the application of our Advanced Data Analytics on mobile data.

The central role of IoT and Advanced Data Analytics in our strategy will be also reflected in our intention to create specific market units dedicated to those activities and supported by a central unit, the Factory, responsible for the technological developments. We have so far finalised the definition of our IoT-strategy and started its execution during the first half of the year.

<sup>1</sup> Source: Ranken, Margaret (Machina Research).  
M2M Global Forecast & Analysis 2014–2024. June 2015.

## G09—Our Ambitions in 2016



We will thus continue to accelerate our transformation towards the Onlife Telco by means of increased efficiencies driven by digitalisation efforts which result in simplified structures, better capital allocation and new revenue streams across all market areas.

## Structure of the Telefónica Deutschland Group

Telefónica Deutschland Holding AG (hereinafter Telefónica Deutschland or company) is a stock 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 business address is Georg-Brauchle-Ring 23–25, 80992 Munich, Germany (telephone number: +49 89 2442-0; [WWW.TELEFONICA.DE](http://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 German Securities Identification Number (WKN) is A1J5RX, the ISIN (International Securities Identification Number) is DE000A1J5RX9.

### Share capital

The share capital amounts to EUR 2,974,554,993 and is divided into the same number of no-par-value registered shares.

In general, each non-par share grants one vote at the Annual General Meeting.

### Authorised capital

According to the relevant resolution of the Annual General Meeting of 19 May 2016, Telefónica Deutschland Holding AG had authorised capital 2016/I of EUR 1,487,277,496 as of 30 June 2016.

### Conditional capital

Telefónica Deutschland Holding AG's conditional capital 2014/I amounted to EUR 558,472,700 as of 30 June 2016.

### 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 parent

company, Telefónica, S.A., Madrid, Spain (Telefónica, S.A.; its group is: the Telefónica, S.A. Group). The direct parent company of the 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 30 June 2016, the companies included in the Interim Condensed Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart.

In the first quarter, Fonix GmbH was merged with Telefónica Germany GmbH & Co. OHG.

### Management and executive bodies

The company's executive bodies are the Management Board, the Supervisory Board and the Annual General Meeting.

The powers of these bodies are established by the Aktiengesetz (AktG – German Stock Corporation Act), 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 Management Board members before the end of their terms in office for good cause cause, such as a gross violation of duty or in the event of a vote of no-confidence at an Annual General Meeting. Other reasons for termination, such as a mutual termination agreement, are also possible. The Supervisory Board can nominate one Management Board member as the Chairperson for the Management Board and another Management Board member as the Deputy Chairperson. As of June 30 2016, the company's Management Board comprised three members:

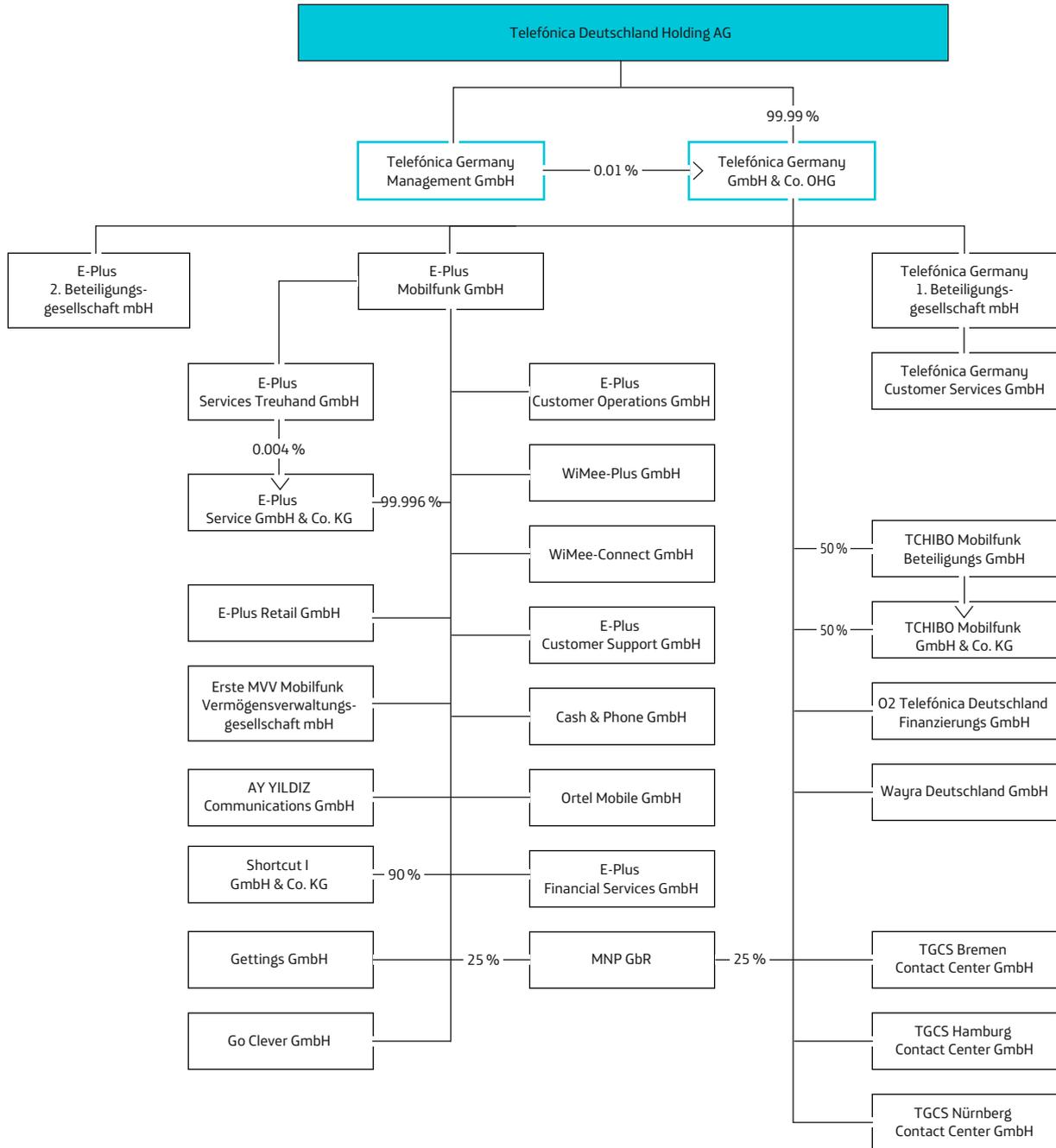
- Thorsten Dirks, CEO (Chief Executive Officer)
- Rachel Empey, CFO (Chief Financial and Strategy Officer)
- Markus Haas, COO (Chief Operating Officer)

### Supervisory Board

In accordance with section 11 para. 1 of the articles of association, of the company, sections 95 and 96 AktG and section 7 of the Mitbestimmungsgesetz (MitbestG – German Co-Determination Act), the Supervisory Board comprises 16 members, of which eight are shareholder representatives and eight employee representatives.

All current shareholder representatives on the Supervisory Board were appointed for the period until the end of the Annual General Meeting 2017.

1 — G 10 — Telefónica Deutschland Group Companies



Unless otherwise stated, the holding quotes amount to 100%.

# Economic Report of the Group\_

## Overall economic and industry conditions

*The German economy is growing robustly./ Growth opportunities are arising from the rising demand for bandwidth./ The German mobile market is the largest in the EU in terms of customer numbers./ Our markets continue to be characterised by intense competition./ The Telefónica Deutschland Group is exposed to numerous regulatory influences.*

### Economic environment

#### Solid economic development in Germany

The German economy held its ground in a difficult global economic environment in the first half of 2016 and continued to develop positively. The strongest stimuli came mostly from the country's domestic strengths. Private consumption ranks first here, having been boosted mainly by the positive development in employment, and the number of employed persons is still rising. According to the German Federal Employment Agency (Bundesagentur für Arbeit), it reached its highest level since the reunification at 43.4 million. Consumers are very optimistic when it comes to their income development. The good employment situation means that collectively agreed wages in many industries are rising rapidly. In addition, due to the inflation rate of nearly 0% nominal income growth means an almost equally sharp rise in purchasing power.

#### Trends on the German telecommunications market bring growth potential

Various trends can be observed in the German telecommunications sector in addition to continuing customer demand for more bandwidth.

The strong demand for mobile data usage and increasing smartphone and tablet penetration are opening up further opportunities for growth for mobile telecommunications network operators. This trend will continue in the future. Smartphones and tablets are trailblazers for the digital revolution in Germany. At the same time, the monetisation of the mobile

data business will continue to be a top priority for mobile telecommunications providers.

Advancing digitalisation is changing the world long-term. The telecommunications industry is a major trailblazer for digitalisation. Alongside the connection of people, the intelligent connection of things via the internet (IoT) also offers numerous application and growth possibilities. Another trend is data analysis, which is facilitating new insights as well as new business models.

#### Demand for mobile data services drives market development

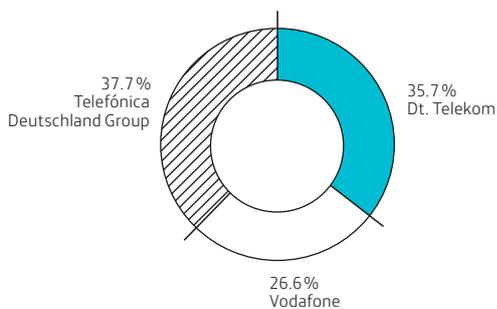
With 114 million customers (SIM cards) at the end of March 2016, the German mobile telecommunications market is the largest in the EU. The notional mobile penetration rate was 142%, i.e. each German citizen had an average of 1.4 mobile SIM cards. The customer growth from January to March 2016 remained attributable primarily to the more valuable postpaid sector. Overall, postpaid customers made up 52.5% of total connections as of the end of March 2016. This share had been 52.1% at the end of December 2015.

The mobile telecommunications market continued to develop dynamically in the first half of 2016 and was characterised by an increasingly intense competition in all areas, driven primarily by the strong demand for attractive smartphones and smartphone tariffs. According to a survey by the industry association Bitkom, currently 76% of German citizens from 14 years use a smartphone. Two years earlier, it was just 55%. However, a slowdown in the growth of the smartphone market can be observed, driven by its increasing saturation, and smartphones are being used for longer. According to the German Association for Consumer and Communication Electronics (gfu), around 5.4 million smartphones were sold in the first quarter of 2016, which equates to a drop of around 11% compared to the same quarter of the previous year.

Mobile media use resulted in a growing mobile data usage. According to Dialog Consult, 510 million GB of data were transmitted on mobile networks in 2015, or 29% more than in 2014 (395 million GB).

The increasing penetration of mobile end-devices with internet capability, such as smartphones or tablets, and the increasing use of mobile data services is also evident in the strong growth of revenues from mobile data in the German market: according to estimates by Analysys Mason, mobile data revenues increased by over 14 % in 2015 compared to the previous year. By contrast, revenues from mobile telephony and SMS have fallen, driven by price decline, regulatory effects and changes in customer behaviour.

### G11 — Market Share in the Mobile Telecommunications Market per Customer (in %) by the End of March 2016



Source: Company data, Analysys Mason, GfK Consumer Index, DIW, Bitkom

#### The German mobile telecommunications market is an established market

Following the merger of the Telefónica Deutschland Group with the E-Plus Group, the German mobile telecommunications market consists of three network operators and several service providers and MVNOs. As of the end of March 2016, the Telefónica Deutschland Group had a market share of 37.7 % with around 43 million connections in total. It is therefore the largest German mobile telecommunications network operator in terms of number of customer connections.

#### German fixed line market characterised by strong growth

Intense competition also still prevails on the German market for fixed line broadband services. The number of connections increased by approximately 5 % year on year; the customer base therefore grew to approximately 30.8 million by the end of December 2015. The share of DSL connections here is almost 80%. The relevance of VDSL continued to grow. According to the German Federal Network Agency (BNetzA),

around 20 % of DSL customers were using VDSL technology at the end of 2015. The increased customer demand for more bandwidth is also reflected in the data volume generated per broadband connection and month. According to Dialog Consult, this increased by nearly 20 % compared to 2014 to 31.8 GB per connection.

Source: Analysys Mason, Dialog Consult/VATM analyses and forecasts, German Federal Network Agency

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.

### Regulatory influences on the Telefónica Deutschland Group

The following section shows the material new decisions and additions to the Group Management Report for the financial year that ended 31 December 2015 in the section, Regulatory influences on the Telefónica Deutschland Group.

#### BNetzA prepares decision on MTR

The current mobile termination rates (MTR) of 1.66 euro cents per minute expire at the end of November 2016. For the new round of fee approval, the BNetzA consulted nationally on a draft of a new regulatory decision on market definition and analysis regarding the market for call termination in individual mobile networks and notified it to the European Commission in early July 2016. The draft provides with pureLRIC (LRIC = long-run incremental costs), a new cost benchmark for calculating the MTR. The Telefónica Deutschland Group participated in the consultation process.

#### BNetzA presents draft decision on local loop access for local vectoring to the European Commission

The BNetzA notified the European Commission of the draft decision. After a review process, the latter expressed serious doubts and initiated a phase 2 proceeding. Shortly before a working group of the Body of European Regulators for Electronic Communications (BEREC) could comment on the decision-making procedure, the BNetzA withdrew the notification and on 17 June 2016 presented a revised draft decision that was again consulted upon nationally in parallel up to 15 July 2016. On 19 July 2016, the European Commission published its decision to not initiate another phase 2 proceeding due to serious doubts regarding the revised draft of the BNetzA. A final BNetzA decision is expected in August 2016.

### **BNetzA to issue transparency regulation**

To strengthen the position of consumers, the BNetzA will issue a regulation containing measures aimed at increasing the transparency of mobile and fixed line telephone and internet services. After further discussion, the current draft of the regulation includes provisions on cost control, the review and documentation of contractually agreed data transfer rates and the provision of information on contract content to customers prior to conclusion. On 15 June 2016, the cabinet of the German Federal Government approved the BNetzA's transparency regulation. As a result, the German Federal Parliament (Bundestag) will now consider the transparency regulation. The regulation is expected to enter into force in the third quarter of 2016. However, parts of the regulation will not take effect until the first half of 2017 or, in some cases, in the second half of 2017 owing to the implementation periods provided for in the regulation.

### **The Telefónica Deutschland Group adjusts roaming tariffs**

On 29 November 2015, a regulation came into force following publication in the official journal of the European Commission that provides for an end to roaming charges for end customers from 15 June 2017 and the consistent regulation of net neutrality throughout Europe.

There were discussions between the BNetzA and the Telefónica Deutschland Group regarding the requirements of the regulation that are open to interpretation. In order to settle these discussions, the Telefónica Deutschland Group voluntarily declared itself willing to adjust its own tariffs.

