

MUNICH, 22 February 2017

Preliminary results for January to December 2016

Telefónica Deutschland meets outlook 2016, driving operating momentum with O₂ Free and realising significant synergies

- **Completion of brand restructuring and customer migration by year-end; successful launch of Sky cooperation in January 2017**
- **Underlying MSR excluding regulatory effects improving over the year despite continued headwinds from retail to wholesale mix-shift; non-premium pricing further improving**
- **The successful capture of operating cash flow synergies of approx. EUR 150 million leads to OIBDA¹ growth of +3.8% year-on-year for the full year (+5.3% in the fourth quarter)**
- **The financial outlook for 2017 reflects our confidence in our ability to generate further operating momentum and realise more synergies than originally expected, with a new total target of approx. EUR 900 million operating cash flow savings in 2019**

Fourth quarter 2016 operational & financial highlights

- **Net additions in mobile postpaid** came in at 336 thousand, with a continued strong contribution from partner brands. Contract churn was slightly higher at 1.6% year-on-year (vs. 1.5% in the third quarter) as a result of seasonality and the customer migration.
- **Mobile prepaid** was affected by disconnections relating to seasonal effects and as such registered net disconnection of 89 thousand in the final quarter of 2016.
- The **LTE customer base** further increased to 12.1 million (+53.0% year-on-year) by the end of 2016, reflecting successful data monetisation efforts; data usage also grew +40.5% year-on-year in the fourth quarter to approx. 1.7 GB per month for O₂ consumer postpaid customers.
- The retail DSL business remained stable with approx. 2.4k net additions, while demand for highspeed broadband accesses continued to be solid with 74k net VDSL additions in the fourth quarter. The planned decommissioning of the ULL infrastructure became more visible in Q4 with almost 100k net wholesale disconnections.

¹ Excluding exceptional and special effects. For the period January to December 2016 exceptional effects include restructuring expenses amounting to EUR 89 million (EUR 73 million in the same period of 2015) and the net capital gain from the sale of passive tower infrastructure to Telxius amounting to EUR 352 million, while in the same period of 2015 a one-off gain from the sale of yourfone GmbH was registered. For the period January to December 2016 special effects consist of the impact of the Telxius deal on OIBDA (EUR -23 million for the twelve months 2016) resulting primarily from higher operating lease expenses starting in May 2016

- **Revenues** came to EUR 1,936 million (-6.0% year-on-year) with the handset business showing a continued decline of 17.6% driven by slower handset replacement cycles and a relatively mild Christmas season compared to previous years.
- **Mobile service revenues** amounted to EUR 1,349 million and were -0.9% lower year-on-year excluding regulatory impacts, and -2.1% year-on-year reported terms. In particular, mobile termination rates fell from 1.66 Eurocent to 1.1 Eurocent as of 1 December 2016. While our new premium portfolio O₂ Free is well received by new and existing customers and the pricing environment in non-premium continues to improve, we still saw headwinds from the strong wholesale business and legacy base effects in the fourth quarter.
- **OIBDA** excluding exceptional and special effects² increased by 5.3% year-on-year to EUR 501 million, driven by additional integration savings of approx. EUR 25 million.
- **Capex**³ increased by 9.0% year-on-year to EUR 358 million as investments were back-end loaded as expected. LTE coverage reached almost 80% by year-end 2016.
- **Consolidated net financial debt**⁴ was EUR 798 million as of the end of December 2016 and leverage reduced further to 0.4x as a result of strong Free Cash Flow driven by the expected seasonal working capital movements in the quarter.

² Excluding exceptional and special effects. For the period October to December 2016 exceptional effects include restructuring expenses amounting to EUR 30 million (EUR 7 million in the same period of 2015) and the special effects consist of the impact of the Telxius deal on OIBDA (EUR -8 million in the fourth quarter of 2016) resulting primarily from higher operating lease expenses

³ Excluding capitalised costs on borrowed capital in 2016 for investments in spectrum in June 2015

⁴ Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing liabilities as well as cash and cash equivalents and excludes the payables for the spectrum auction

Progress of integration and transformation activities

Telefónica Deutschland achieved the expected EUR 150 million of operating cash flow synergies in 2016, finalising core integration projects such as the customer migration and the finalisation of the brand portfolio. Other projects such as the ongoing FTE restructuring and network integration are also on track.

- As of the year-end 2016 Telefónica Deutschland has completed approx. 80% of the FTE restructuring programme of 1,600 FTEs by 2018. We have also continued to optimise the management of external staff, including agency workers, outsourcing and consultants.
- The Company has also completed the majority of location reorganisation, with two-thirds of the planned shop reduction of 600 shops completed and 50% of the office reduction of approximately 100 thousand square metres.
- The postpaid and prepaid customer migration between E-Plus and Telefónica Deutschland brands as well as the associated IT restructuring has also now been finalised, with the focus on O₂ as our only premium brand, as well as the rebranding of Blau as core brand in the non-premium segment.
- The physical integration and further development of the 4G network is also taking shape, with approx. 5,000 mobile sites decommissioned (35% of target) in 2016. We continue to prioritise metropolitan areas to ensure a fast and effective transformation.
- The transfer of customer service agents in the customer service entities in Hamburg, Bremen and Nuremberg to independent subsidiaries within the Company has also been completed. We continue to develop our customer service with a focus on digitalisation and a consistent high service quality across different customer care channels.

Transformation: Opportunities beyond Connectivity

Parallel to our core business, we are working on innovative digital solutions. In 2016 Telefónica Deutschland founded Telefónica NEXT to provide businesses and public institutions with innovative consumer insight based solutions to better address their customers' needs in a connected digital world. Core focus areas are targetted communication (Smart Media), decision-making based on customer movements (Smart moves), the customer journey (Smart Retail) and the development of smart products for customers (Smart Sensor solutions) based on our Geeny platform.

