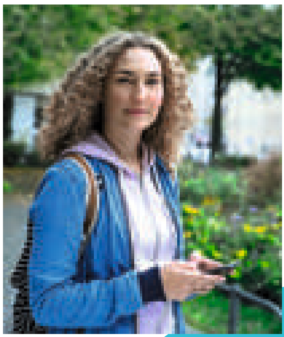
ON LIFE

Name: Isabell
Job : Student
Age : 21

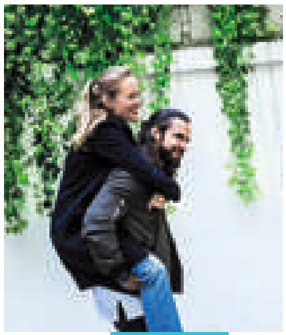


— 06

Name: Zoé
Job : Office manager
Age : 27

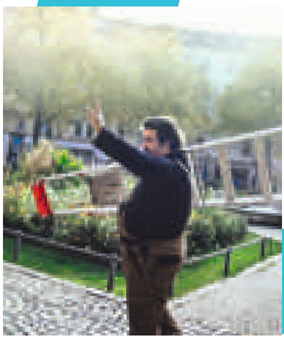
— 08

Name: Laura and Ben
Job : Banker and architect
Age : 27 and 31



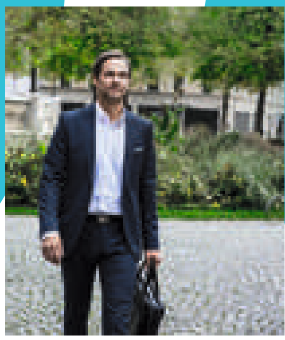
— 10

Name: Marco
Job : Electrician
Age : 51



— 14

Name: Gregor
Job : Executive consultant
Age : 44



— 16

Name: Jasmin and Nils
Job : Educator and photographer
Age : 32 and 34

— 18

SHAPING DIGITAL LIVES

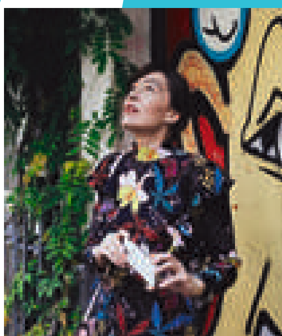
Name: Manuel
Job : Musician
Age : 35

— 20

Name: Christian
Job : Project manager in IT
Age : 42

— 24

Name: Angelika
Job : Artist
Age : 39

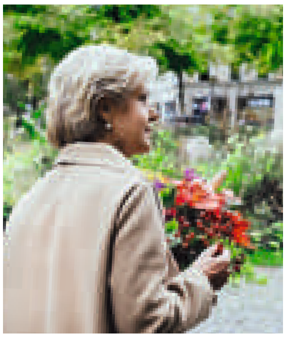


— 28

Name: Fritz and Leo
Job : Pensioner and scholar
Age : 65 and 12

— 30

Name: Vera
Job : Lawyer
Age : 55

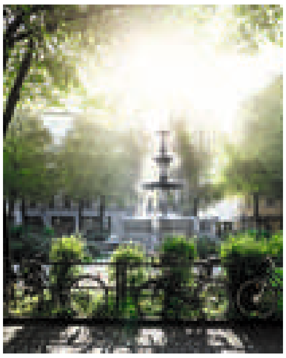


— 32

Magazine
2016

Telefónica
Deutschland

Scene: public open space in Germany



OnLife. Shaping digital lives.

People cross it while shopping or on their way to work. It is where they meet their friends, bump into old acquaintances, or start up a conversation while on a break. Public space is the focus of everyday interaction. It embodies different situations, expectations, and negotiations on the big and small aspects of day-to-day life.

As a company with more than 49 million customer accesses, Telefónica Deutschland occupies a similar place at the heart of society. Listening to what people want and giving them what they need to achieve it: this is what drives us as a telecommunications company. What is the young couple talking about? What is on the minds of the family or those who are out on a walk?

On its way to becoming the OnLife Telco, Telefónica Deutschland is the pacemaker of digitalisation. We help our customers to use the achievements of the digital world in a way that caters to their desires and customs.

We know our place. Come with us as we explore the topics we encounter there.

Markus Haas

Chief Executive Officer (CEO)
Chairman of the Management Board
Telefónica Deutschland Holding AG

Rachel Empey

Chief Financial and Strategy Officer (CFO)
Member of the Management Board
Telefónica Deutschland Holding AG

On the way to becoming the OnLife Telco

Telefónica Deutschland is becoming the OnLife Telco. We are helping our customers to shape their digital life according to their wants and needs. We achieve this with a clear strategy which has been built on our three guiding principles since the merger of Telefónica Deutschland and E-Plus: We are maintaining our momentum on the market. We are successfully completing the integration. And we are driving the digital transformation of our company.