In November 2015, the European Commission initiated a review of the wholesale roaming market in order to assess what measures are required to enable the elimination of roaming charges for consumers by 15 June 2017. The

Commission submitted a report and a legislative proposal on this in June 2016, which is currently being consulted on.

### **New telecommunications transparency requirements under the Telecoms Single Market Regulation (TSM-R) specified**

TSM-R, which includes regulations on net neutrality, took effect on 30 November 2015; the transparency requirements have been applicable since 30 June 2016. So far, however, it has not been determined how the individual rules of the regulation are to be implemented. On 6 June 2016, BEREC submitted draft guidelines for consultation, which could be commented upon until 18 July 2016. The final guidelines are expected to be published at the end of August 2016.

### **Section 111 TKG amended under the Act for Better Information Sharing to Combat International Terrorism**

On 24 June 2016, the German parliament passed the 'Gesetz zum besseren Informationsaustausch bei der Bekämpfung des internationalen Terrorismus' (German Act for Better Information Sharing to Combat International Terrorism). This also amends section 111 of the Telekommunikationsgesetz (TKG – German Telecommunications Act), which stipulates which customer data must be collected before activating the connection. In the future, this standard will require the identity of customers to be checked by means of certain identification documents or other methods yet to be determined by the BNetzA before prepaid SIM cards are activated. It cannot be ruled out that these regulations will entail considerable complexity in data collection and restrictions in sales opportunities for the industry. However, the scope cannot be predicted until the requirements of the BNetzA are known.

## Overview of the First Half of 2016

*In the first half 2016 we continued to drive momentum in an increasingly competitive environment. / Executing integration according to plan. / Full year mobile service revenue outlook reiterated with range narrowed to slightly negative year-on-year. / Full year 2016 outlook for OIBDA before exceptional and special effects reiterated. / Full year CapEx outlook updated to mid to high single-digit percentage growth.*

In the first half of 2016, Telefónica Deutschland Group continued to drive momentum in an increasingly competitive environment in German mobile, leveraging investments in the O<sub>2</sub> brand and thus the premium segment with a clear focus on retention and the development of the customer base.

At the same time, we saw further progress on the integration of E-Plus and are executing according to plan, while moving the focus from integration to transformation. Important milestones reached in 2016 include the second wave of the leaver programme, decisions with regards to the future multi-brand portfolio as well as good progress in network integration and the migration of the postpaid customer base of BASE and E-Plus to O<sub>2</sub>.

As of the end of June 2016, Telefónica Deutschland Group's access base increased by 1.2 % year-on-year to 48.6 million on the back of a 1.9 % year-on-year growth of the mobile base, which stood at 43.4 million accesses. Mobile postpaid continued to show good momentum in the market with 520 thousand net additions in the first six months of 2016 compared to 342 thousand in the same period of the previous year. The postpaid customer base grew 2.6 % year-on-year

to 19.6 million accesses as of 30 June 2016 on the back of an increasingly strong performance of the partner business. The mobile prepaid customer base was up 1.3 % year-on-year to 23.8 million accesses.

As expected, mobile service revenues (MSR) declined 1.5 % year-on-year for January to June 2016 to EUR 2,694 million, reflecting the increasing competitive dynamics and associated strength of the partner business, which resulted in a higher share of wholesale revenues. In addition, the company continued to focus on the development of its customer base and saw headwinds from regulatory effects. Telefónica Deutschland Group reiterates the full-year outlook for MSR, but is narrowing the range from 'slightly negative to broadly stable year-on-year' to 'slightly negative year-on-year', mainly on the back of the above-mentioned effects.

Operating Income before Depreciation and Amortisation (OIBDA) in the first half of 2016 (EUR 1,170 million) benefited from the net capital gain related to the sale of the company's passive tower infrastructure to Telefónica S.A.'s infrastructure company Telxius S.A. in the second quarter of EUR 352 million (➤ **OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32**). It also continued to reflect the roll-over effects of synergies executed in prior year as well as transformation-related OpEx effects.

OIBDA before exceptional and special effects in the first six months of 2016 grew 3.5 % year-on-year to EUR 860 million in line with our expectations, with in-year savings from integration activities (OPEX and revenue) amounting to approx. EUR 95 million. The OIBDA margin increased by 1.7 %-points year-on-year to 23.3 %. As such, Telefónica Deutschland Group reiterates its full year 2016 outlook for OIBDA before exceptional and special effects.

### T01 — Overview First Half 2016

	Base line for 2015 (Euros in millions)	Initial Outlook 2016 (year-on-year pct. growth)	First Half 2016 (y-o-y pct. growth)	Evaluation of the First Half 2016
MSR	5,532	Slightly negative to broadly stable	-1.5 %	As expected
OIBDA before exceptional and special effects	1,760	Low to mid-single- digit % growth	+3.5 %	As expected
CapEx	1,032	% growth in the low tens	-7.1 %	As expected

As expected, CapEx fell 7.1 % year-on-year in the first half of 2016 (EUR 430 million). Telefónica Deutschland Group is executing according to plan, with back-end loaded CapEx phasing across the year. We are updating our full year CapEx outlook to mid to high single digit percentage growth on the back of a more efficient CapEx spend as well as phasing topics related to network roll-out.

Business development is further detailed in the following sections.

### Significant events

#### Placement of a syndicated loan

On 22 March 2016, the Telefónica Deutschland Group agreed a syndicated loan facility in the amount of EUR 750 million, of which EUR 600 million was utilised in the reporting period. It serves general business purposes and has a term of five years. The loan term can be extended to no later than March 2023.

#### Framework redundancy plan

After the execution of the restructuring programme and the related reduction of around 800 full-time equivalents (FTEs) in 2015, according to an agreement with the Works Council another 500 FTEs were given clarity about their employment situation by the middle of 2016. The company continues to target a reduction of around 1,600 FTEs in total by 2018.

#### Annual General Meeting and dividend

The Annual General Meeting for the 2015 financial year took place on 19 May 2016. In addition to presenting the Annual Financial Statements of Telefónica Deutschland, including the Group Management Report and the Consolidated Financial Statements, and electing a new member of the Supervisory Board, the resolutions adopted by the Annual General Meeting included a dividend payment of EUR 0.24 per entitled share, EUR 713,893,198.32 in total. The dividend was paid to the shareholders on 20 May 2016.

In addition, the Annual General Meeting resolved new authorised capital 2016/I of EUR 1,487,277,496, suspending the former authorised capital 2012/I, and resolved a new authorisation to buy back own shares up to a total of 10 % of share capital on the date of the resolution or – if lower – on

the date the authorisation is exercised, suspending the previous authorisation to buy back own shares of 5 October 2012.

#### Changes in the Supervisory Board of Telefónica Deutschland

Antonio Manuel Ledesma Santiago left the Supervisory Board of Telefónica Deutschland with effect as of the end of the Annual General Meeting on 19 May 2016.

Peter Erskine was elected as his successor by the Annual General Meeting on 19 May 2016. His term in office began at the end of the 2016 Annual General Meeting and will last until at the end of the 2017 Annual General Meeting.

In addition, the Deputy Chairperson of the Supervisory Board Imke Blumenthal left the Supervisory Board of Telefónica Deutschland on 30 June 2016 (REPORT ON EVENTS AFTER THE REPORTING PERIOD, P. 44).

#### Sale of passive tower infrastructure to Telxius S.A.

According to a decision of the relevant bodies of Telefónica Deutschland in April 2016, the Telefónica Deutschland Group sold passive tower infrastructure to Telefónica, S.A.'s infrastructure company Telxius Telecom S.A. (Telxius S.A.) on 21 April 2016 with a net capital gain from the sale of EUR 352 million.

The cash proceeds from the transaction enhance the company's financial flexibility and will be reinvested in the business to support infrastructure development and the development of new growth areas.

Following the sale, the Telefónica Deutschland Group will continue to use the wireless towers through operating lease agreements. The transaction will have no impact on the Telefónica Deutschland Group's targeted synergies from the merger with E-Plus.

#### Financing agreement signed with European Investment Bank (EIB)

On 13 June 2016, the Telefónica Deutschland Group signed its first financial agreement with the EIB amounting to EUR 450 million. The facility was not yet utilised in the reporting period and serves to finance the consolidation, modernisation and expansion of the Telefónica Deutschland Group's mobile network after the acquisition of the E-Plus Group. The funds provided by the EIB have terms of up to eight years.

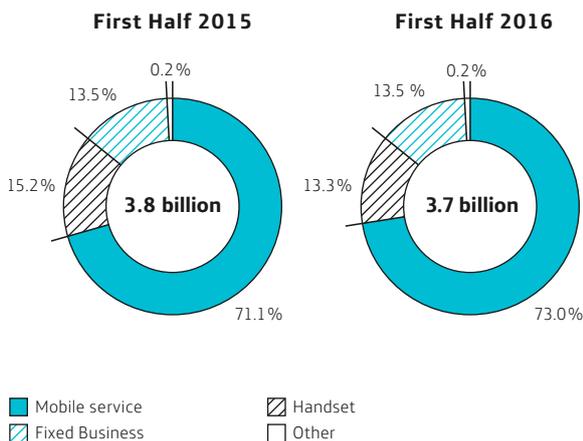
## Results of operations

*Revenues declined to EUR 3.7 billion./Mobile service revenues down slightly as expected./Expenses declined due to the realisation of synergies./OIBDA before exceptional and special effects increased to EUR 860 million.*

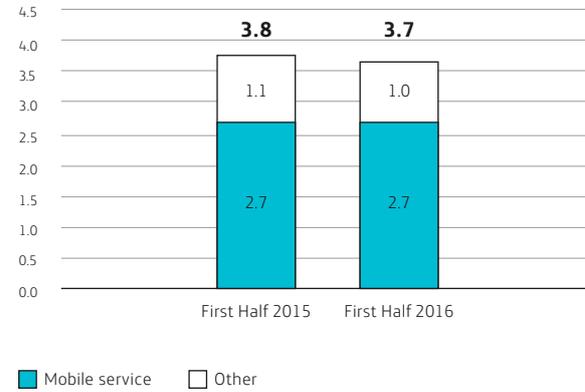
### Revenues declined

In the first half of 2016, our revenues declined by EUR 158 million or 4.1 % to EUR 3,691 million compared to the same period of the previous year. This is due to the lower level of revenues from mobile business, especially handset revenues driven by a market slowdown in the demand for handsets. Also mobile service revenues decreased slightly. This is a reflection of the increasingly competitive dynamics and the associated strength of the partner business, which resulted in a higher share of wholesale revenues. Revenues from fixed business were lower due to the smaller DSL customer base and phasing of promotions. The positive effect of the increasing demand for mobile data continued and therefore mobile data business (without sms) still increased.

**G12—Revenues (in %)**



**G13—Revenues (Euros in billion)**



### Mobile service revenues down slightly

Our mobile service revenues in the first half of 2016 amounted to EUR 2,694 million and, in line with our expectations, were down slightly with a decline of EUR 41 million or 1.5 % year on year.

In an increasingly demanding and competitive market in Germany, we performed well thanks to our focus on customer retention measures for our own brands and the strong growth in customer numbers, especially for our partner brands. Accordingly, our postpaid mobile customer base grew by 520 thousand net adds to 19.6 million in the first half of 2016 (increase in the first half of 2015: 342 thousand), which resulted in an increase in the proportion of postpaid customers in our mobile customer base of 0.3 percentage points to 45.2%. Due to a lower price level in the partner business, the average revenue per user (ARPU) declined accordingly to EUR 10.3 compared to the previous year (first half of 2015: EUR 10.7). Network enhancements in connection with the use of both mobile networks of O<sub>2</sub> and E-Plus by way of national roaming since 2015 also improved the customer experience in the first half of 2016. Moreover, the increase in LTE network coverage is progressing continuously. Demand for data services (e.g. mobile internet, service applications and other data content) remained on the rise, boosted by the growing number of LTE-enabled mobile phones in connection with the increased usage of mobile audio and video applications. We have further intensified the monetisation of our

mobile data business with our “O<sub>2</sub> Blue All-in” portfolios and our customers' use of the data automatic and data upselling mechanisms ( GOALS AND STRATEGIES, S. 20).

#### Handset revenues down

Handset revenues are subject to fluctuation, as they depend on the launch of new mobile devices. In the first half of 2016, handset revenues were EUR 493 million and thus EUR 93 million or 15.9 % lower than in the previous year. Sales figures for mobile devices – including to mobile partners – declined, in particular due to an increasing German handset market saturation and smartphones being used longer. This is consistent with the general development of the European markets ( OVERALL ECONOMIC AND INDUSTRY CONDITIONS, P. 28).

Mobile revenues, comprising mobile service revenues and handset revenues, amounted to EUR 3,187 million in the first half of 2016. This corresponds to a year-on-year decline of EUR 134 million or 4.0 %.

#### Decline in revenues from fixed business slows down

In the first half of 2016, revenues from fixed business amounted to EUR 498 million. This corresponds to a decline of EUR 24 million or 4.5 % compared with the same period of the previous year whereas VDSL retail business momentum

was strong. Therefore in both quarters of the first half of 2016, growth in net adds was generated in the retail DSL business (first half of 2016: 6 thousand). We continued to benefit from spot trading opportunities in the carrier voice business, while wholesale DSL declined in line with expectations. DSL retail revenue also declined on the back of a customer base reduction of 0.5 % in comparison to the previous year as a result of the progressive decommissioning of the ULL broadband access infrastructure and the decline in fixed voice accesses and phasing of promotions.

#### Other revenues broadly stable

In the first half of 2016, other revenues declined by 5.5 % year on year and remained broadly stable at EUR 6 million.

#### Other income increased by exceptional effects

In the first half of 2016, other income increased by EUR 353 million or 427.4 % to EUR 436 million. Both 2016 and 2015 included exceptional effects. In the first half of 2016, this included a one-time net capital gain from the sale of passive tower infrastructure to Telxius S.A. ( OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32). In the first half of 2015, there was a non-recurring gain (before purchase price adjustment) of EUR 17 million on the disposal of yourfone GmbH.