With Advanced Data Analytics (ADA), the company is leveraging the considerable social and economic benefits from the analysis of large data pools. Big data will drive business solutions of the future. Our mobile customer base of 44,3 million already generates four billion data points per day. We are also committed to ensuring that our customers retain sovereignty over their data and can shape their digital life with confidence.

In the context of business solutions built around the Internet of Things (IoT), we are optimising business processes by connecting machines and vehicles to enable them to communicate with each other. Here we are currently building an IoT platform which helps companies develop their own IoT propositions in a fast and cost-efficient manner.

Commercial update

Telefónica Deutschland continued to drive momentum in a rational yet dynamic environment in the last quarter of 2016.

- In 2016 we finalised our brand portfolio. O₂ is our only premium brand, while Blau addresses value-oriented customers and BASE is positioned as online-only brand. We continue to believe in a multi-channel approach to distribution.
- Our cooperation with Sky Deutschland started in January 2017. O₂ customers have the opportunity to use Sky day passes for sports, movies and TV series on the move or at home. The cooperation enables us to offer our customers another value-added service after the launch of our O₂ TV and video app earlier in 2016 and grow data usage.
- Shortly after its launch in October 2016, O₂ Free won an innovation award by allnet-vergleich-24.de. The jury stressed that by removing the data barrier, O₂ Free addresses a key need of its customers.
- Independent network tests, as well as customer perception-based tests continue to confirm quality improvements within our network:
 - Connect 'Netzwetter' attested Telefónica Deutschland the best signal strength in Germany across all technologies. Voice drop call rates have also reduced significantly.
 - The COMPUTER BILD network test, which is the result of a survey of almost 50,000 readers, confirms good coverage with high stability and a solid UMTS network in smaller cities.
 - The annual network test of CHIP and connect in December also showed that we have been able to maintain and in some areas even improve network quality during the consolidation. We will continue with the network integration as planned, aiming for steady quality gains and targeting one network over time.

Financial outlook 2017

Telefónica Deutschland achieved significant commercial and operational success in 2016 and will continue to build on these achievements in 2017. We see key opportunities as well as external risk factors for the year ahead. 2016 saw a clear focus on customer base development and data monetisation in the premium segment of the German mobile market, with the first price increases for a number of years. We successfully launched our new premium portfolio O₂ Free in October 2016, with customers responding well to the concept of 'more-for-more' and continuous mobile data access. We expect to drive operating momentum with O₂ Free in 2017, selling the new portfolio to new customers as well as using it to develop the existing customer base. The new offer will also help us counteract the drag from the remaining legacy base and OTT effects.

In contrast, the non-premium segment remained dynamic, albeit with signs of easing competitive pressure in the fourth quarter of 2016. We remain cautiously optimistic about this development and its implications for the positioning of our own brands. Nevertheless, we expect strong partner trading in the non-premium segment to continue resulting in a retail-to-wholesale mix-shift, which already weighed on mobile service revenue in 2016. The price competition amongst providers in the non-premium postpaid segment is also driving pre- to postpaid migration. In addition, the new federal prepaid legislation, which requires customer identification for prepaid products, could further impact the prepaid market from July 2017.

However, in 2017 regulatory topics present the largest headwind to mobile service revenue. As of 1 December 2016 the BNetzA cut mobile termination rates from 1.66 to 1.1 Eurocents, and the European roaming legislation will bring the roaming glide path to zero in July 2017. The roaming regulation applies to all European mobile telecommunication operators. Roaming revenue exhibits a strong seasonality due to customer travel patterns, with a major portion falling into the second half of the year. Altogether, termination and roaming effects will result in a drag on 2017 mobile service revenue of approx. 3-4% year-on-year. **Excluding these regulatory effects, we expect the underlying mobile service revenue to be slightly negative to flat year-on-year in 2017.** We base our expectations for 2017 on the assumption of a sustained rational market structure and a stable economic environment. As in 2016, fixed-line revenues will continue to be negatively affected by the progressive decommissioning of the ULL broadband access infrastructure.

We are also **upgrading our total synergy target from approx. EUR 800 million to approx. EUR 900 million operating cash flow (Opex-Capex) synergies in 2019.** This upgrade is driven by improved visibility and the realisation of further synergy opportunities identified during the integration process, such as additional Opex savings from FTE restructuring and network integration, as well as infrastructure optimisation and simplification initiatives. Capex synergies continue to result primarily from the roll-out of one LTE network. In 2017 we are expecting to reach a **cumulated savings level of approx. EUR 670 million or 75% of our new total target, with a further EUR ~160 million of incremental Opex and revenue-related in-year savings.** Savings in 2017 will result mainly from the network consolidation and the effects of the ongoing FTE restructuring. We are also expecting to realise a further **EUR ~80 million of Capex-related synergies.**

This translates into expected **flat to mid single-digit year-on-year percentage growth in OIBDA (post Group-Fees, pre exceptionals⁵)**, predominantly driven by synergies. This includes the expected impact from the European roaming regulation and the termination rate effects, which will result in an OIBDA drag of approximately 4-5% year-on-year. Our estimation of regulatory impacts is based on the expectation of a rational customer response to the new European roaming legislation. We will continue to invest in our market positioning in a rational manner and our estimation of ongoing commercial investment needs for 2017 is equally based on the assumptions of a continued rational market structure. Handsets are considered broadly neutral for margin development.

In terms of Capex development Telefónica Deutschland is focusing on the network consolidation and the roll-out of LTE in 2017, resulting in an expected **capital expenditure of around EUR 1 billion**.