As Germany's largest mobile telco with more than 44 million mobile customer accesses, we maintained our momentum in the financial year 2016. We also took key strategic measures in order to turn the OnLife Telco vision into reality. Good progress has been made with the integration of Telefónica Deutschland and E-Plus. We have completed the reorientation of our brand and product family and pressed ahead with the integration of the mobile networks. We have also streamlined our sales network and made extremely good headway in terms of our organisational restructuring. In light of this progress, our focus has shifted to the digital transformation of our company since mid-2016.

»As an OnLife Telco, we want to help our customers to live a self-determined digital life according to their wants and needs. Our aim is to identify and meet their expectations in real-time,« explains Markus Haas, Chief Executive Officer of Telefónica Deutschland. »These capabilities are becoming a crucial factor for achieving competitive success.«

» As an OnLife Telco, we want to help our customers to live a self-determined digital life according to their wants and needs.«

Markus Haas

Rachel Empey

» Our attractive products and services are aimed at monetising our customers' increasing consumption of data.«

The companies of the future will be particularly successful if they can offer customers suitable products and services as quickly as possible on the basis of real-time analysis. Customers are increasingly focusing on the actual benefit of such offers. In 2016, Telefónica Deutschland launched pioneering products and services with a view to meeting this customer demand. Examples include the new O_2 Free tariff family, which allows customers to continue using key mobile apps for their everyday digital life even after using up their high-speed allowance. Or O_2 Banking, the first fully mobile bank account, where users are rewarded with an increased data allowance. We are also focusing on interesting content as an additional incentive for customers to use their mobile devices. To this end, we are entering into partnerships with well-known content providers including Sky Deutschland and TV Spielfilm.

»Our attractive products and services are aimed at monetising our customers' increasing consumption of data in order to leverage new revenue opportunities for Telefónica Deutschland. At the same time, we are working hard to improve our efficiency and cost base in order to achieve our earnings targets in a tough fiercely competitive environment,« explains Rachel Empey, Management Board member responsible for Finance, Strategy and Innovation.

A powerful network is and remains a key factor for a successful OnLife Telco. In the past financial year, Telefónica Deutschland forged ahead with the integration of the O_2 and E-Plus networks and continued the LTE rollout. In 2017, we will increasingly focus on network consolidation. In doing so, Telefónica Deutschland's extremely reliable network offers a persuasive customer experience on a day-to-day basis.

We also make it easier for customers to interact with us however they wish to. In the past year, we stepped up the integration of our online and offline channels in order to enable a seamless customer journey. As part of the digital transformation, we are simplifying our own structures and processes in order to improve the customer experience and allow us to operate more quickly and efficiently on the market.

Telefónica Deutschland is also making progress in establishing new growth areas of business. We want to play a leading role in the next phase of digitalisation, which will primarily involve the extensive networking of vehicles, machines and devices as part of Industry 4.0. In 2016, we therefore bundled the Advanced »Data Analytics« (ADA) and »Internet of Things« (IoT) business areas to form the new company Telefónica NEXT. Based in

» Our aim is to identify and meet our customers' expectations in real-time. These capabilities are becoming a crucial factor for achieving competitive success. «

Markus Haas

Berlin, Telefónica NEXT is an independent, entrepreneurial market player that seeks to provide other companies with solutions to help them to better exploit the opportunities presented by digitalisation. Following on from an ADA app for in-store retail, we intend to present further solutions in 2017. In the area of IoT, Telefónica NEXT is working on a software platform to support companies in offering networked solutions to end users.

Success in new business areas based on data analysis requires user acceptance. Accordingly, Telefónica Deutschland is helping its customers to use digital applications with self-determination and ensuring that they retain sovereignty over how their data is used. This will create the strategic foundations for our long-term success as the OnLife Telco and improve our customers' lives. It is our firm belief that customers and employees need to be part of the digitalisation process. After all, digitalisation has only one purpose after all: to serve people.

The Management Board of Telefónica Deutschland

Since 1 January 2017 the Management Board of Telefónica Deutschland Holding AG has comprised of two members: Markus Haas is CEO and Rachel Empey, in addition to her previous responsibility for Finance and Corporate Strategy, is also responsible for the areas of Transformation & Integration, Business Intelligence, Innovation and Telefónica NEXT.

At the end of 31 December 2016, the former CEO, Thorsten Dirks, left the Management Board. The Supervisory Board had approved on 21 November 2016, as per Thorsten Dirks' request an early termination of his contract. »On behalf of the Supervisory Board I would like to take the opportunity to thank Thorsten Dirks for the exceptional collaboration and successful development of the company,« says Eva Castillo, Chairperson of the Supervisory Board of Telefónica Deutschland.

More information can be found on the internet
telefonica.de/management

Name : Isabell
Job : Student
Age : 21

On her way to university, Isabell uses her smartphone as a ticket. She looks up her professor's consultation hours online. She Facebooks her fellow students so they can decide when to meet at the cafeteria and shares her holiday photos with her friends on Instagram. Analogue or digital is an irrelevant distinction for her – as long as things are practical and quick.