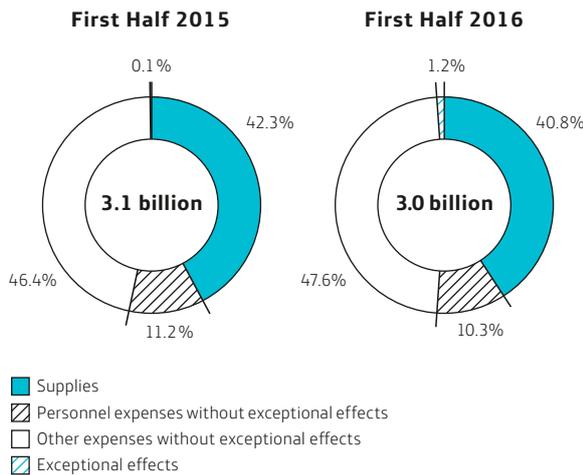
## T02 — Revenue Breakdown

(Euros in millions)	January 1 to June 30			
	2016	2015	Change	% Change
<b>Mobile business</b>	<b>3,187</b>	<b>3,321</b>	<b>(134)</b>	<b>(4.0)</b>
Mobile service revenues	2,694	2,735	(41)	(1.5)
Handset revenues	493	586	(93)	(15.9)
<b>Fixed business</b>	<b>498</b>	<b>521</b>	<b>(24)</b>	<b>(4.5)</b>
<b>Other revenues</b>	<b>6</b>	<b>7</b>	<b>(0)</b>	<b>(5.5)</b>
<b>Revenues</b>	<b>3,691</b>	<b>3,849</b>	<b>(158)</b>	<b>(4.1)</b>

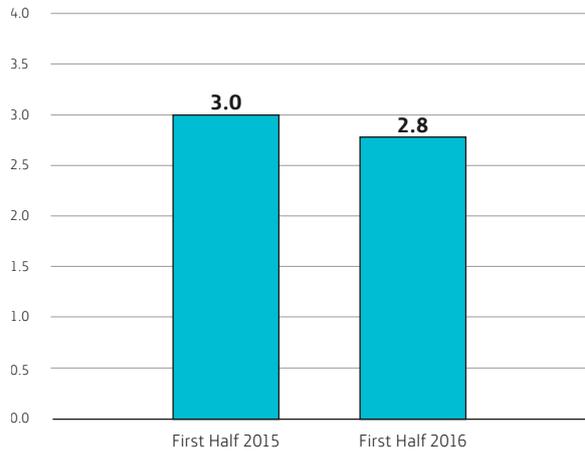
**Development of operating expenses reflects savings due to post-merger synergies**

In the first half of 2016, operating expenses, comprising supplies, personnel expenses and other expenses, decreased by EUR 129 million or 4.2 % year on year to EUR 2,958 million. The decrease in operating expenses is due primarily to the fast realisation of integration-related synergies as a result of the merger with the E-Plus Group from 1 October 2014. Expenses for restructuring in the context of the integration in an amount of EUR 37 million were recognised in both personnel expenses and other expenses.

**G 14 — Operating Expenses (in %)**



**G 15 — Sum of operating expenses and other income without exceptional effects (Euros in billions)**



**Decline in supplies driven by lower revenues**

In the first half of 2016, supplies amounted to EUR 1,206 million. This corresponds to a year-on-year decline of EUR 99 million or 7.6 %, due especially to lower expenses for handsets sold as a result of the decreased demand for mobile devices as well as lower service revenues.

**Personnel expenses reduced in half-year comparison**

Personnel expenses declined by EUR 11 million or 3.2 % to EUR 333 million in the first half of 2016. Adjusted for personnel-related restructuring expenses (first half of 2015: EUR 0 million; first half of 2016: EUR 28 million), the decrease would actually have amounted to 11.7 %. This is due primarily to the lower number of full-time equivalents.

### Decrease in other expenses

Other expenses amounted to EUR 1,418 million in the first half of 2016, a decrease of EUR 19 million or 1.3 % as against the first half of 2015. Adjusted for restructuring expenses (first half of 2015: EUR 4 million; first half of 2016: EUR 8 million), the decrease would have amounted to 1.9 %. Savings resulted from the 2015 synergy initiatives, but were partly offset by commercial and other investments related to customer migration activities in the first half 2016.

### Progress in integration reflected in positive OIBDA development

We generated OIBDA adjusted for exceptional and special effects of EUR 860 million in the first half of 2016, which corresponds to a growth of EUR 29 million or 3.5 % for the first half of 2016. This reflects the lower cost base thanks to the realisation of synergies from the integration. At 23.3 %, the resulting OIBDA margin before exceptional and special effects was up by 1.7 %-points compared to the figure of the previous year.

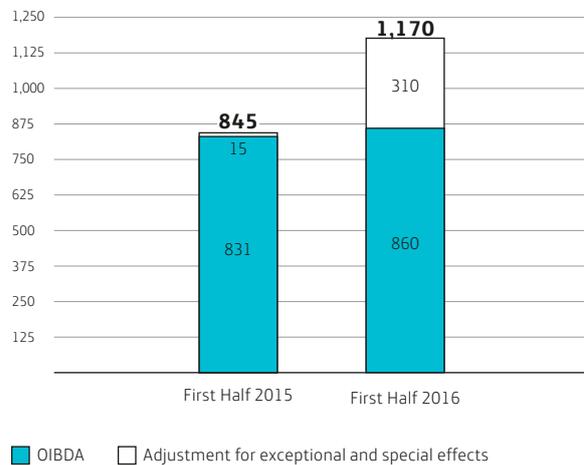
Exceptional effects in the first half of 2016 comprise restructuring costs in an amount of EUR 37 million and a one-time net capital gain of EUR 352 million from the sale of passive tower infrastructure to Telxius S.A. while in the previous year's period a non-recurring gain of EUR 17 million on the disposal of yourfone GmbH was included.

Special effects in the first half 2016 comprise effects which the Telxius transaction had on OIBDA. These refer to higher operating-lease expenses (EUR 6 million in the first half 2016).

OIBDA for the first half of 2016 amounted to EUR 1,170 million, an increase of EUR 324 million or 38.3 % as against the same period of the previous year. This is due in particular to the one-time net capital gain from the sale of EUR 352 million on the sale of passive tower infrastructure to Telxius S.A. (OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32).

The resulting OIBDA margin was above the previous year's level at 31.7 % (first half of 2015: 22.0 %).

### G 16 — OIBDA without exceptional and special effects (Euros in millions)



**Depreciation and amortisation nearly unchanged**

Depreciation and amortisation increased by EUR 36 million or 3.5 % to EUR 1,069 million during the reporting period (first half of 2015: EUR 1,033 million). The increase mainly resulted from higher investments in software and network equipment in connection with the accelerated network expansion (• **NET ASSETS, P. 41**).

**Operating income improved by exceptional effects**

Operating income improved by EUR 288 million or 153.5 % to EUR 100 million compared to the previous year (first half of 2015: EUR -188 million). This increase is primarily due to the sale of passive tower infrastructure to Telxius S.A., which resulted in a net capital gain of EUR 352 million (• **OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32**).

**Net financial expense improved due to lower interests**

Net financial expense for the six month ended 30 June 2016 amounted to EUR -18 million (first half of 2015: EUR -25 million) and – with a similar level of net debt – has improved primarily because of lower interest from the finance lease obligation and lower interest due to the full repayment of the loan from Telfisa Global B.V. in 2016. Net financial expense primarily includes interest for the bonds issued in November 2013 and February 2014 and the private placement of promissory notes and registered bonds on 13 March 2015. In addition, net financial expense also includes interest from the financial lease obligation and interest for the revolving credit facility concluded in March 2016.

The above mentioned effects resulted in net income for the period of EUR 83 million for the first six months of 2016 compared to the loss for the period of EUR -213 million in the previous year.

**T03— Consolidated Income Statement**

(Euros in millions)	January 1 to June 30			
	2016	2015 <sup>1</sup>	Change	% Change
<b>Revenues</b>	<b>3,691</b>	<b>3,849</b>	<b>(158)</b>	<b>(4.1)</b>
Other income	436	83	353	>100
Operating expenses	(2,958)	(3,087)	129	(4.2)
Supplies	(1,206)	(1,306)	99	(7.6)
Personnel expenses	(333)	(345)	11	(3.2)
Other expenses	(1,418)	(1,436)	19	(1.3)
<b>Operating income before depreciation and amortisation (OIBDA)</b>	<b>1,170</b>	<b>845</b>	<b>324</b>	<b>38.3</b>
<b>OIBDA margin</b>	<b>31.7%</b>	<b>22.0%</b>		<b>9.7%-p.</b>
Depreciation and amortisation	(1,069)	(1,033)	(36)	3.5
<b>Operating income</b>	<b>100</b>	<b>(188)</b>	<b>288</b>	<b>&gt;(100)</b>
Net financial income/(expense)	(18)	(25)	8	(30.5)
<b>Profit/(loss) before tax</b>	<b>83</b>	<b>(213)</b>	<b>296</b>	<b>&gt;(100)</b>
Income tax	0	0	(0)	(80.8)
<b>Total profit/(loss) for the period</b>	<b>83</b>	<b>(213)</b>	<b>296</b>	<b>&gt;(100)</b>

<sup>1</sup> In the Interim Condensed Consolidated Statement of Financial Position as of 30 June 2016, the previous year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Statement for the year ended December 31, 2015 (Note No 7, Business Combination).

## Financial position

*The net leverage ratio will be kept at or below 1.0x in the medium term./Net financial debt amounted to EUR 1,356 million./Net leverage ratio of 0.8x./Free cash flow increased to EUR 599 million as a result of the sale of passive tower infrastructure to Telxius S.A.*

### Finance analysis

#### Growth in net financial debt due to factors including the dividend payment

Table 4 shows the composition of net financial debt – i.e. the net amount of interest-bearing financial liabilities less any cash and cash equivalents and interest-bearing financial assets and receivables.

Compared to 31 December 2015, net financial debt increased by EUR 132 million to EUR 1,356 million as of 30 June 2016, resulting in a leverage ratio<sup>2</sup> of 0.8x.

The increase in net financial debt during the first six months of the year was mainly attributable to the dividend payment for the financial year 2015 of EUR 714 million. The cash inflow from the sale of passive tower infrastructure to Telxius S.A. had a contrary effect of EUR 587 million (**OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32**).

Graph 17 on page 39 illustrates the development of net financial debt during the first six months of the financial year 2016.

<sup>2</sup> Leverage is defined as the net financial debt divided by adjusted LTM (Last Twelve Months) OIBDA before exceptional effects (30 June 2016: EUR 1,784 million; 31 December 2015: EUR 1,760 million).

### T04 — Development of consolidated net financial debt

(Euros in millions)	As of June 30	As of December 31		
	2016	2015	Change	% Change
A Liquidity	276	533	(257)	(48.2)
B Current financial assets	330	324	7	2.1
C Current financial debt	87	564	(478)	(84.6)
D=C-A-B Current net financial debt	(520)	(292)	(227)	77.9
E Non-current financial assets	147	169	(22)	(13.2)
F Non-current financial debt	2,023	1,686	337	20.0
G=F-E Non-current net financial debt	1,876	1,517	359	23.7
H=D+G Net financial debt <sup>1</sup>	1,356	1,225	132	10.8

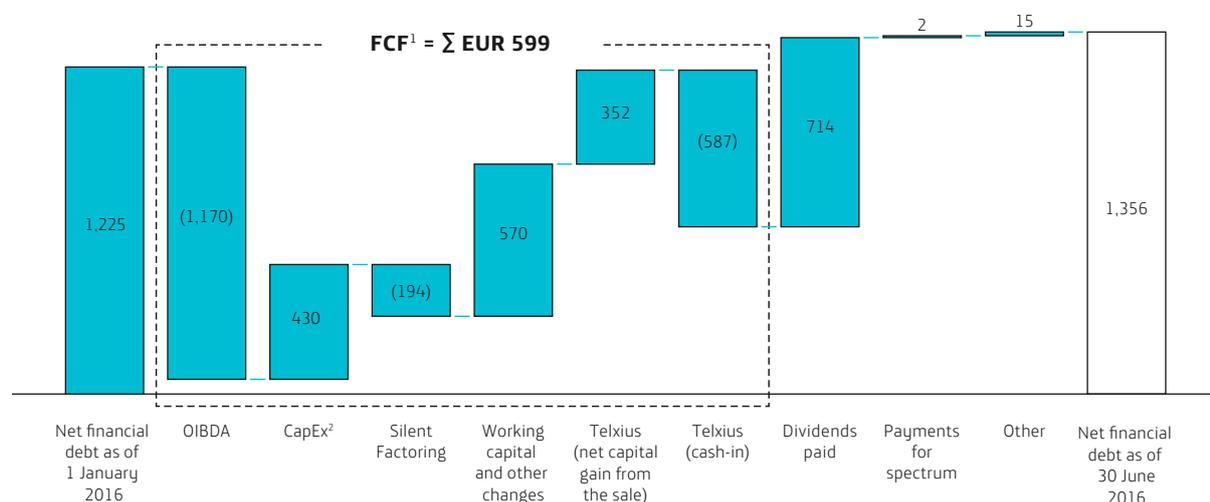
<sup>1</sup> Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents.

**B + E** Current and non-current financial assets include handset – receivables (current: EUR 327 million in 2016 and EUR 321 million in 2015; non-current: EUR 132 million in 2016 and EUR 157 million in 2015), positive Fair value Hedge for fixed interest financial liabilities (current: EUR 2 million in 2016 and EUR 2 million in 2015; non-current: EUR 15 million in 2016 and EUR 12 million in 2015) as well as loans to third parties (current: EUR 1 million in 2016 and EUR 1 million in 2015; non-current: EUR 0 million in 2016 and EUR 1 million in 2015).

**C + F** Current and non-current net financial debt include bonds, promissory notes and registered bonds issued (EUR 1,421 million in 2016 and EUR 1,420 million in 2015), other loans (EUR 598 million in 2016 and EUR 501 million in 2015), finance lease payables (current: EUR 73 million in 2016 and EUR 180 million in 2015; non-current: EUR 17 million in 2016 and EUR 32 million in 2015) as well as current interest bearing trade payables (EUR 0 in 2016 and EUR 119 million in 2015).

**Note:**

Handset - receivables are shown under trade and other receivables in the Consolidated Statement of Financial Position. Pending payments for spectrum amounting to EUR 221 million (including capitalised costs of borrowed capital) are shown under trade payables against third parties in the Consolidated Statement of Financial Position and are therefore not included in the net financial debt calculation.

**G 17 — Development of net financial debt** (Euros in millions)

1 Free cash flow pre dividends and payments for spectrum as well as pre-acquisition of E-Plus net of cash acquired

2 Excluding investments in spectrum in June 2015 amounting to EUR 1,198 million (including capitalised costs on borrowed capital)

**Liquidity analysis****Consolidated Statement of Cash Flows**

The following is an analysis of the cash flow development of the Telefónica Deutschland Group in the first six months of the financial years 2016 and 2015.

**Changes in cash flow from operating activities slightly below previous year level**

Cash flow from operating activities for the first six months of 2016 amounted to EUR 605 million, and thus EUR 36 million or 5.6 % slightly lower than the amount of the previous year (first half of 2015: EUR 641 million).