The company leverage⁶ target of 'at or below 1.0x Net Debt/OIBDA over the medium term remains unchanged and will be continually reviewed, as we manage the cash flows resulting from the integration. Nevertheless, we have strong confidence in our ability to generate Free Cash Flow, which also gives us confidence in our dividend outlook. We continue to view ourselves as a dividend-paying company, supporting a high payout ratio in relation to Free Cash Flow. We **reiterate our dividend outlook**, with a **proposal of EUR 0.25/share for the financial year 2016 and projected dividend growth over 3 years (2016-18)**. We will consider expected future synergies when making dividend proposals.

During the first two years of the merger process the corporate strategy of Telefónica Deutschland was based on the concept of 'MIT': Momentum, Integration and Transformation. Having successfully completed a majority of integration milestones, our focus is now shifting from integration to transformation. The focus range of our corporate strategy thus narrows to **'M+T': Momentum and Transformation**. Maintaining momentum in the market will remain the first operational priority of Telefónica Deutschland. Furthermore, our long-term strategic transformation will be based around the core principles of digitalisation, simplification and automation. We are a beneficiary and driver of digitalisation, and the integration process has afforded us the opportunity to rethink existing mechanisms and to further embrace simplification and automation. We will continue to invest in the transformation of our business into the leading digital 'onlife' telco. The resulting operational efficiency will drive profitability and Free Cash Flow generation in the mid-term, and thus total shareholder return.

⁵ Exceptional effects such as restructuring costs are excluded from our 2017 OIBDA guidance. We have calculated a comparable for 2016, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016, as if it had occurred on 1 January 2016

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

Financial Outlook 2017:

	Base line 2016 (EUR million)	Outlook 2017
MSR Underlying ⁷	5,437	Slightly negative to flat y-o-y
OIBDA Before exceptional effects ⁸	1,793	Flat to mid single-digit % growth y-o-y
Capex	1,102	Around EUR 1 billion
Dividend⁹	EUR 0.25/share	Annual dividend growth for 3 years

⁷ The impact from regulatory changes in form of the termination rate effect and the glide path of the European roaming legislation are excluded from MSR guidance

⁸ For 2016: Exceptional effects include restructuring costs as well as the net capital gain from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016. We have calculated an OIBDA comparable for 2016 reported, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016, as if it had occurred on 1 January 2016

For 2017: Exceptional effects such as restructuring costs are excluded from our 2017 OIBDA guidance

⁹ For 2016: Proposal to the Annual General Meeting 2017

Operating performance in 2016

At the end of December 2016 Telefónica Deutschland's **access base** was **49.3 million** (a +2.0% year-on-year increase) driven by growth in the mobile base of 2.9% to 44.3 million. In fixed-line, we were able to maintain the positive year-on-year trend in the retail DSL business, while wholesale DSL accelerated its decline due to the planned dismantling of the legacy platform after 2018.

Net additions in mobile postpaid for 2016 came in at 1,281 thousand¹⁰ (336 thousand in Q4 2016), compared to 709 thousand in the prior year. In the retail postpaid business we maintained our strategic focus on retention and customer base development. At the same time, partner brands sustained their strong performance with a gross add contribution of 54% in the twelve months period (58% in the fourth quarter, slightly lower than previous quarter). At the end of December our mobile postpaid base reached 20.5 million accesses (+7.6% year-on-year) and increased its share of the total mobile base to 46.3% (+2.0 percentage points year-on-year).

Prepaid registered 195 thousand net disconnections in 2016 and finished the year with 23.8 million accesses (-0.8% year-on-year). The fourth quarter saw 89 thousand net disconnections, mainly the result of seasonal activity in the partner business.

Postpaid churn in 2016 improved by 0.1 percentage points year-on-year to 1.6% for January to December. The O₂ consumer brand reported an even lower churn of 1.4% for the same period (stable year-on-year).

Smartphone penetration¹¹ continued to rise across brands and segments, reaching 59.5% at the end of December, up 5.2 percentage point year-on-year and +0.3% percentage points quarter-on-quarter. In the O₂ consumer postpaid brand smartphone penetration was 77.3% at the end of 2016, 0.4 percentage points lower year-on-year as a result of the customer migration.

The **LTE customer base** continued to see strong growth (+14.2% quarter-on-quarter) and stood at 12.1 million at the end of December, reflecting the continued high demand for high-speed mobile access from customers in all segments.

Mobile ARPU was EUR 10.3 for the twelve months period (-3.7% year-on-year) and EUR 10.1 (-3.8% year-on-year) in the fourth quarter of 2016. Postpaid ARPU came to EUR 16.5 for January to December 2016 (-4.1% year-on-year) and EUR 16.0 in the fourth quarter (-5.6% year-on-year), reflecting the higher share of wholesale customers within the base. Prepaid ARPU was EUR 5.7 in 2016 (-1.6% year-on-year) and EUR 5.6 (-3.1% year-on-year) in the fourth quarter of 2016 on the back of prepaid to postpaid migration trends.

¹⁰ Excluding the reclassification of 172 thousand customers from prepaid to postpaid as part of the customer migration activities in the third quarter of 2016

¹¹ Defined as the number of active mobile data tariffs over total mobile customer base, excluding M2M and data-only accesses

Retail fixed broadband benefitted from the strong demand for high-speed VDSL accesses and registered 289 thousand VDSL net additions in 2016 (+10.9% year-on-year), thereof 74 thousand in the fourth quarter (+1.2% year-on-year). As a result, retail fixed BB customers were up slightly (+0.3% year-on-year) and stood at 2.1 million at year-end.

Fixed wholesale accesses continued their expected decline on the back of the planned decommissioning of the ULL broadband access infrastructure and saw 281 thousand net disconnections in 2016 (100 thousand net disconnections in the fourth quarter), ending 2016 with 691 thousand accesses.