**Changes in cash flow from investing activities positively driven by lower investments in frequency usage rights**

Cash flow from investing activities amounted to EUR -8 million for the first six months of 2016 (first half of 2015: EUR -1,492 million). Cash inflow increased amounting to EUR 508 million compared to the previous year. Cash outflow decreased amounting to EUR 976 million compared to the previous year.

The decline in cash outflows is primarily caused by the one time effect amounting to EUR 976 million (first half of 2016: EUR 2 million) due to investments in frequency usage rights in the previous year. In addition, the reduction in cash flow from investing activities was affected by the EUR 587 million cash inflow from the sale of passive tower infrastructure

**T 05 — Consolidated Statement of Cash Flows**

(Euros in millions)	January 1 to June 30	
	2016	2015
<b>Cash and cash equivalents at the beginning of the period</b>	<b>533</b>	<b>1,702</b>
Cash flow from operating activities	605	641
Cash flow from investing activities	(8)	(1,492)
Cash flow from financing activities	(854)	(637)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(257)</b>	<b>(1,488)</b>
<b>Cash and cash equivalents at the end of the period</b>	<b>276</b>	<b>214</b>

to Telxius S.A. (OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32). Investments in property, plant and equipment and intangible assets<sup>3</sup> declined, totalling EUR 599 million in the first six months of the financial year 2016. These related mainly to investments for the acquisition of software and network equipment in connection with the accelerated network expansion.

<sup>3</sup> Investments, or CapEx (first half of 2016: EUR 430 million; first half of 2015: EUR 463 million) plus payments on investments in mobile phone frequency auctions (first half of 2016: EUR 2 million; first half of 2015: EUR 976 million) plus the change in liabilities for investments made (first half of 2016: EUR 107 million; first half of 2015: EUR 168 million) plus the change in provisions for outstanding invoices for investments (first half of 2016: EUR 60 million; first half of 2015: EUR -32 million) result in payments for investments in property, plant and equipment and intangible assets of EUR 599 million in the first six months of the financial year 2016 (first half of 2015: EUR 1,575 million).

#### Changes in Cash flow from financing activities influenced in particular by loan repayment

Cash flow from financing activities amounted to EUR -854 million during the first six months of 2016. Cash outflows increased in comparison to the previous year (first half of 2015: EUR -637 million) by EUR 217 million.

Cash outflow was primarily driven by the repayment of the remaining loan from Telfisa Global B.V. of EUR 500 million and offset by the EUR 300 million increase in cash inflow from the proceeds received from interest-bearing debt. For this purpose, EUR 600 million was drawn from the syndicated credit facility concluded in March 2016 in the first half of 2016.

#### Cash and cash equivalents lower year on year

Due to the cash inflows/outflows described above, cash and cash equivalents decreased in comparison to the reporting date as of 31 December 2015 by EUR 257 Million. Cash and cash equivalents amounted to EUR 276 million as of 30 June 2016 (31 December 2015: EUR 533 million).

### T06— Reconciliation of cash flow and OIBDA minus CapEx

(Euros in millions)	January 1 to June 30			
	2016	2015	Change	% Change
<b>OIBDA</b>	<b>1,170</b>	<b>845</b>	<b>324</b>	<b>38.3</b>
- CapEx <sup>1</sup>	(430)	(463)	33	(7.1)
<b>= Operating cash flow (OpCF)</b>	<b>740</b>	<b>383</b>	<b>357</b>	<b>93.3</b>
+ Silent Factoring <sup>2</sup>	194	367	(172)	(47.1)
+/- Other working capital movements	(554)	(672)	118	(17.5)
<b>Change in working capital</b>	<b>(360)</b>	<b>(306)</b>	<b>(55)</b>	<b>17.9</b>
+/- Gains/(losses) from sale of companies	(353)	(17)	(335)	>100
+/- Proceeds from sale of companies	-	61	(61)	(100.0)
+/- Proceeds from sale of fixed assets and other effects	591	-	591	-
+ Net interest payments	(19)	(18)	(1)	5.9
+ Proceeds/Payment on financial assets	(1)	(0)	(0)	>100
<b>= Free cash flow pre dividends and payments for spectrum<sup>3</sup> as well as pre-acquisition of E-Plus net of cash acquired</b>	<b>599</b>	<b>102</b>	<b>496</b>	<b>&gt;100</b>
+ Acquisition of E-Plus net of cash acquired	-	22	(22)	(100.0)
<b>= Free cash flow pre dividends and payments for spectrum<sup>3</sup></b>	<b>599</b>	<b>125</b>	<b>474</b>	<b>&gt;100</b>
- Payments for spectrum	(2)	(976)	974	(99.8)
- Dividends <sup>4</sup>	(714)	(714)	0	(0.0)
<b>= Free cash flow post dividends and spectrum</b>	<b>(117)</b>	<b>(1,565)</b>	<b>1,448</b>	<b>(92.5)</b>

<sup>1</sup> Excluding investments in spectrum in June 2015 amounting to EUR 1,198 million and excluding capitalised costs on borrowed capital.

<sup>2</sup> Full impact (YTD) of silent factoring in the first half year of 2016 of EUR 194 million and of EUR 367 million in the first half year of 2015 (transactions were executed in March and June 2016 respectively in January, March and June 2015).

<sup>3</sup> Free cash flow pre dividends and payments for spectrum is defined as the sum of cash flow from operating activities and cash flow from investing activities and does not contain payments for investments in spectrum in June 2015 as well as related interest payments.

<sup>4</sup> Dividend payment of EUR 714 million in May 2016. Dividend payment of EUR 714 million in May 2015.

**Free cash flow before dividends and payments for spectrum and before E-Plus acquisition considerably improved through the sale of passive tower infrastructure to Telxius S.A.**

Free cash flow<sup>4</sup> before dividends and payments for spectrum and before the acquisition of E-Plus increased by EUR 496 million and amounted to EUR 599 million in the six-month period ended 30 June 2016 (first half of 2015: EUR 102 million).

This development is primarily the result of the sale of passive tower infrastructure to Telxius S.A., which resulted in the Group recognising a net capital gain of EUR 352 million and which is reflected in the EUR 357 million increase in operating cash flow (first half of 2016: EUR 740 million; first half of 2015: EUR 383 million). The payment received for the purchase price receivable for the above sale to Telxius S.A.

<sup>4</sup> See Annual Report 2015, p. 21

amounted to EUR 587 million (OVERVIEW OF THE FIRST HALF 2016 – SIGNIFICANT EVENTS, P. 32).

The EUR 55 million decrease in the change to working capital in the first half of the financial year 2016 is mainly attributable to the payment of the non-current portion of the liability in the amount of EUR 100 million as a result of the assumption of obligations from mobile network sites transferred to Deutsche Telekom as part of the network integration. Movements in other working capital lines had contrary effects.

### Net assets

The following analysis of the asset and capital structure in table 7, page 41, compares the assets and liabilities as of 30 June 2016 to the figures as of 31 December 2015.

The group reported total assets of EUR 15,712 million as of 30 June 2016 (31 December 2015: EUR 16,654 million), which represents a decrease of 5.7%.

## T07— Consolidated Statement of Financial Position

(Euros in millions)	As of June 30		As of December 31	
	2016	2015	Change	% Change
Goodwill and other intangible assets	8,546	9,014	(468)	(5.2)
Property, plant and equipment	4,193	4,507	(314)	(7.0)
Trade and other receivables	1,725	1,677	48	2.9
Deferred tax assets	505	505	–	–
Other financial assets	77	73	3	4.7
Other non-financial assets	314	221	93	41.9
Inventories	76	123	(47)	(38.5)
Cash and cash equivalents	276	533	(257)	(48.2)
<b>Total assets = Total equity and liabilities</b>	<b>15,712</b>	<b>16,654</b>	<b>(942)</b>	<b>(5.7)</b>
Interest-bearing debt	2,113	2,254	(141)	(6.2)
Provisions	796	712	85	11.9
Trade and other payables	2,202	2,425	(223)	(9.2)
Other non-financial liabilities	96	48	49	>100
Deferred income	871	895	(24)	(2.7)
<b>Equity</b>	<b>9,633</b>	<b>10,321</b>	<b>(688)</b>	<b>(6.7)</b>

### **Intangible assets decreased in particular due to amortisation**

Intangible assets including goodwill amounted to EUR 8,546 million as of 30 June 2016 (31 December 2015: EUR 9,014 million). The decline of EUR 468 million or 5.2 % resulted from the amortisation of intangible assets with a finite useful life of EUR 602 million during the six-month period ended 30 June 2016 (first half of 2015: EUR 575 million) and from the decline in goodwill due to the sale of Telxius Towers Germany GmbH (formerly Telefónica Germany Vermögensverwaltungsgesellschaft mbH) to Telxius S.A. (OVERVIEW OF THE FIRST HALF OF 2016 - SIGNIFICANT EVENTS, P. 32). This was offset by the additions to intangible assets of EUR 158 million, which related primarily to investments in software.

### **Property, plant and equipment reduced by sale of passive tower infrastructure to Telxius S.A.**

Property, plant and equipment amounted to EUR 4,193 million as of 30 June 2016 (31 December 2015: EUR 4,507 million), which represents a decline of EUR 314 million or 7.0 %. The majority of this decline resulted from the sale of passive tower infrastructure with a net book value of EUR 277 million to Telxius S.A. (OVERVIEW OF THE FIRST HALF OF 2016 - SIGNIFICANT EVENTS, P. 32).

Additions to property, plant and equipment in the reporting period amounted to EUR 275 million (first half of 2015: EUR 337 million) and related mainly to investments in network equipment in connection with the accelerated network expansion including the further roll-out of the LTE network, the expansion of UMTS technology capacities, the expansion of IP technologies and improved coverage, with mobile data services offering even quicker download times.

Additions to assets in property, plant and equipment relating to dismantling and removal obligations increased by

EUR 160 million, which is attributable primarily to the higher cost estimates based on new insights and to the interest rate trend.

The effect of the additions was offset by depreciation of EUR 467 million (first half of 2015: EUR 512 million).

### **Lower investments (CapEx)**

CapEx amounted to EUR 430 million in the first half of 2016 compared with EUR 463 million in the first half of 2015. CapEx phasing throughout the year is back-end loaded due to the intensification of network integration efforts in the second half of 2016 as expected.

### **Slight increase in trade and other receivables**

Trade and other receivables amounted to EUR 1,725 million as of 30 June 2016 and were thus slightly higher than the previous year's figure (31 December 2015: EUR 1,677 million). The change of EUR 48 million or 2.9 % relates to the reporting date date.

### **Other financial assets slightly above the previous year's level**

Other financial assets amounted to EUR 77 million as of 30 June 2016, which represents a slight increase of EUR 3 million or 4.7 % from the previous year (31 December 2015: EUR 73 million). This item consisted primarily of the positive fair value of two interest rate swaps, equity investments in start-up enterprises, a silent factoring deposit and claims for reimbursement under insurance policies.

### **Other non-financial assets increased due to advance payments made**

Other non-financial assets amounted to EUR 314 million as of 30 June 2016 (31 December 2015: EUR 221 million). The increase of EUR 93 million or 41.9 % is mainly due to the increase in advance payments for rent of antenna sites and leased lines.

### **Inventories decreased due to increased sale of mobile devices**

Inventories amounted to EUR 76 million as of 30 June 2016 (31 December 2015: EUR 123 million). The decline of EUR 47 million or 38.5% was essentially due to the increased sale of mobile devices.

### **Cash and cash equivalents declined**

Cash and cash equivalents totalled EUR 276 million as of 30 June 2016 (31 December 2015: EUR 533 million). This decrease of EUR 257 million or 48.2% is due to several effects. (LIQUIDITY ANALYSIS, P. 39).

### **Interest-bearing debt down slightly on previous year**

Compared to 31 December 2015, interest-bearing debt fell by EUR 141 million or 6.2% from EUR 2,254 million to EUR 2,113 million as of 30 June 2016. This decline resulted in particular from the full repayment of the remaining loan of EUR 500 million granted by Telfisa Global B.V., the payment of trade payables of EUR 119 million, for which agreements were made in the past financial year to extend the payment periods, and the EUR 121 million decline in finance lease obligations.

This was offset by the syndicated loan facility of EUR 750 million signed on 22 March 2016, of which EUR 600 million had been utilised as of 30 June 2016.

### **Slight increase in provisions**

Provisions increased from EUR 712 million as of 31 December 2015 by EUR 85 million or 11.9% to EUR 796 million as of 30 June 2016. This increase related primarily to the change in non-current dismantling and removal of asset obligations totalling EUR 76 million. In addition to higher cost estimates based on new insights and an addition attributable to the interest rate trend of EUR 160 million, this change includes a disposal relating to the sale of passive tower infrastructure to

Telxius S.A. of EUR 83 million (OVERVIEW OF THE FIRST HALF OF 2016 – SIGNIFICANT EVENTS, P. 32).

### **Decrease in trade and other payables**

Trade and other payables amounted to EUR 2,202 million as of 30 June 2016. Compared to 31 December 2015 (EUR 2,425 million), this equates to a decline of EUR 223 million or 9.2%. The decline is attributable in particular to the payment of the non-current portion of the liability in the amount of EUR 100 million as a result of the assumption of obligations from mobile network sites transferred to Deutsche Telekom in the course of the network integration process.

### **Other non-financial liabilities above previous year**

Other non-financial liabilities amounted to EUR 96 million as of 30 June 2016 (31 December 2015: EUR 48 million). These include VAT payables, wage taxes and social security contributions in particular.

### **Slight decrease in deferred income**

Deferred income decreased by EUR 24 million or 2.7% compared to 31 December 2015 and amounted to EUR 871 million as of 30 June 2016. The decrease resulted in particular from the decrease in advance payments for prepaid credit by EUR 16 million. Deferred income was further impacted by services rendered in connection with the MBA MVNO contract as well as services received that were covered by advance payments in the past.

### **Equity declines**

Equity declined by EUR 688 million or 6.7% as of 30 June 2016 to EUR 9,633 million. The change in equity is mainly due to the dividend payment of EUR 714 million on 12 May 2016 and the remeasurement of the defined benefit plans of EUR 59 million. This was offset by the net income for the period of EUR 83 million.

# Report on Events after the Reporting Period\_

## **Change in the Supervisory Board of Telefónica Deutschland**

Christoph Braun is a member of the Supervisory Board of Telefónica Deutschland as successor to Imke Blumenthal (➔ **OVERVIEW OF THE FIRST HALF OF 2016 – SIGNIFICANT EVENTS, P. 32**) with effect from 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

## **Dividend Proposal for the financial year 2016**

On 26 July 2016, the Management Board of Telefónica Deutschland resolved its intention to propose a cash dividend of EUR 0.25 per share to the next Annual General Meeting.