Financial performance in 2016

Revenues came to EUR 7,503 million (-4.9% year-on-year) for the twelve months of 2016 and EUR 1,936 million in the fourth quarter (-6.0% year-on-year), reflecting the year-on-year trends in the handset market as well as lower year-on-year mobile service revenues.

Mobile service revenues (MSR) in 2016 were 1.7% lower year-on-year at EUR 5,437 million, with the fourth quarter contributing EUR 1,349 million (-2.1% year-on-year). Excluding regulatory effects from termination rate cuts and the glidepath of the European roaming legislation, MSR were 1.1% and 0.9% lower year-on-year, respectively. In addition to the regulatory headwinds, we are seeing a higher share of wholesale revenues as a result of the highly competitive environment in the partner business. We continue to focus on the development of our customer base through retention and upsell mechanisms.

Mobile data revenues rose 5.3% year-on-year to EUR 2,992 million for the twelve months period (EUR 746 million or +4.8% year-on-year in the fourth quarter), with the steady growth of mobile data usage and non-SMS data revenues outweighing the continuous decline in SMS revenues. Non-SMS data revenues grew 13.1% year-on-year to EUR 2,300 million in 2016 and 12.9% year-on-year to EUR 583 million in the fourth quarter. As a result, the share of mobile data revenues in 2016 over total mobile service revenues rose to 55.0% (+3.7 percentage points year-on-year) and non-SMS data further grew its share of data revenues by 5.3 percentage points to 76.9% in the twelve month period.

Handset revenues came to EUR 1,061 million for the full year (-18.4% year-on-year) and EUR 341 million in the fourth quarter (-17.6% year-on-year), thus reflecting the European market trends with longer replacement cycles and generally weaker demand also in the strongest quarter of the year.

Fixed revenue trends fell 5.9% in the twelve month period and -10.3% fourth quarter, resulting in total fixed revenues of EUR 981 million and EUR 238 million respectively. We continue to see good traction in terms of VDSL net additions, and the retail fixed broadband customer base was up slightly year-on-year. However, retail DSL revenues contributed -6.8% in 2016 (-7.8% in the fourth quarter) to the year-on-year decline, inter alia due to the phasing of promotional effects. The wholesale DSL customer base decline accelerated in the fourth quarter of the year due to the planned dismantling of the legacy infrastructure, which further impacted the total fixed revenue trajectory.

Other income amounts to EUR 502 million for 2016 compared to EUR 265 million in the previous year¹². The year-on-year increase mainly results from the capital gain of EUR 352 million related to the sale of the passive tower infrastructure in April 2016.

Operating expenses amounted to EUR 5,936 million in 2016, a reduction of 6.5% year-on-year and EUR 1,505 million (-7.9% year-on-year) in the fourth quarter, driven by the savings from integration projects. Operating expenses included restructuring costs of EUR 89 million for the twelve months period and EUR 30 million in the fourth quarter, mainly driven by network consolidation.

- **Supplies** amounted to EUR 2,452 million in 2016 (-9.6% year-on-year) and EUR 674 million in the fourth quarter (-9.8% year-on-year). The decline is mainly driven by lower hardware cost of sales

¹² Including the extraordinary effects from the sales of yourfone in the first quarter of 2015 and the agreement with KPN on the final purchase price for E-Plus in the fourth quarter of 2015

(44% of supplies in the full year period versus 47% in 2015) and lower connectivity-related cost of sales (48% of supplies in 2016 versus 45% in 2015).

- **Personnel expenses** totalled EUR 646 million for January to December 2016 (EUR 157 million in the fourth quarter) compared to EUR 655 million in 2015. The decline of 1.4% year-on-year is mainly driven by the successful execution of the employee restructuring programme, partly offset by the incourcing of external employees, e.g. in customer service. Excluding restructuring costs of EUR 46 million in 2016 (EUR 4 million in prior year), personnel expenses in the twelve month period fell 7.9% year-on-year.
- **Other operating expenses** amounted to EUR 2,838 million in the twelve months of 2016 (EUR 674 million in the fourth quarter), 4.8% lower year-on-year. They include higher operating lease expenses for the period May to December 2016 of EUR 23 million as well as restructuring costs of EUR 43 million (compared to EUR 69 million in 2015). Savings in the full year resulted mainly from the successful execution of synergy projects. These savings were partly offset by commercial and other investments related to customer and brand migration activities in the first half of 2016. Commercial and non-commercial costs represent 57% and 39% respectively in the twelve month period.

Operating Income before Depreciation and Amortisation (OIBDA) in 2016 benefitted from the net capital gain of EUR 352 million related to the sale of the Company's passive tower infrastructure in April 2016, as well as the before-mentioned cost reductions. In reported terms OIBDA came to EUR 2,069 million in 2016 and EUR 463 million in the fourth quarter.

OIBDA excluding exceptional and special effects¹³ came to EUR 1,828 million, an increase of 3.8% year-on-year in the twelve months period, and to EUR 501 million (+5.3% year-on-year) in the final quarter of 2016. In-year savings from integration activities contributed approx. EUR 150 million in the full year (approx. EUR 25 million in the fourth quarter) to the year-on-year OIBDA growth. The OIBDA margin was up 2.0 percentage points year-on-year to 24.4% for the twelve months period and +2.8 percentage points higher year-on-year to 25.9% in the final quarter of 2016.

Group fees amounted to EUR 55 million in the full-year 2016 and EUR 9 million in the fourth quarter.

Depreciation & Amortisation amounted to EUR 2,118 million for 2016, compared to EUR 2,067 million reported in 2015. The increase resulted from higher software investments and the accelerated amortisation of software assets due to IT integration measures. This was partly offset by lower depreciation of property, plant and equipment due to the sale of the passive tower infrastructure to Telxius SA.