There were no other reportable events after the end of the reporting period.

# Risk and Opportunity Management\_

In the combined management report for the 2015 financial year we presented certain risks that could have a significant, disadvantageous impact on our business, our net assets, financial position and result of operations and our reputation. Furthermore, in this report we described our main opportunities and the design of our risk management system.

In the reporting period we did not identify any further significant risks or opportunities in addition to those already presented in the combined management report for the 2015 financial year. Other risks and opportunities not currently known to us or that we presently consider to be immaterial could also influence our business activities. We do not anticipate the occurrence of any risks that, individually or in combination with other risks, could endanger the future of our company as a going concern.

# Report on expected developments\_

*Economic growth in Germany is set to continue./The market for mobile telecommunications services is expected to remain broadly stable./Outlook for mobile service revenues reiterated but the range is narrowed from "slightly negative to broadly stable year-on-year" to "slightly negative year-on-year"./Outlook for OIBDA before exceptional and special effects reiterated./CapEx Outlook is adjusted from "percentage growth in the low tens" to "mid to high single-digit growth" in year-on-year terms in 2016.*

## Economic outlook for Germany until 31 December 2016

The leading economic research institutes expect economic growth in Germany to continue in 2016. They are forecasting a 1.6% increase in gross domestic product. Private consumer spending will remain the pillar of the German economy in 2016. According to the GfK (Gesellschaft für Konsumforschung, consumer research association), consumer spending will rise by 2% in 2016. At the same time, the favourable conditions in the labour market and the sustained positive income expectations among private households are creating considerable scope for purchases, while the incentive to save remains low within the low-interest environment.

Any escalation at international trouble spots still poses a risk to the consumer economy, and thus also to overall economic development in Germany. It also remains to be seen how the planned United Kingdom exit from the European Union (Brexit) will affect the European, and above all the German, economy.

A rise in economic performance of 1.5% is expected for the euro area in 2016.

Source: GfK Konsumklima, Focus Economics, Bundesbank

## T 08 — GDP growth 2014–2016 for Germany and the Euro area

In %	2014	2015	2016
Germany	1.5	1.7	1.6
Euro area	0.8	1.5	1.5

## Market expectations

Market developments in Germany, one of Europe's largest telecommunications markets, will again be driven by rising customer demand for mobile and fixed line broadband and data services. The increasing use in smartphones and tablets, in addition to growing demand for LTE, are driving growth in mobile data services. Smartphones and tablets are becoming the trailblazers for the digital revolution of an all-round digital lifestyle in Germany. At the same time, the growing proliferation of data-based communications services, i.e. "over-the-top" (OTT) applications such as WhatsApp, Skype, Facebook, or Apple Facetime, is increasing data usage. This means that the monetisation of mobile data business will remain a strong focus of mobile telecommunications providers.

At the same time, the negative trend for mobile voice and SMS will continue as a result of further price pressure and changing customer behaviour. Analysts expect revenues in the market for mobile services in Germany to remain more or less stable until 2016.

Advancing digitalisation is changing the world long-term. The telecommunications industry is a major trailblazer for digitalisation here. Alongside the connection of people, the intelligent connection of things via the internet (IoT) also offers numerous application and growth possibilities. Another trend is data analysis, which is facilitating new insights as well as new business models.

Quelle: Analysys Mason, Bitkom

## Outlook until 31 December 2016

We reiterate our full-year outlook for MSR, but are narrowing the range from 'slightly negative to broadly stable' year-on-year to 'slightly negative' year-on-year on the back of increased competitive dynamics, especially in the non-premium end of the market. As expected, we also continue to see MSR headwinds from legacy customer base effects and regulatory effects. In contrast, data usage and our LTE customer base continue to grow, and we still expect this data growth to drive an inflection point in our MSR trajectory in the future.

At the same time we are reiterating our OIBDA outlook of 'low to mid single digit' year-on-year OIBDA percentage growth (before exceptional and special effects<sup>5</sup>). The narrowing of the MSR outlook range has no impact on our OIBDA outlook, as we continue to benefit from the roll-over effects of the successful integration initiatives in 2015, as well as

<sup>5</sup> Exceptional and special effects are excluded from our guidance. As of 30 June 2016 exceptional effects include restructuring expenses of EUR 37 million and the net capital gain from the sale of passive tower infrastructure to Telxius S.A. amounting to EUR 352 million, while in the same period of 2015 a one-off gain from the sale of yourfone GmbH was registered. As of 30 June 2016 special effects consist of the impact which the Telxius deal had on OIBDA (EUR -6 million in the first six months of 2016) resulting primarily from higher operating lease expenses starting in May 2016.

pushing ahead with employee restructuring, customer migration and network integration efforts in 2016. We thus continue to expect incremental OpEx and revenue-related in-year savings from synergies of approximately EUR 150 million, as well as a cumulated savings level of approximately EUR 430 million (>50 % of total operating cash flow target of EUR 800 million) by year-end 2016.

We are adjusting our CapEx outlook (excluding spectrum) from 'percentage growth in the low tens' to 'mid to high single-digit growth' in year-on-year terms in 2016. This is largely the result of more efficient CapEx spend as well as phasing topics related to the network integration.

We reiterate our general dividend policy. We view ourselves as a dividend-paying company with the intention to support a high payout ratio in relation to free cash flow. More specifically, over the next 3 years we intend to grow our dividend annually, starting with a dividend proposal of EUR 0.25 per share in 2016. The company leverage<sup>6</sup> target of 'at or below 1.0x net debt/OIBDA over the medium term' remains unchanged and will be continually reviewed.

<sup>6</sup> Leverage is defined as net financial debt divided by the OIBDA of the last twelve months before exceptional effects.

### T09— Summary of the financial outlook for 2016

	Base line 2015 (EUR million)	Initial Outlook 2016 (year-on-year pct. growth)	Updated Outlook 2016 (year-on-year pct. growth)
MSR	5,532	Slightly negative to broadly stable	Slightly negative
OIBDA before exceptional and special effects	1,760	Low to mid-single-digit % growth	Low to mid-single-digit % growth
CapEx	1,032	% growth in the low tens	mid to high single-digit % growth

# Material Related Party Transactions\_

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For information on material transactions with related parties please see the section “Related Parties” in the Condensed Notes to the Interim Consolidated Financial Statements as of 30 June 2016.

Munich, 11 August 2016

Telefónica Deutschland Holding AG

The Management Board



Thorsten Dirks



Rachel Empey



Markus Haas

Interim Condensed  
Consolidated Financial  
Statements\_  
for the period 1 January  
to 30 June 2016

# Consolidated Statement of Financial Position\_

Assets (Euros in millions)	Notes	As of 30 June 2016	As of 31 December 2015
<b>A) Non-current assets</b>		<b>13,567</b>	<b>14,406</b>
Goodwill	[6a]	1,932	1,955
Other intangible assets	[6b]	6,614	7,059
Property, plant and equipment	[6c]	4,193	4,507
Trade and other receivables	[6d]	132	157
Other financial assets		63	63
Other non-financial assets	[6e]	127	160
Deferred tax assets		505	505
<b>B) Current assets</b>		<b>2,145</b>	<b>2,248</b>
Inventories		76	123
Trade and other receivables	[6d]	1,593	1,520
Other financial assets		13	10
Other non-financial assets	[6e]	187	61
Cash and cash equivalents		276	533
<b>Total assets (A+B)</b>		<b>15,712</b>	<b>16,654</b>

Equity and Liabilities (Euros in millions)	Notes	2016	2015
<b>A) Equity</b>		<b>9,633</b>	<b>10,321</b>
Subscribed capital		2,975	2,975
Additional paid-in capital		4,800	4,800
Retained earnings		1,859	2,546
Equity attributable to owners of the parent		9,633	10,321
<b>B) Non-current liabilities</b>		<b>3,212</b>	<b>2,779</b>
Interest-bearing debt	[6f]	2,023	1,686
Trade and other payables	[6g]	153	154
Provisions	[6h]	641	516
Deferred income		396	424
<b>C) Current liabilities</b>		<b>2,867</b>	<b>3,554</b>
Interest-bearing debt	[6f]	90	568
Trade and other payables	[6g]	2,050	2,272
Provisions	[6h]	156	196
Other non-financial liabilities		96	48
Deferred income		475	471
<b>Total equity and liabilities (A+B+C)</b>		<b>15,712</b>	<b>16,654</b>

# Consolidated Income Statement\_

(Euros in millions)	Notes	1 April to 30 June		1 January to 30 June	
		2016	2015 <sup>1</sup>	2016	2015 <sup>1</sup>
Revenues	[7a]	1,834	1,949	3,691	3,849
Other income	[7b]	405	36	436	83
Supplies		(578)	(646)	(1,206)	(1,306)
Personnel expenses		(160)	(166)	(333)	(345)
Other expenses		(710)	(723)	(1,418)	(1,436)
<b>Operating income before depreciation and amortisation (OIBDA)</b>		<b>791</b>	<b>450</b>	<b>1,170</b>	<b>845</b>
Depreciation and amortisation		(529)	(505)	(1,069)	(1,033)
<b>Operating income</b>		<b>262</b>	<b>(54)</b>	<b>100</b>	<b>(188)</b>
Finance income		2	3	4	5
Exchange gains		(0)	(0)	0	1
Finance costs		(11)	(16)	(21)	(30)
Exchange losses		0	0	(0)	(3)
<b>Net financial income/(expense)</b>	[7c]	<b>(9)</b>	<b>(14)</b>	<b>(18)</b>	<b>(25)</b>
<b>Profit/(loss) before tax</b>		<b>252</b>	<b>(68)</b>	<b>83</b>	<b>(213)</b>
Income tax		(0)	0	0	0
<b>Total profit/(loss) for the period</b>		<b>252</b>	<b>(68)</b>	<b>83</b>	<b>(213)</b>
<b>Profit/(loss) for the period attributable to owners of the parent</b>		<b>252</b>	<b>(68)</b>	<b>83</b>	<b>(213)</b>
<b>Profit/(loss) for the period</b>		<b>252</b>	<b>(68)</b>	<b>83</b>	<b>(213)</b>
<b>Earnings per share</b>					
<b>Basic earnings per share in EUR</b>		<b>0.08</b>	<b>(0.02)</b>	<b>0.03</b>	<b>(0.07)</b>
<b>Diluted earnings per share in EUR</b>		<b>0.08</b>	<b>(0.02)</b>	<b>0.03</b>	<b>(0.07)</b>

1 In the Interim Consolidated Financial Statements as of 30 June 2016, the previous-year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 7, Business Combinations).

# Consolidated Statement of Comprehensive Income\_

(Euros in millions)	1 April to 30 June		1 January to 30 June	
	2016	2015 <sup>1</sup>	2016	2015 <sup>1</sup>
<b>Profit/(loss) for the period</b>	<b>252</b>	<b>(68)</b>	<b>83</b>	<b>(213)</b>
<b>Other comprehensive income/(loss)</b>				
<b>Items that will not be reclassified to profit/(loss)</b>	<b>(24)</b>	<b>48</b>	<b>(59)</b>	<b>11</b>
Remeasurement of defined benefit plans	(24)	48	(59)	11
<b>Total other comprehensive income/(loss)</b>	<b>(24)</b>	<b>48</b>	<b>(59)</b>	<b>11</b>
<b>Total comprehensive income</b>	<b>229</b>	<b>(20)</b>	<b>24</b>	<b>(202)</b>
Total comprehensive income for the period attributable to owners of the parent	229	(20)	24	(202)
<b>Total comprehensive income</b>	<b>229</b>	<b>(20)</b>	<b>24</b>	<b>(202)</b>

1 In the Interim Consolidated Financial Statements as of 30 June 2016, the previous-year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 7, Business Combinations).

# Consolidated Statement of Changes in Equity\_

(Euros in millions)	Subscribed capital	Additional paid-in capital	Retained earnings	Total equity attributable to owners of the parent	Equity
<b>Financial position as of 1 January 2015<sup>1</sup></b>	<b>2,975</b>	<b>4,800</b>	<b>3,637</b>	<b>11,412</b>	<b>11,412</b>
Profit/(loss) for the period <sup>1</sup>	–	–	(213)	(213)	(213)
Other comprehensive income/(loss)	–	–	11	11	11
<b>Total comprehensive income<sup>1</sup></b>	<b>–</b>	<b>–</b>	<b>(202)</b>	<b>(202)</b>	<b>(202)</b>
Dividends	–	–	(714)	(714)	(714)
Other movements	–	–	(0)	(0)	(0)
<b>Financial position as of 30 June 2015<sup>1</sup></b>	<b>2,975</b>	<b>4,800</b>	<b>2,721</b>	<b>10,496</b>	<b>10,496</b>
<b>Financial position as of 1 January 2016</b>	<b>2,975</b>	<b>4,800</b>	<b>2,546</b>	<b>10,321</b>	<b>10,321</b>
Profit/(loss) for the period	–	–	83	83	83
Other comprehensive income/(loss)	–	–	(59)	(59)	(59)
<b>Total comprehensive income</b>	<b>–</b>	<b>–</b>	<b>24</b>	<b>24</b>	<b>24</b>
Dividends	–	–	(714)	(714)	(714)
Other movements	–	–	2	2	2
<b>Financial position as of 30 June 2016</b>	<b>2,975</b>	<b>4,800</b>	<b>1,859</b>	<b>9,633</b>	<b>9,633</b>

<sup>1</sup> In the Interim Consolidated Financial Statements as of 30 June 2016, the previous-year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 7, Business Combinations).

# Consolidated Statement of Cash Flows\_

(Euros in millions)	1 January to 30 June	
	2016	2015 <sup>1</sup>
<b>Cash flow from operating activities</b>		
<b>Profit/(loss) for the period</b>	83	(213)
<b>Adjustments to profit/(loss)</b>		
Net financial income/(expense)	18	25
Gains on disposal of assets	(353)	(17)
Income tax	(0)	(0)
Depreciation and amortisation	1,069	1,033
<b>Change in working capital and others</b>		
Other current and non-current assets	(105)	(116)
Other non-current liabilities and provisions	(42)	(134)
Other current liabilities and provisions	(46)	81
<b>Others</b>		
Taxes paid	–	0
Interest received	6	8
Interest paid	(25)	(27)
<b>Cash flow from operating activities</b>	<b>605</b>	<b>641</b>
<b>Cash flow from investing activities</b>		
Proceeds on disposals of property, plant and equipment and intangible assets	591	–
Payments on investments relating to mobile phone frequency auctions <sup>2</sup>	(2)	(976)
Payments on investments in property, plant and equipment and other intangible assets	(597)	(599)
Proceeds on disposals of companies <sup>3</sup>	–	61
Acquisition of E-Plus net of cash acquired	–	22
Proceeds/payments made on financial assets	(1)	(0)
<b>Cash flow from investing activities</b>	<b>(8)</b>	<b>(1,492)</b>
<b>Cash flow from financing activities</b>		
Payments made for capital increase costs	–	(6)
Proceeds from interest-bearing debt	600	300
Repayment of interest-bearing debt	(740)	(217)
Dividends paid	(714)	(714)
<b>Cash flow from financing activities</b>	<b>(854)</b>	<b>(637)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>(257)</b>	<b>(1,488)</b>
<b>Cash and cash equivalents at the beginning of the period</b>	<b>533</b>	<b>1,702</b>
<b>Cash and cash equivalents at the end of the period</b>	<b>276</b>	<b>214</b>

1 In the Interim Consolidated Financial Statements as of 30 June 2016, the previous-year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 7, Business Combinations).