¹³ Excluding exceptional and special effects. For the period January to December 2016 exceptional effects include restructuring expenses amounting to EUR 89 million (EUR 73 million in the same period of 2015) and the net capital gain from the sale of passive tower infrastructure to Telxius amounting to EUR 352 million, while in the same period of 2015 a one-off gain from the sale of yourfone GmbH was registered. For the period January to December 2016 special effects consist of the impact of the Telxius deal on OIBDA (EUR -23 million for the twelve months 2016) resulting primarily from higher operating lease expenses starting in May 2016

The **Operating loss** was EUR 50 million for the period January to December 2016 (EUR -54 million in the fourth quarter). The increase of EUR 213 million compared to FY 2015 is primarily due to a net capital gain of EUR 352 million from the sale of passive tower infrastructure to Telxius S.A., while in 2015 we registered a net income of EUR 102 million resulting from the agreement on the final purchase price for the acquisition of the E-Plus.

The net financial result for the twelve months of 2016 was negative in the amount of EUR 36 million (EUR -11 million in the fourth quarter) compared to EUR -48 million in the prior year. The improvement is driven by lower interest costs mainly due to the full repayment of a loan from Telfisa Global B.V. in 2016. This effect is partly offset by interest expenses for the revolving credit facility completed in March 2016.

The Company reported an **income tax expense** for January to December 2016 of EUR 90 million, mainly relating to changes in deferred taxes.

The result for full year 2016 came to EUR -176 million (EUR -154 million for October to December 2016).

Capex¹⁴ increased 6.7% year-on-year to EUR 1,102 million for the full year; in the final quarter investments were 9.0% higher year-on-year at EUR 358 million. Telefónica Deutschland continued to invest in the rollout of the LTE network and network integration, as well as seeing higher software investments as a result of the migration of E-Plus customers to the O₂ brand.

Operating cash flow (OIBDA minus Capex¹⁴) for the twelve months period of 2016 was EUR 967 million and EUR 104 million in the fourth quarter. Excluding exceptional and special effects¹⁵, operating cash flow was broadly stable year-on-year (-0.3%) at EUR 727 million.

Free Cash Flow (FCF)¹⁶ reached EUR 1,408 million in 2016 and includes the proceeds from the sale of passive tower infrastructure to Telxius.

Working capital movements were EUR 237 million in 2016 compared to EUR 29 million in prior year. This development is due the seasonal Capex and prepayment reversals, positive effects from silent factoring and other factoring transactions as well as a reduction in trade receivables, partly offset by restructuring and other working capital movements.

Consolidated net financial debt¹⁷ stood at EUR 798 million at the end of December 2016, bringing the leverage ratio to 0.4x. The reduction in net financial debt in the financial year 2016 was primarily driven by Free Cash Flow¹⁵ of EUR 1,408 million, including the effect from the sale of towers. The dividend payment for the financial year 2015 (EUR 714 million), the decrease in handset receivables (EUR 156 million) and the payment of the second tranche for the 700 MHz spectrum acquired in the frequency auction amounting to EUR 111 million partly offset the FCF effect.

¹⁴ Excluding capitalised costs on borrowed capital in 2016 for investments in spectrum in June 2015

¹⁵ Exceptional effects as of 31 December 2016 include restructuring expenses amounting to EUR 89 million (31 December 2015: EUR 73 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. For 2016 special effects consist of the impact of the Telxius deal on OIBDA (EUR -23 million in 2016) resulting primarily from higher operating lease expenses starting in May 2016

¹⁶ 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 978 million

¹⁷ Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents

APPENDIX – DATA TABLES

TELEFÓNICA DEUTSCHLAND GROUP
SELECTED CONSOLIDATED FINANCIAL DATA

Unaudited

(Euros in millions)	1 October to 31 December			1 January to 31 December		
	2016	2015	% Chg	2016	2015	% Chg
Revenues	1,936	2,059	(6.0)	7,503	7,888	(4.9)
Operating income before depreciation and amortisation (OIBDA), before exceptional effects (1) and before special effects (2)	501	476	5.3	1,828	1,760	3.8
<i>OIBDA before exceptional effects and special effects-margin</i>	25.9%	23.1%	2.8%-p.	24.4%	22.3%	2.0%-p.
Special effects (2)	(8)	–	(100.0)	(23)	–	(100.0)
Operating income before depreciation and amortisation (OIBDA) and before exceptional effects (1)(7)	493	476	3.6	1,805	1,760	2.5
<i>OIBDA before exceptional effects-margin</i>	25.4%	23.1%	2.4%-p.	24.1%	22.3%	1.7%-p.
Exceptional effects (1)	(30)	95	(>100.0)	264	43	>100.0
Operating income before depreciation and amortisation (OIBDA)	463	570	(18.9)	2,069	1,804	14.7
<i>OIBDA margin</i>	23.9%	27.7%	(3.8%-p.)	27.6%	22.9%	4.7%-p.
Group fees	9	16	(42.7)	55	54	1.0
Operating income before depreciation and amortisation (OIBDA) and before group fees	472	586	(19.5)	2,124	1,858	14.3
<i>OIBDA before group fees margin</i>	24.4%	28.5%	(4.1%-p.)	28.3%	23.6%	4.7%-p.
Operating income	(54)	49	(>100.0)	(50)	(263)	(81.1)
Total profit (loss) for the period	(154)	(35)	>100.0	(176)	(383)	(54.0)
Basic earnings per share (in euros) (3)	(0.05)	(0.01)	>100.0	(0.06)	(0.13)	(54.0)
CapEx (4)	(358)	(328)	9.0	(1,102)	(1,032)	6.7
Operating cash flow (OIBDA-CapEx) (5)	104	140	(25.3)	967	670	44.4
Free cash flow pre dividends and payments for spectrum (6) and pre-acquisition of E-Plus net of cash acquired	457	350	30.6	1,408	700	>100.0
Free cash flow pre dividends and payments for spectrum (6)	457	460	(0.6)	1,408	832	69.2

(1) Exceptional effects as of 31 December 2016 include restructuring expenses amounting to EUR 89m and the net capital gain from the sale of passive tower infrastructure to Telxius amounting to EUR 352m.

(2) Special effects as of 31 December 2016 consist of the Telxius deal's OIBDA impact resulting primarily from higher operating lease expenses starting in May 2016.

(3) 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 Mio. for the years 2016 and 2015.

(4) Excluding investments in spectrum (including capitalised costs on borrowed capital).

(5) Excluding investments in spectrum (including capitalised costs on borrowed capital) and adjusted by other income and expenses resulting from finalization of purchase price.

(6) 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 as well as related interest payments.

(7) For 2016: Exceptional effects include restructuring costs as well as the net capital gain from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016. The OIBDA impact resulting primarily from higher operating lease expenses between May and December 2016 was treated as a special effect for 2016.

For 2017: We have calculated an OIBDA comparable for 2016 reported, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016, as if it had occurred on 1 January 2016.

(Euros in millions)	1 October to 31 December			1 January to 31 December		
	2016	2015	% Chg	2016	2015	% Chg
Operating income before depreciation and amortisation (OIBDA) and before exceptional effects (1)(7)	493	476	3.6	1,805	1,760	2.5
Special effects Jan. - Apr.	-	-	–	(12)	-	–
Operating income before depreciation and amortisation (OIBDA) and before exceptional effects (1)(7) and after special effects for comparable purposes	493	476	3.6	1,793	1,760	1.9

Note:

OIBDA margin, OIBDA before group fees margin and OIBDA before exceptional effects-margin are calculated as percentage of total revenues, respectively.

TELEFÓNICA DEUTSCHLAND GROUP
ACCESSES
Unaudited

(in thousands)	2016				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Final clients accesses	47,342	47,754	48,405	48,655	46,573	46,981	47,627	47,391
Fixed telephony accesses	2,003	2,007	2,007	2,010	2,022	2,010	2,000	1,998
Internet and data accesses	2,331	2,330	2,325	2,324	2,372	2,355	2,339	2,331
Narrowband	229	226	223	221	243	240	236	233
Broadband	2,101	2,104	2,102	2,104	2,128	2,115	2,103	2,098
<i>thereof VDSL</i>	593	669	732	806	322	380	444	517
Mobile accesses	43,008	43,417	44,074	44,321	42,179	42,617	43,289	43,063
Prepaid	23,744	23,814	23,873	23,784	23,264	23,501	24,004	23,979
Postpaid	19,264	19,603	20,201	20,537	18,915	19,116	19,285	19,083
<i>thereof M2M</i>	682	704	748	788	443	506	571	632
Postpaid (%)	44.8%	45.2%	45.8%	46.3%	44.8%	44.9%	44.5%	44.3%
Smartphone penetration (%) (1)	55.4%	56.2%	59.2%	59.5%	49.8%	51.3%	52.9%	54.2%
LTE customers (2)	8,691	9,400	10,566	12,063	5,146	6,093	7,002	7,883
Wholesale accesses (3)	911	850	791	691	1,085	1,059	1,018	972
Total accesses	48,252	48,605	49,196	49,346	47,658	48,041	48,645	48,363

(1) Smartphone penetration is calculated based on the number of customers with a smallscreen tariff (e.g. for smartphones) divided by the total mobile customer base, less M2M and customers with a bigscreen tariff (e.g. for surfsticks, dongles, tablets).

(2) LTE customer defined customer with LTE enabled handset & LTE tariff.

(3) Wholesale accesses incorporate unbundled lines offered to 3rd party operators, including wirelines telephony and high-speed Internet access.

TELEFÓNICA DEUTSCHLAND GROUP
SELECTED OPERATIONAL DATA
Unaudited

	2016				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
ARPU (in euros) (1)	10.3	10.4	10.5	10.1	10.6	10.8	10.9	10.5
Prepaid	5.7	5.7	5.9	5.6	5.6	5.9	6.0	5.8
Postpaid excl. M2M	16.6	16.6	16.6	16.0	17.2	17.2	17.4	16.9
Data ARPU (in euros)	5.6	5.8	5.8	5.6	5.5	5.6	5.6	5.5
% non-SMS over data revenues (2)	75.4%	76.7%	77.2%	78.2%	70.5%	71.5%	71.9%	72.5%
Voice Traffic (m min) (3)	23,696	24,689	23,275	24,553	24,236	23,647	23,409	24,383
Data Traffic (TB) (4)	51,599	61,726	74,361	81,641	40,172	42,255	45,898	50,501
Churn (%)	2.5%	2.1%	2.1%	2.3%	2.4%	2.1%	2.1%	2.8%
Postpaid churn (%) excl. M2M	1.8%	1.6%	1.2%	1.6%	1.7%	1.7%	1.7%	2.4%

Notes:

(1) ARPU (average revenue per user) is calculated as monthly average of the quarter.

(2) % non-SMS over data revenues in relation to the total data revenues.

(3) Voice Traffic is defined as minutes used on the company's network, both outbound and inbound. Promotional traffic and traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is also included. Traffic volume is non rounded.

(4) Data traffic is defined as Terabytes used by the company customers, both upload and download (1TByte = 1012 bytes). Promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is also included. Traffic volume non-rounded.