2 As of 30 June 2016 the total amount of interest paid EUR 27 million is presented in interest paid EUR 25 million as well as payment on investments relating to mobile phone frequency auctions EUR 2 million.

3 A cash and cash equivalent balance of EUR 16 million was included in assets held for sale as of 31 December 2014 and was transferred in the transaction. Therefore, the net cash received amounted to EUR 45 million.

# Condensed Notes to the Interim Condensed Consolidated Financial Statements\_ for the period 1 January to 30 June 2016

## 1.

**Reporting Entity**

The Interim Condensed Consolidated Financial Statements (hereinafter “Interim Consolidated Financial Statements”) of Telefónica Deutschland Holding AG have been prepared for the period from 1 January to 30 June 2016 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 stock 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](http://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 German Securities Identification Number (WKN) is A1J5RX, the ISIN (International Securities Identification Number) is DE000A1J5RX9.

As of 30 June 2016, 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.

As of 30 June 2016, 21.32 % of the shares are in free float. 63.22 % are 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 15.46 % are held by Koninklijke KPN N.V., The Hague, Netherlands (KPN).

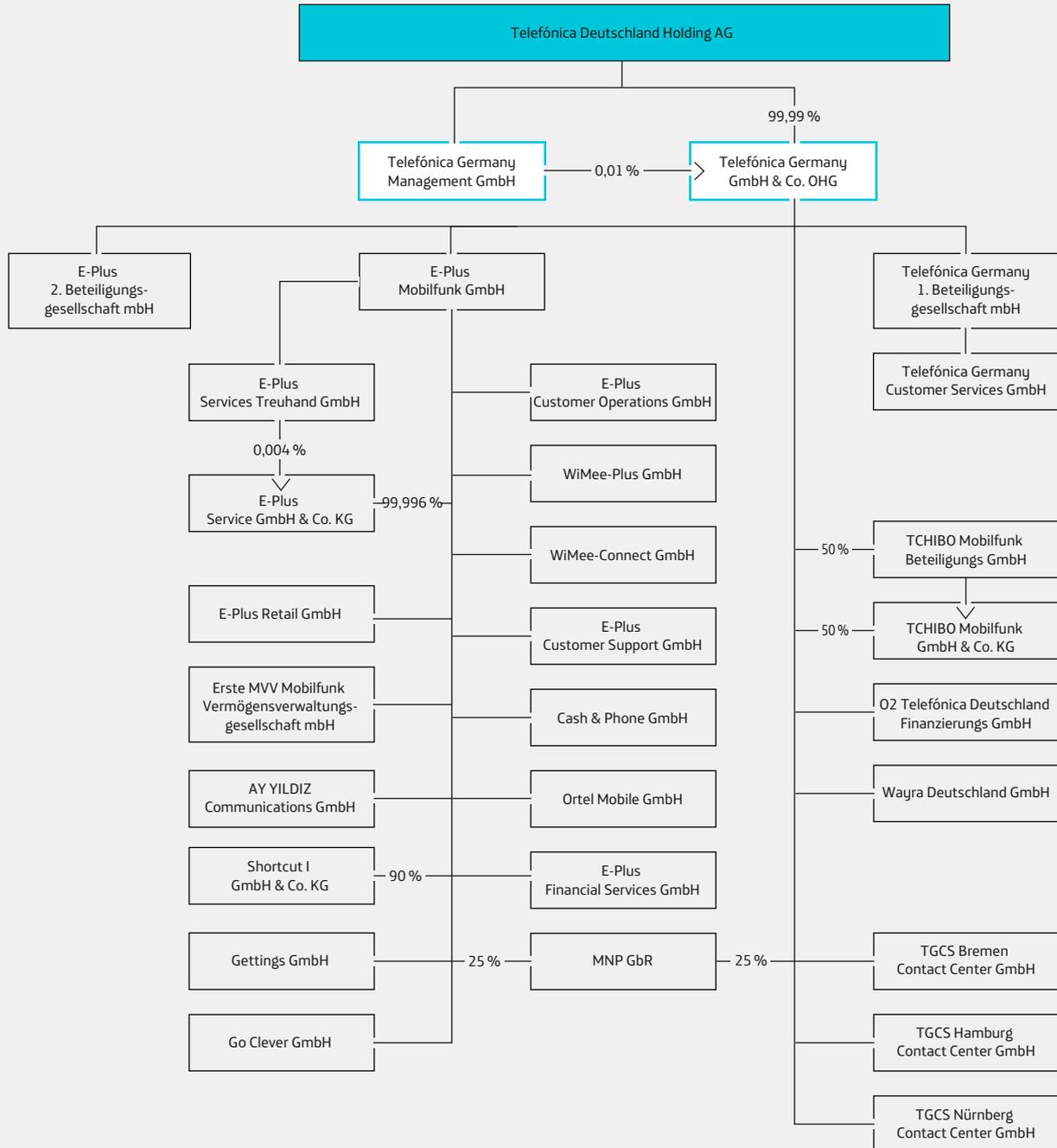
As of 30 June 2016, Telefónica Deutschland Holding AG had Authorised Capital 2016/I of EUR 1,487,277,496.

As of 30 June 2016, Telefónica Deutschland Holding AG's Contingent Capital 2014/I amounted to EUR 558,472,700.

Telefónica Deutschland Holding AG is the parent company of the Telefónica Deutschland Group, which is included in the Interim 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 O<sub>2</sub> (Europe) Limited, Slough, United Kingdom (O<sub>2</sub> (Europe) Limited), and an indirect subsidiary of Telefónica, S.A.

The Telefónica Deutschland Group, which since 1 October 2014 has also contained E-Plus Mobilfunk GmbH, Duesseldorf (E-Plus), and its direct and indirect subsidiaries (E-Plus Group), has been one of the three leading integrated network operators in Germany since the acquisition of E-Plus. The Telefónica Deutschland Group offers private and business customers voice, data and value added services in mobile and fixed line networks. In addition, the Telefónica Deutschland Group ranks among the leading wholesale providers in Germany. Wholesale partners are offered access to the Group's infrastructure and services. The Telefónica Deutschland Group is part of the Telefónica, S.A. Group, one of the biggest telecommunications corporations in the world.

As of 30 June 2016, the companies included in the Interim Condensed Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart:



Unless otherwise stated, the ownership interests amount to 100%.

In the first quarter, Fonice GmbH was merged with Telefónica Germany GmbH & Co. OHG.

## 2.

**Significant Events and Transactions in the Reporting Period****Placement of a syndicated loan**

On 22 March 2016, the Telefónica Deutschland Group agreed a syndicated loan facility in the amount of EUR 750 million, of which EUR 600 million was utilised in the reporting period. It serves general business purposes and has a term of five years. The loan term can be extended to no later than March 2023.

**Framework redundancy plan**

After the execution of the restructuring programme and the related reduction of around 800 full-time equivalents (FTEs) in 2015, according to an agreement with the workers' council another 500 FTEs were given clarity about their employment situation by the middle of 2016. The company continues to target a reduction of around 1,600 FTEs in total by 2018.

**Annual General Meeting and dividend**

The Annual General Meeting for the 2015 financial year took place on 19 May 2016. In addition to presenting the Annual Financial Statements of Telefónica Deutschland, including the Group Management Report and the Consolidated Financial Statements, and electing a new member of the Supervisory Board, the resolutions adopted by the Annual General Meeting included a dividend payment of EUR 0.24 per entitled share, EUR 713,893,198.32 in total. The dividend was paid to the shareholders on 20 May 2016.

In addition, the Annual General Meeting resolved new authorised capital 2016/I of EUR 1,487,277,496, suspending the former authorised capital 2012/I, and resolved a new authorisation to buy back own shares up to a total of 10% of share capital on the date of the resolution or – if lower – on the date the authorisation is exercised, suspending the previous authorisation to buy back own shares of 5 October 2012.

**Changes in the Supervisory Board of Telefónica Deutschland**

Antonio Manuel Ledesma Santiago left the Supervisory Board of Telefónica Deutschland with effect as of the end of the Annual General Meeting on 19 May 2016.

Peter Erskine was elected as his successor by the Annual General Meeting on 19 May 2016. His term in office began at the end of the 2016 Annual General Meeting and will last until at the end of the 2017 Annual General Meeting.

In addition, the Deputy Chairperson of the Supervisory Board Imke Blumenthal left the Supervisory Board of Telefónica Deutschland on 30 June 2016 (for further information, see Note No. 12 Report on Events after the Reporting Period).

**Sale of passive tower infrastructure to Telxius S.A.**

According to a decision of the relevant bodies of Telefónica Deutschland in April 2016, the Telefónica Deutschland Group sold passive tower infrastructure to Telefónica, S.A.'s infrastructure company Telxius Telecom S.A. (Telxius S.A.) on 21 April 2016 with a net capital gain from the sale of EUR 352 million.

The cash proceeds from the transaction enhance the company's financial flexibility and will be reinvested in the business to support infrastructure development and the development of new growth areas.

Following the sale, the Telefónica Deutschland Group will continue to use the wireless towers through operating lease agreements.

**Financing agreement signed with European Investment Bank (EIB)**

On 13 June 2016, the Telefónica Deutschland Group signed its first financial agreement with the EIB amounting to EUR 450 million. The facility was not yet utilised in the reporting period and serves to finance the consolidation, modernisation and expansion of the Telefónica Deutschland Group's mobile network after the acquisition of the E-Plus Group. The funds provided by the EIB have terms of up to eight years.

**3.****Basis of Preparation**

The Interim Consolidated Financial Statements of Telefónica Deutschland Holding AG are prepared in accordance with International Accounting Standard (IAS) 34 – Interim Financial Reporting. Accordingly, the Interim Consolidated Financial Statements do not contain all the information and disclosures required for a full set of consolidated financial statements, and should therefore be read in conjunction with the Consolidated Financial Statements for the year ended 31 December 2015 (see Note No. 3, Basis of Preparation).

These Interim Consolidated Financial Statements as of 30 June 2016 are unaudited.

**Functional currency and presentation currency**

The Interim Consolidated Financial Statements are presented in Euro, which is the functional currency of the Telefónica Deutschland Group and its subsidiaries.

Unless stated otherwise, the figures in these Interim Consolidated Financial Statements are presented in millions of Euros (Euros in millions) and rounded according to established commercial principles. Additions of the figures can thus lead to amounts that deviate from the totals shown in the same tables.

**Other**

The preparation of the Interim Consolidated Financial Statements requires that the management makes judgements, estimates and assumptions concerning the accounting policies applied and that influence the amount of the assets, liabilities, income and expenses reported. A significant change in the facts and circumstances on which these judgements, estimates and assumptions are based could materially affect the Telefónica Deutschland Group's net assets, financial position and result of operations.

In preparing the Interim Consolidated Financial Statements of the Telefónica Deutschland Group, the significant judgements made by the management regarding the application of accounting policies and main causes of estimation uncertainties were the same as applied in the Consolidated Financial Statements for the year ended 31 December 2015. Additionally, the changes shown under Note No. 4, Accounting Policies, were applied, but do not have a material impact on the Group's net assets, financial position and result of operations.

For further information, please refer to the Consolidated Financial Statements for the year ended 31 December 2015 (see Note No. 4, Accounting Policies).

**Comparative information**

The Consolidated Statement of Financial Position presented in these Interim Consolidated Financial Statements relates to information as of 30 June 2016, which is compared to information as of 31 December 2015.

The Consolidated Income Statement and the Consolidated Statement of Comprehensive Income relate to the six- and three-month periods ended 30 June 2016 and 30 June 2015. The Consolidated Statement of Cash Flows and the Consolidated Statement of Changes in Equity compare the first six-month periods of 2016 and 2015<sup>1</sup>.

#### **Seasonal business activity**

Previous earnings performance has provided no indication that the business activity is subject to material seasonal fluctuations.

## 4.

### Accounting Policies

The significant estimates, assumptions and judgements made by the management in preparing the Interim Financial Statements of the Telefónica Deutschland Group do not fundamentally differ from the assumptions in the Consolidated Financial Statements for the year ended 31 December 2015 with regard to potential uncertainties inherent in the estimates (see Note No. 4, Accounting Policies). Nevertheless, the company has adjusted the provision for dismantling a portion of the network due to new insights with regard to cost estimates. The adjustment of the provision consequently resulted in a corresponding adjustment of the associated assets.

Starting 1 January 2016, the Telefónica Deutschland Group applies the amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation (EU Regulation of 2 December 2015), the amendments to IFRS 11 – Accounting for Acquisitions of Interests in Joint Operations (EU Regulation of 24 November 2015), the amendments to IAS 27 – Equity Method in Separate Financial Statements according to EU Regulation of 18 December 2015, the Annual Improvements to the IFRSs 2012 – 2014 (EU Regulation of 15 December 2015) and the amendments to IAS 1 – Disclosure Initiative (EU Regulation of 18 December 2015).

With the respective regulations, the European Union (EU) approved the required adoption of the amendments for financial years beginning on or after 1 January 2016. Early adoption was permitted. The IASB also allows for adoption for financial years beginning on or after 1 January 2016.

These amendments to the standards have no or no significant effect on the net assets, financial position or result of operations of the Group.

<sup>1</sup> In the Interim Consolidated Financial Statements as of 30 June 2016, the previous-year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 7, Business Combinations).