TELEFÓNICA DEUTSCHLAND GROUP
CONSOLIDATED INCOME STATEMENT

Unaudited

(Euros in millions)	1 October to 31 December				1 January to 31 December			
	2016	2015	Change	% Chg	2016	2015	Change	% Chg
Revenues	1,936	2,059	(124)	(6.0)	7,503	7,888	(385)	(4.9)
Other income	32	146	(114)	(77.8)	502	265	237	89.3
Operating expenses	(1,505)	(1,635)	130	(7.9)	(5,936)	(6,349)	413	(6.5)
Supplies	(674)	(747)	73	(9.8)	(2,452)	(2,712)	260	(9.6)
Personnel expenses	(157)	(155)	(3)	1.6	(646)	(655)	9	(1.4)
Other expenses	(674)	(733)	59	(8.1)	(2,838)	(2,982)	144	(4.8)
Operating income before depreciation and amortisation (OIBDA)	463	570	(108)	(18.9)	2,069	1,804	265	14.7
OIBDA margin	23.9%	27.7%		(3.8%-p.)	27.6%	22.9%		4.7%-p.
Depreciation and amortisation	(517)	(522)	5	(1.0)	(2,118)	(2,067)	(52)	2.5
Operating income	(54)	49	(102)	(>100.0)	(50)	(263)	213	(81.1)
Net financial income (expense)	(11)	(12)	1	(9.7)	(36)	(48)	11	(23.9)
Profit (loss) before tax for the period	(65)	37	(101)	(>100.0)	(86)	(311)	225	(72.3)
Income tax	(90)	(72)	(18)	24.5	(90)	(72)	(18)	24.8
Total profit for the period	(154)	(35)	(119)	>100.0	(176)	(383)	207	(54.0)
Number of shares in millions as of end of period date	2,975	2,975	-	-	2,975	2,975	-	-
Basic earnings per share (in euros) (1)	(0.05)	(0.01)	(0)	>100.0	(0.06)	(0.13)	0.07	(54.0)

(1) Basic earnings per share are calculated by dividing profit (loss) after taxes for the period by the weighted average number of ordinary shares of 2,975 Mio. for the years 2016 and 2015.

TELEFÓNICA DEUTSCHLAND GROUP
REVENUE BREAKDOWN

Unaudited

(Euros in millions)	1 October to 31 December				1 January to 31 December			
	2016	2015	Change	% Change	2016	2015	Change	% Change
Revenues	1,936	2,059	(124)	(6.0)	7,503	7,888	(385)	(4.9)
Mobile business	1,690	1,791	(101)	(5.7)	6,498	6,832	(334)	(4.9)
Mobile service revenues	1,349	1,378	(29)	(2.1)	5,437	5,532	(95)	(1.7)
Handset revenues	341	413	(73)	(17.6)	1,061	1,300	(239)	(18.4)
Fixed business	238	266	(27)	(10.3)	981	1,043	(62)	(5.9)
Other revenues	8	3	5	>100.0	23	12	11	92.4

TELEFÓNICA DEUTSCHLAND GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited

(Euros in millions)	As of December 31		Change	% Change
	2016	2015		
NON-CURRENT ASSETS	13,055	14,406	(1,351)	(9.4)
Goodwill	1,932	1,955	(23)	(1.2)
Other intangible assets	6,215	7,059	(844)	(12.0)
Property, plant and equipment	4,217	4,507	(291)	(6.4)
Trade and other receivables	77	157	(79)	(50.5)
Other financial assets	60	63	(2)	(3.9)
Other non-financial assets	128	160	(32)	(20.2)
Deferred tax assets	427	505	(79)	(15.6)
CURRENT ASSETS	2,246	2,248	(2)	(0.1)
Inventories	85	123	(38)	(30.7)
Trade and other receivables	1,460	1,520	(60)	(4.0)
Other financial assets	25	10	15	>100.0
Other non-financial assets	63	61	2	3.3
Cash and cash equivalents	613	533	80	15.0
Total assets = Total equity and liabilities	15,301	16,654	(1,353)	(8.1)
EQUITY	9,408	10,321	(912)	(8.8)
Common Stock	2,975	2,975	-	-
Additional paid-in capital & retained earnings	6,434	7,346	(912)	(12.4)
Equity attributable to owners of the company	9,408	10,321	(912)	(8.8)
NON-CURRENT LIABILITIES	2,637	2,779	(142)	(5.1)
Interest-bearing debt	1,721	1,686	35	2.1
Trade payables and other payables	17	154	(136)	(88.8)
Provisions	561	516	45	8.7
Deferred income	338	424	(85)	(20.1)
CURRENT LIABILITIES	3,256	3,554	(298)	(8.4)
Interest-bearing debt	37	568	(531)	(93.5)
Trade payables and other payables	2,286	2,272	14	0.6
Provisions	190	196	(6)	(3.1)
Other non-financial liabilities	79	48	32	66.7
Deferred income	664	471	193	40.9
Financial Data				
Net financial debt (1)	798	1,225	(426)	(34.8)
Leverage (2)	0.4x	0.7x	(0.3)	(36.4)

(1) Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents.
* Current and non-current financial assets include handset - receivables (current: EUR 245m in 2016 and EUR 321m in 2015; non-current: EUR 77m 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 12m in 2016 and EUR 12m in 2015) as well as loans to third parties (current: EUR 4m 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 1,422m in 2016 and EUR 1,420m in 2015), other loans (EUR 298m in 2016 and EUR 501m in 2015), finance lease payables (current: EUR 15m 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.

The present value of pending payments for spectrum amounting to EUR 110m (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.