At the time of publication of the Interim 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 IFRS 10, IFRS 12 and IAS 28	Applying the Consolidation Exception	1 January 2016 <sup>1</sup>
Amendments to IAS 12	Recognition of Deferred Tax Assets for Unrealised Losses	1 January 2017 <sup>1</sup>
Amendments to IAS 7	Disclosure Initiative	1 January 2017 <sup>1</sup>
IFRS 15	Revenue from Contracts with Customers	1 January 2018 <sup>1</sup>
IFRS 9	Financial Instruments	1 January 2018 <sup>1</sup>
Amendments to IFRS 2	Share-Based Payment	1 January 2018 <sup>1</sup>
IFRS 16	Leases	1 January 2019 <sup>2</sup>
Amendments to IFRS 10 and IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	<sup>2</sup>

<sup>1</sup> Endorsement by EU still outstanding, information for first-time adoption according to IASB.

<sup>2</sup> First-time adoption postponed indefinitely according to IASB resolution of 17 December 2015.

For a comprehensive description of the new standards, amendments to standards and interpretations applicable for the Group, please refer to the disclosures in the Consolidated Financial Statements for the year ended 31 December 2015 (see Note No. 4, Accounting Policies). An assessment of the expected impact on the net assets, financial position and result of operations of the Group is provided there, which still applies to the Interim Consolidated Financial Statements as of 30 June 2016.

In addition, the IASB issued amendments to IAS 7 – Disclosure Initiative on 29 January 2016. These amendments are intended to improve information provided to users of financial statements about an entity's liabilities arising from financing activities.

Moreover, the IASB issued amendments to IFRS 15 – Revenue from Contracts with Customers on 12 April 2016. The clarifications mainly deal with the identification of performance obligations, the distinction between principal and agent, and the recognition of licences. Additional practical expedients are also provided regarding the transition requirements for modified and completed contracts. The amendments are to be implemented with the adoption of IFRS 15. Endorsement by the EU is currently outstanding.

On 20 June 2016, the IAS published amendments to IFRS 2 – Share-Based Payment. These amendments contain clarifications on the accounting for cash-settled share-based payment transactions that include a performance condition, the classification of share-based payment transactions with net settlement features, and the accounting for modifications of share-based payment transactions from cash-settled to equity-settled. Subject to their endorsement in EU law, the amendments will be required to be applied for the first time in reporting periods beginning on or after 1 January 2018. Early adoption was permitted.

## 5.

### Related Parties

As of 30 June 2016, the nature and amount of transactions by the Telefónica Deutschland Group with related parties has not changed significantly in comparison to those disclosed in the Consolidated Financial Statements for the year ended 31 December 2015, with the following exception.

Effective 1 January 2016, Telefónica Germany GmbH & Co. KG entered into a lease agreement for the use of passive tower infrastructure with Telxius Towers Germany GmbH, a direct subsidiary of Telxius Telecom S.A. (itself a wholly owned indirect subsidiary of Telefónica, S.A.), which was sold to Telxius Telecom S.A. on 21 April 2016. The lease has a term until 31 December 2030 and two successive extension options, each for a period of five years. The monthly lease obligation amounts to EUR 3 million.

#### Transactions with the Telefónica, S.A. Group

##### Revenues, other income and expenses with the Telefónica, S.A. Group

Other income comprises realised net capital gain from the sale of passive tower infrastructure to Telxius S.A. Further information can be found in Note No. 11, Disposal Groups.

For further information, please refer to the Consolidated Financial Statements for the year ended 31 December 2015 (Note No. 14, Related Parties).

## 6.

### Selected Explanatory Notes to the Consolidated Statement of Financial Position

#### a) Goodwill

The carrying amount of goodwill was EUR 1,932 million as of 30 June 2016 (31 December 2015: EUR 1,955 million). The decrease of EUR 23 million is attributable to the sale of Telxius Towers Germany GmbH to Telxius S.A. Further information can be found in Note No. 11, Disposal Groups.

#### b) Other intangible assets

The other intangible assets comprise the following:

(Euros in millions)	Service concession arrangements and licence	Customer bases	Software	Brand names	Others	Construction in progress/ Prepayments on intangible assets	Other intangible assets
Net book value							
As of 31 December 2015	2,676	2,541	538	81	22	1,201	7,059
As of 30 June 2016	2,455	2,377	493	71	21	1,197	6,614

Other intangible assets amounted to EUR 6,614 million as of 30 June 2016 (31 December 2015: EUR 7,059 million). The decline in comparison to the end of 2015 was EUR 445 million or 6.3 % and is attributable to amortisation of finite intangible assets. The amortisation costs amounted to EUR 602 million (30 June 2015: EUR 575 million). This was offset by additions of EUR 158 million (30 June 2015: EUR 1,321 million).

In the reporting period, EUR 10 million of the mobile frequencies acquired in 2015 were reclassified from construction in progress/prepayments on intangible assets to service concession arrangements and licences due to their active use.

In the reporting period, borrowing costs were capitalised as a component of the frequencies acquired in 2015 in the amount of EUR 2.9 million.

The Telefónica Deutschland Group based the capitalisation on a borrowing cost rate averaging 1.3 %.

### c) Property, plant and equipment

Property, plant and equipment was composed as follows as of 30 June 2016:

(Euros in millions)	Land and buildings	Plant and machinery	Furniture, tools and other items	PP&E in progress	Property, plant and equipment
Net book value					
As of 31 December 2015	212	4,144	84	68	4,507
As of 30 June 2016	186	3,852	82	73	4,193

Property, plant and equipment amount to EUR 4,193 million as of 30 June 2016 (31 December 2015: EUR 4,507 million). The decrease of EUR 314 million or 7.0 % compared with the end of 2015 was primarily attributable to the sale of passive tower infrastructure to Telxius S.A. in the amount of EUR 277 million. Further information can be found in Note No. 11, Disposal Groups. The decrease is also due to depreciation in the amount of EUR 467 million. This was offset by additions of EUR 275 million as well as additions in property, plant and equipment relating to dismantling and removal obligations of EUR 160 million, which is attributable primarily to the higher cost estimates based on new insights and to the interest rate trend.

### d) Trade and other receivables

The breakdown of this item of the Consolidated Statement of Financial Position is as follows:

(Euros in millions)	As of 30 June 2016		As of 31 December 2015	
	Non-current	Current	Non-current	Current
Trade receivables	141	1,705	169	1,648
Receivables from related parties	–	40	–	37
Other receivables	–	33	–	29
Provisions for bad debts	(9)	(185)	(13)	(194)
<b>Trade and other receivables</b>	<b>132</b>	<b>1,593</b>	<b>157</b>	<b>1,520</b>

### e) Other non-financial assets

This item of the Consolidated Statement of Financial Position consists of:

(Euros in millions)	As of 30 June 2016		As of 31 December 2015	
	Non-current	Current	Non-current	Current
Prepayments	127	183	160	46
Prepayments to related parties	–	3	–	0
Tax receivables for indirect taxes	–	1	–	15
<b>Other non-financial assets</b>	<b>127</b>	<b>187</b>	<b>160</b>	<b>61</b>

The non-financial assets primarily relate to prepayments for rent for antenna locations.

### f) Interest-bearing debt

The breakdown of this item of the Consolidated Statement of Financial Position is as follows:

(Euros in millions)	As of 30 June 2016		As of 31 December 2015	
	Non-current	Current	Non-current	Current
Bonds	1,109	11	1,105	12
Promissory notes and registered bonds	299	1	299	4
Loan liabilities	598	1	250	251
Finance leases	17	73	32	180
Contribution and compensation obligations	–	3	–	3
Other financial liabilities	–	–	–	119
<b>Interest-bearing debt</b>	<b>2,023</b>	<b>90</b>	<b>1,686</b>	<b>568</b>

#### Bonds

Interest-bearing debt contains two bonds that the Telefónica Deutschland Group issued 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.

#### Promissory notes/registered bonds

On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds. The carrying amount of the two debt instruments amounted to EUR 301 million as of 30 June 2016.

#### Loan liabilities

As of 31 December 2015, the loan liabilities included a loan of EUR 500 million, which the Telefónica Deutschland Group borrowed in September 2012 at an original total value of EUR 1,250 million from Telfisa Global B.V. This loan has been repaid in full as of 30 June 2016.

The Group entered into a EUR 750 million revolving credit facility on 22 March 2016. EUR 600 million of this revolving credit facility (RCF) had been drawn as of 30 June 2016. The credit facility expires in March 2021 and can be renewed for a maximum of two years. It bears a variable interest rate at Euribor money market conditions plus an agreed margin.

**Finance leases**

This item comprises finance lease liabilities in the amount of EUR 91 million as of 30 June 2016 (31 December 2015: EUR 212 million).

The obligations arising from finance leases mainly result from agreements for mobile phones and network elements concluded under sale and leaseback transactions and classified as finance leases in accordance with their contract design.

**Contribution obligations and other financial liabilities**

In addition, interest-bearing debt includes contribution and compensation obligations in conjunction with investments in start-ups.

**g) Trade and other payables**

The composition of trade and other payables is as follows:

(Euros in millions)	As of 30 June 2016		As of 31 December 2015	
	Non-current	Current	Non-current	Current
Trade payables to third parties	110	568	109	573
Accruals	18	1,002	19	1,105
Payables to related parties	–	289	–	298
<b>Trade payables</b>	<b>127</b>	<b>1,859</b>	<b>128</b>	<b>1,975</b>
Other creditors non-trade	2	60	2	69
Other payables to related parties	–	53	–	53
Other payables	23	78	23	175
<b>Other payables</b>	<b>25</b>	<b>191</b>	<b>25</b>	<b>296</b>
<b>Trade and other payables</b>	<b>153</b>	<b>2,050</b>	<b>154</b>	<b>2,272</b>

Trade payables to third parties include the outstanding payment obligations from the mobile phone frequency auction (non-current portion: EUR 110 million; current portion: EUR 111 million).

Accruals mainly relate to outstanding invoices for goods and services and for non-current assets.

Other creditors non-trade mainly consist of liabilities due to personnel.

Alongside debtors with credit balances, the other liabilities primarily include a non-current portion of the liabilities in the amount of EUR 23 million as a result of the assumption of obligations from mobile network sites transferred to Deutsche Telekom as part of the network integration. The current portion of EUR 100 million included as of 31 December 2015 was already paid in the first quarter of the year 2016.

## h) Provisions

The provisions are recognised at the following amounts:

(Euros in millions)	As of 30 June 2016		As of 31 December 2015	
	Non-current	Current	Non-current	Current
Pension obligations	129	–	76	–
Restructuring	50	130	52	169
Dismantling	449	22	372	22
Other provisions	13	4	16	5
<b>Provisions</b>	<b>641</b>	<b>156</b>	<b>516</b>	<b>196</b>

The Telefónica Deutschland Group's provisions have changed compared to 31 December 2015, particularly due to the obligations for dismantling and pensions.

The provision for dismantling obligations comprises the estimated costs for the dismantling and removal of assets (e.g. radio masts and other fixed assets). The EUR 76 million change in this provision is in particular due to the higher cost estimate based on new insights and the interest rate trend (EUR 160 million), offset by the disposal in connection with the sale of passive tower infrastructure to Telxius S.A. in 2016 (EUR 83 million; for further information, see Note No. 11, Disposal Groups).

The change in pension obligations mainly results from a remeasurement at the current lower interest rate of 1.37 % (31 December 2015: 2,46 %).

Other changes in provisions relate to the reduction in the restructuring obligation, largely as a result of utilisation.

For further information, please refer to the Consolidated Financial Statements for the year ended 31 December 2015 (see Note No. 5.12, Provisions).

## 7.

## Selected Explanatory Notes to the Consolidated Income Statement

### a) Revenues

Revenues are comprised as follows:

(Euros in millions)	1 April to 30 June		1 January to 30 June	
	2015	2014	2015	2014
Rendering of services	1,603	1,642	3,192	3,257
Other revenues	231	307	499	593
<b>Revenues</b>	<b>1,834</b>	<b>1,949</b>	<b>3,691</b>	<b>3,849</b>

Revenues from the rendering of services comprise mobile service revenues as well as revenues from fixed line/DSL business. The other revenues comprise revenues from the sale of handsets and other revenues.

None of the Telefónica Deutschland Group's customers account for more than 10 % of total revenues. The breakdown of revenues according to mobile business and fixed line/DSL business is shown in the following table:

(Euros in millions)	1 April to 30 June		1 January to 30 June	
	2016	2015	2016	2015
Mobile business	1,584	1,685	3,187	3,321
Mobile service revenues	1,358	1,382	2,694	2,735
Handset revenues	226	303	493	586
Fixed business	245	260	498	521
Other revenues	5	3	6	7
<b>Revenues</b>	<b>1,834</b>	<b>1,949</b>	<b>3,691</b>	<b>3,849</b>

#### b) Other income

The other income of the Telefónica Deutschland Group for the first six months of the current financial year amounted to EUR 436 million (first half of 2015: EUR 83 million).

This increase was primarily attributable to the net capital gain from the sale of passive tower infrastructure to Telxius S.A. Further information can be found in Note No. 11, Disposal Groups.

#### c) Net financial income/(expense)

The net financial income/(expense) of the Telefónica Deutschland Group for the first six months of the current financial year amounts to EUR -18 million (30 June 2015: EUR -25 million).

The breakdown of net financial income/(expense) is as follows:

(Euros in millions)	1 January to 30 June	
	2016	2015 <sup>1</sup>
Interest income from financial assets	4	5
Interest expenses from financial liabilities	(20)	(29)
Accretion of provisions and other liabilities	(1)	(1)
Other exchange gains/(losses)	(0)	(1)
<b>Net financial income/(expense)</b>	<b>(18)</b>	<b>(25)</b>

<sup>1</sup> In the Interim Consolidated Financial Statements as of 30 June 2016, the previous-year figures as of 30 June 2015 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 7, Business Combinations).

The interest income from financial assets mainly comprises the interest income in connection with "O<sub>2</sub> My Handy" receivables and receivables from finance leases.

The interest expenses from financial liabilities mainly include interest for the loan borrowed from Telfisa Global B.V. in September 2012, interest on the revolving credit facility concluded on 22 March 2016, for the bonds issued in November 2013 and February 2014, and for the promissory notes and registered bonds issued in March 2015. Interest from the finance lease obligation is also included.

## 8. Measurement Categories of Financial Assets and Financial Liabilities

In the following tables, the fair value of all financial assets and financial liabilities of the Telefónica Deutschland Group are disclosed in accordance with the measurement categories from IAS 39 considering the requirements of IFRS 13.

As of 30 June 2016, the carrying amounts of the financial assets and financial liabilities represent an appropriate approximation for their fair values (with the exception of the portion of the bonds that is not hedged, see below).

For further information, please refer to the Consolidated Financial Statements for the year ended 31 December 2015 (see Note No. 10, Measurement Categories of Financial Assets and Financial Liabilities).