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

TELEFÓNICA DEUTSCHLAND GROUP

RECONCILIATION OF FREE CASH FLOW AND RECONCILIATION TO NET DEBT

Unaudited

(Euros in million)	2016				2015			
	Jan - Mar	Jan - Jun	Jan - Sept	Jan - Dec	Jan - Mar	Jan - Jun	Jan - Sept	Jan - Dec
OIBDA	379	1,170	1,606	2,069	395	845	1,234	1,804
+ Other income and expenses resulting from finalization of purchase price (1)	-	-	-	-	-	-	-	(102)
- CapEX (2)	(218)	(430)	(743)	(1,102)	(221)	(463)	(704)	(1,032)
= Operating Cash Flow (OpCF)	161	740	863	967	175	383	530	670
+ Silent Factoring (3)	135	194	315	424	314	367	301	544
-/+ Other working capital movements	(294)	(554)	(440)	(187)	(421)	(672)	(503)	(515)
Change in working capital	(159)	(360)	(125)	237	(107)	(306)	(201)	29
+/- (Gains) losses from sale of assets	-	(353)	(353)	(352)	(17)	(17)	(15)	(15)
+/- Proceeds from sale of companies	-	-	-	-	68	61	58	57
+/- Proceeds from sale of fixed assets and other effects	-	591	591	591	0	-	0	1
+ Net interest payments	(18)	(19)	(16)	(23)	(14)	(18)	(22)	(33)
+ Taxes paid	-	-	-	(0)	-	0	0	0
+/- Proceeds / Payments on financial assets	(4)	(1)	(10)	(13)	0	(0)	(0)	(10)
= Free cash flow pre dividends and payments for spectrum (4) as well as pre-acquisition of E-Plus net of cash acquired	(20)	599	951	1,408	105	102	350	700
+ Acquisition of E-Plus net of cash acquired (5)	-	-	-	-	-	22	22	132
= Free cash flow pre dividends and payments for spectrum (4)	(20)	599	951	1,408	105	125	372	832
- Payments for spectrum	(1)	(2)	(114)	(115)	-	(976)	(977)	(978)
- Dividends (5)	-	(714)	(714)	(714)	-	(714)	(714)	(714)
= Free cash flow post dividends and payments for spectrum	(21)	(117)	123	578	105	(1,565)	(1,319)	(860)
= Net financial debt at the beginning of the period	1,225	1,225	1,225	1,225	18	18	18	18
+ Other change in net financial debt	20	15	93	152	212	195	72	340
+ capital increase (less transaction costs of the period)	-	-	-	-	5	6	6	6
= Net financial debt at the end of the period (incl. Restricted cash)	1,266	1,356	1,195	798	130	1,784	1,415	1,225

(1) In the fourth quarter 2015, an agreement on the final purchase price was reached with KPN. The original purchase price was reduced overall by EUR 134m. The differences between the preliminary purchase price and the final purchase price was recognized in an amount of EUR 30m directly to goodwill within the twelve-month period. EUR 104m less expenses to reach the agreement in the amount of EUR 3m (of which EUR 2m have been paid) have been recognized at the end of the 12-month period in December 2015 in the income statement.

(2) Excluding investments in spectrum (including capitalised costs on borrowed capital).

(3) Full impact (YTD) of silent factoring in the twelve months period in 2016 of EUR 424m and of EUR 544m in the twelve months period 2015 (transactions have been executed in March, June, September and December 2016 respectively in January, March, June, October and December of the year 2015).

(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 as well as related interest payments.

(5) Dividend payment of EUR 714m in May 2016. Dividend payment of EUR 714m in May 2015.

	2016				2015			
	Jan - Mar	Jan - Jun	Jan - Sept	Jan - Dec	Jan - Mar	Jan - Jun	Jan - Sept	Jan - Dec
= Free cash flow pre dividends and payments for spectrum (millions)	(20)	599	951	1,408	105	125	372	832
Number of shares (millions)	2,975	2,975	2,975	2,975	2,975	2,975	2,975	2,975
= Free cash flow per share (in euros)	(0.01)	0.20	0.32	0.47	0.04	0.04	0.13	0.28

TELEFÓNICA DEUTSCHLAND GROUP
 CONSOLIDATED NET FINANCIAL DEBT EVOLUTION

Unaudited

(Euros in millions)	As of 31 December		% Chg
	2016	2015	
A Liquidity	613	533	15.0
B Current financial assets	251	324	(22.5)
C Current financial debt	31	564	(94.6)
D=C-A-B Current net financial debt	(833)	(292)	>100.0
E Non-current financial assets	89	169	(47.2)
F Non-current financial debt	1,721	1,686	2.1
G=F-E Non-current net financial debt	1,631	1,517	7.6
H=D+G Net financial debt (1)	798	1,225	(34.8)

(1) Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents.

B + E Current and non-current financial assets include handset - receivables (current: EUR 245m in 2016 and EUR 321m in 2015; non-current: EUR 77m 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 12m in 2016 and EUR 12m in 2015) as well as loans to third parties (current: EUR 4m in 2016 and EUR 1m in 2015; non-current: EUR 0m in 2016 and EUR 1m in 2015).

C + F Current and non-current net financial debt include bonds, promissory notes and registered bonds issued (EUR 1,422m in 2016 and EUR 1,420m in 2015), other loans (EUR 298m in 2016 and EUR 501m in 2015), finance lease payables (current: EUR 15m 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.

The present value of pending payments for spectrum amounting to EUR 110m (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.

Further information

Telefónica Deutschland Holding AG

Investor Relations

Georg-Brauchle-Ring 23-25

80992 München

Veronika Bunk-Sanderson, Director Investor Relations

Marion Polzer, Senior Manager Investor Relations

Abigail Gooren, Investor Relations Officer

Pia Hildebrand, Investor Relations Officer

Saskia Puth, Office Manager Investor Relations

(t) +49 89 2442 1010

ir-deutschland@telefonica.com

www.telefonica.de/investor-relations

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