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 30 June 2016										
Financial assets										
Measurement hierarchy										
(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
Non-current trade and other receivables (Note No. 5.4)	–	–	–	132	–	–	–	132	132	–
Other non-current financial assets (Note No. 5.5)	15	21	–	18	–	15	21	53	53	10
Current trade and other receivables (Note No. 5.4)	–	–	–	1,592	–	–	–	1,592	1,592	1
Other current financial assets (Note No. 5.5)	2	–	–	11	–	2	–	13	13	–
Cash and cash equivalents (Note No. 5.8)	–	–	–	276	–	–	–	276	276	–
<b>Total</b>	<b>17</b>	<b>21</b>	<b>–</b>	<b>2,029</b>	<b>–</b>	<b>17</b>	<b>21</b>	<b>2,067</b>	<b>2,067</b>	<b>11</b>

As of 31 December 2015										
Financial assets										
(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	Measurement hierarchy			Total carrying amount	Total fair value	Not in the scope of IFRS 7
					Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)			
Non-current trade and other receivables (Note No. 5.4)	–	–	–	157	–	–	–	157	157	–
Other non-current financial assets (Note No. 5.5)	12	18	–	23	–	12	18	53	53	9
Current trade and other receivables (Note No. 5.4)	–	–	–	1,519	–	–	–	1,519	1,519	1
Other current financial assets (Note No. 5.5)	2	–	–	8	–	2	–	10	10	–
Cash and cash equivalents (Note No. 5.8)	–	–	–	533	–	–	–	533	533	–
<b>Total</b>	<b>14</b>	<b>18</b>	<b>–</b>	<b>2,240</b>	<b>–</b>	<b>14</b>	<b>18</b>	<b>2,272</b>	<b>2,272</b>	<b>11</b>

As of 30 June 2016, EUR 15 million of the other non-current financial assets and EUR 2 million of the other current financial assets are classified as financial assets at fair value through profit or loss. These relate to swaps concluded in connection with the bond issue.

In addition, EUR 21 million of the other non-current financial assets are classified as available-for-sale financial assets. These relate to investments in start-ups. These assets were measured according to level 3, as 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 at amortised costs.

All other financial assets as of 30 June 2016 were categorised as loans and receivables.

Please see the respective notes for further information.

As of 30 June 2016									
Financial liabilities									
Measurement hierarchy									
(Euros in millions)	Liabilities at fair value through profit or loss	Liabilities at amortised cost	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	Not in the scope of IFRS 7
Non-current interest-bearing debt (Note No. 5.10)	363	1,643	17	–	363	–	2,023	2,085	–
Non-current trade and other payables (Note No. 5.11)	–	150	–	–	–	–	150	150	2
Current interest-bearing debt (Note No. 5.10)	–	17	73	–	–	–	90	90	–
Current trade and other payables (Note No. 5.11)	–	1,989	–	–	–	–	1,989	1,989	60
<b>Total</b>	<b>363</b>	<b>3,799</b>	<b>91</b>	<b>–</b>	<b>363</b>	<b>–</b>	<b>4,253</b>	<b>4,315</b>	<b>62</b>

As of 31 December 2015									
Financial liabilities									
Measurement hierarchy									
(Euros in millions)	Liabilities at fair value through profit or loss	Liabilities at amortised cost	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	Not in the scope of IFRS 7
Non-current interest-bearing debt (Note No. 5.10)	360	1,294	32	–	360	–	1,686	1,733	–
Non-current trade and other payables (Note No. 5.11)	–	151	–	–	–	–	151	151	2
Current interest-bearing debt (Note No. 5.10)	–	388	180	–	–	–	568	568	–
Current trade and other payables (Note No. 5.11)	–	2,203	–	–	–	–	2,203	2,203	69
<b>Total</b>	<b>360</b>	<b>4,036</b>	<b>212</b>	<b>–</b>	<b>360</b>	<b>–</b>	<b>4,608</b>	<b>4,655</b>	<b>71</b>

As of 30 June 2016, EUR 363 million of the non-current interest-bearing debt are classified as liabilities at fair value through profit or loss. These relate to the part of the bonds that is accounted for as a fair value hedge with one interest rate swap each.

The fair value of the bonds (non-current interest-bearing debt) is determined based on primary market values (unadjusted quoted prices in active markets).

In addition to the bonds, the non-current and current interest-bearing debt as of 30 June 2016 contains promissory notes and registered bonds with a total nominal value of around EUR 300 million and the utilisation of a credit facility amounting to EUR 600 million. These debts are classified as financial liabilities measured at amortised cost.

The non-current and current trade and other payables are classified as financial liabilities at amortised cost.

Please see the respective notes for further information.

## 9.

### General Financial Market Risks

The Telefónica Deutschland Group is exposed to various financial market risks as part of its business activity. Due to the regional focus of the Telefónica Deutschland Group's 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) and from receivables from 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 net assets, financial position and result of operations 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.

#### Liquidity risk

Liquidity risk involves 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, Telefónica Deutschland Group ensures that it has sufficient liquidity at all times to fulfil its obligations, both under normal and under demanding circumstances. Telefónica Deutschland Group works on its liquidity management closely with the Telefónica, S.A. Group and, in accordance with the corporate policy, has cash pooling and deposit agreements in place with Telfisa Global B.V., Netherlands. The Group deposits most of its cash surpluses into these accounts. Liquidity risk is reduced by the cash inflows from operating activities of the Telefónica Deutschland Group, the opportunity to factor receivables and the availability of (currently unused) credit facilities.

As of 30 June 2016, Telefónica Deutschland Group has available current and non-current credit lines totalling EUR 1,375 million compared to EUR 750 million as of 31 December 2015.

For further information, please refer to the Consolidated Financial Statements for the year ended 31 December 2015 (Note No. 18, Financial Instruments and Risk Management).

## 10. Contingent Assets and Liabilities

As one of the leading network operators in Germany, Telefónica Deutschland Group is exposed to the risk of claims from patent violations. In this context, patent owners could assert claims for licence payments and/or for the prohibition of the use of certain patent-violating technologies. This risk is mitigated by Telefónica Deutschland Group's exemption and compensation claims against its relevant suppliers. Besides compensation claims for legal costs, patent owners currently have potential licence claims that come under consideration on the basis of the provisional/court-assessed values in dispute. These claims are almost completely offset by the potentially mitigating exemption and compensation claims. The amount of the legal costs and licence claims is estimated in the low millions.

Telefónica Deutschland Group could be subject to claims or other proceedings arising in the ordinary course of business. The possible effects are of minor significance for the Group's net assets, financial position and result of operations.

For further information, please refer to the Consolidated Financial Statements as of 31 December 2015 (see Note No. 19, Contingent Assets and Liabilities).

## 11. Disposal Groups

### Disposal groups in 2016:

#### sale of passive tower infrastructure to Telxius

Telxius Telecom S.A., a wholly owned subsidiary of Telefónica S.A., acquired all of the shares in Telxius Towers Germany GmbH, a formerly wholly owned subsidiary of E-Plus Mobilfunk GmbH, in accordance with a share purchase and transfer agreement dated 21 April 2016.

Telxius Towers Germany GmbH was formed as part of the spin-off of radio towers and the corresponding assets and liabilities and lease agreements. The purpose of the company is the leasing of passive tower infrastructure for the operation of mobile communications networks.

The disposal of Telxius Towers Germany GmbH had the following impact on the Group's net assets and financial position in the reporting period:

(Euros in millions)	As of 21 April 2016
Intangible assets	(23)
Property, plant and equipment	(277)
Trade and other receivables	(0)
Prepaid expenses	(4)
Provisions	83
Trade and other payables	0
Deferred income	8
<b>Net assets and liabilities</b>	<b>(214)</b>
Service receivables from Telxius	1
Liabilities to Telxius	(17)
<b>Effect on net assets exclusive Cash and Cash equivalents</b>	<b>(231)</b>
Fee included in cash and cash equivalents	587
Cash and cash equivalents disposed of	(0)
<b>Net cash inflow</b>	<b>587</b>

Subsequent to the spin-off, Telefónica Germany Group has been leasing the infrastructure back from Telxius Towers Germany GmbH under the terms of a corresponding lease. Furthermore, the parties agreed that the Group will be able to charge certain service fees to Telxius Towers Germany GmbH during a transitional phase.

A net capital gain of EUR 352 million was reported in the Consolidated Income Statement in connection with this disposal. The gain on the disposal of the interest, which is reported in other income, is offset by consulting fees that are reported in other expenses.

## 12.

### Events after the Reporting Period

#### **Change in the Supervisory Board of Telefónica Deutschland**

Christoph Braun is a member of the Supervisory Board of Telefónica Deutschland as successor to Imke Blumenthal (for further information, see Note No. 2 Significant Events and Transactions in the Reporting Period) with effect from 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

#### **Dividend Proposal for the financial year 2016**

On 26 July 2016, the Management Board of Telefónica Deutschland resolved its intention to propose a cash dividend of EUR 0.25 per share to the next Annual General Meeting.

There were no other reportable events after the end of the reporting period.

Munich, 11 August 2016

Telefónica Deutschland Holding AG

The Management Board



Thorsten Dirks



Rachel Empey



Markus Haas

## Telefónica Deutschland Holding AG

### Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles for interim financial reporting and with generally accepted accounting principles, the Interim Condensed Consolidated Financial Statements give a true and fair view of the net assets, financial position and result of operations of the Group, and the Interim Condensed 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 for the remaining months of the financial year.

Munich, 11 August 2016

Telefónica Deutschland Holding AG

The Management Board



Thorsten Dirks



Rachel Empey



Markus Haas

## Review Report

### **To Telefónica Deutschland Holding AG, Munich**

We have reviewed the interim condensed consolidated financial statements, 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 condensed notes, and the interim group management report of Telefónica Deutschland Holding AG, Munich, for the period from 1 January 2016 to 30 June 2016, which are part of the six-monthly financial report pursuant to Sec. 37w WpHG ("Wertpapierhandelsgesetz": German Securities Trading Act). The preparation of the interim condensed consolidated financial statements in accordance with IFRSs (International Financial Reporting Standards) on interim financial reporting as adopted by the EU and of the interim group management report in accordance with the requirements of the WpHG applicable to interim group management reports is the responsibility of the Company's management. Our responsibility is to issue a report on the interim condensed consolidated financial statements and the interim group management report based on our review.

We conducted our review of the interim condensed consolidated financial statements and the interim group management report in accordance with German generally accepted standards for the review 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 review to obtain a certain level of assurance in our critical appraisal to preclude that the interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IFRSs on interim financial reporting as adopted by the EU and that the interim group management report is not prepared, in all material respects, in accordance with the provisions of the WpHG applicable to interim group management reports. A review is limited primarily to making inquiries of company personnel and applying analytical procedures and thus does not provide the assurance that we would obtain from an audit of financial statements. In accordance with our engagement, we have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IFRSs on interim financial reporting as adopted by the EU or that the interim group management report is not prepared, in all material respects, in accordance with the provisions of the WpHG applicable to interim group management reports.

Munich, 11 August 2016

Ernst & Young GmbH  
Wirtschaftsprüfungsgesellschaft

Dahmen  
Wirtschaftsprüfer  
(German Public Auditor)

Vogel  
Wirtschaftsprüferin  
(German Public Auditor)

# Glossary\_

The glossary also contains abbreviations as used in the Group Management Report.

ADA	Advanced Data Analytics
Advanced Data Analytics (ADA)	Data analytics for optimising day-to-day business as well as for the development of new products and services
AktG	Aktiengesetz (German Stock Corporation Act)
ARPU	Average Revenue per User
BEREC	Body of European Regulators for Electronic Communication
Bitkom	Bundesverband Informationswirtschaft, Telekommunikation und neue Medien e. V., Berlin
BNetzA	Bundesnetzagentur (German Federal Network Agency)
bp	Basis points
Brexit	Withdrawal of the United Kingdom (UK) from the European Union (EU).
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
CapEx	Capital expenditures: additions to property, plant and equipment and intangible assets excluding investments in licences for mobile phone frequency usage rights
Carrier	Telecommunication network operator authorised by the federal network agency
CF	Cash flow
Cloud Service	Cloud services are dynamic infrastructure, software or platform services provided online
DSL	Digital Subscriber Line: technology to transmit data in the local loop to private end customers
EU	European Union
Euribor	Euro Interbank Offered Rate
FCF	Free cash flow
FTR	Fixed network Termination Rates
FY	Financial Year
GDP	Gross Domestic Product
GfK	Gesellschaft für Konsumforschung (Consumer research association)
GSM	Global System for Mobile Communications: this is the global standard for digital mobile communications
GSMA	Global System for Mobile Communications Association
H1	First half year
HGB	Handelsgesetzbuch (German Commercial Code)

IFRS	International Financial Reporting Standards
IoT	Internet of Things
ISIN	International Securities Identification Number
IT	Information Technology
Joint Operations	Two or more companies founding a new enterprise for cooperation
KPN	Koninklijke KPN N.V., The Hague, Netherlands
Leaver Program	Severance payment program for the planned downsizing in the context of the merger of E-Plus
LTE	Long Term Evolution: further development of the UMTS/HSPA mobile communications standard
M2M	Machine-to-Machine communication, automatic exchange of information between machines
MBA	Mobile Bitstream Access
MSR	Mobile Service Revenues
MTR	Mobile termination rates
Multi-brand strategy	Enables Telefónica Deutschland to provide customers in all segments with offers that suit their exact needs through various own and partner brands
MVNO	Mobile Virtual Network Operator
Net Adds	New customers for the period less those customers leaving are designated as net additional customers
NFC	Near Field Communication: a short-range wireless connectivity standard
O2 (Europe) Limited	O2 (Europe) Limited, Slough, United Kingdom
O2 My Handy	Monthly payment model for mobile phones and other devices
OIBDA	Operating Income before Depreciation and Amortisation
OpCF	Operating cash flow
Opex	Operating expenses
OTT	Over The Top
OTT services	Over-the-top-Services (Whats app, Facebook etc)
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
PureLRIC	Pure long run incremental costs – cost model to regulate termination rates
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
SoHos	Small offices/Home offices
Tablet	A wireless, portable personal computer with a touch screen interface
Telefónica, S.A.	Telefónica, S.A., Madrid/Spain
Telefónica Deutschland	Telefónica Deutschland Holding AG, Munich
Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telxius S.A.	Telxius Telecom S.A., the infrastructure company of Telefónica S.A.
TSM-R	Telecoms Single Market Regulation
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 third-generation mobile communications standard which unites mobile multimedia and telematics service under the frequency spectrum of 2GHz.
VDSL	Very High Data Rate Digital Subscriber Line (see DSL)
VoLTE	Voice over LTE
VPN	Virtual Private Network
WLAN	Wireless Local Area Network
Wholesale	Selling services to third parties who sell them to their own end customers either directly or after further processing



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