Life happens anywhere, anytime

Isabell could just as well be called Anna. Or Julia. She could be talking on behalf of her university friend Marcel instead – or anyone who grew up with the internet and cannot begin to imagine life without smartphones. Whoever they may be, there is one thing they seek to avoid at all costs: having no network access and running out of data, be it at university, at work, on the bus or at the café.

According to a Bitcom survey from 2016, however, this is by no means only the case for the under-30s. Smartphones are just as popular among 14-year-olds and 64-year-olds. Browsing news apps with a morning coffee, checking Instagram for updates on the train, arranging lunch on WhatsApp: all of this has become part of daily life for young people, parents and even grandparents – not least when they get to see their grandchildren take their first steps live on camera.

Everyday services are also increasingly shifting to the digital world. Mobile shopping is only the start of it. Consumers can save time and money by using digital customer services to renew their mobile contract. Mobile banking means they can pay the latest bill from the garage anywhere, anytime – whether taking a quick break at the office or relaxing in the sauna. And why not?

One thing is for certain: this is only the beginning. App makers, mobile providers, global corporations and start-ups are continuously coming up with new ideas for simplifying and improving people's lives. Like Isabell. She wants to watch TV in bed before she goes to sleep. The fact that she doesn't even own a television makes no difference. After all, there would be no room for a great big box like that in her bedroom. Anyway, best be quiet now: she's already streaming the show to her tablet.

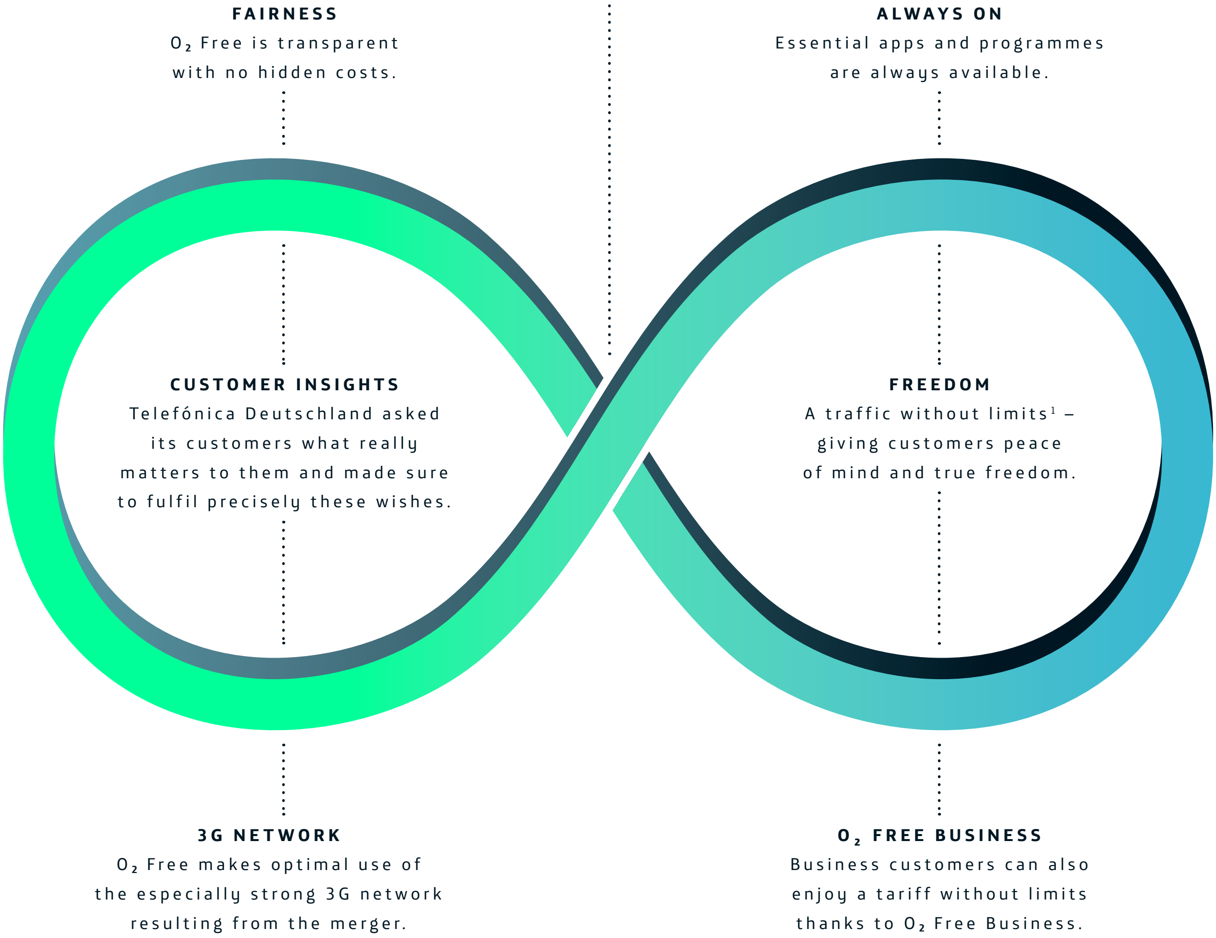
»What Germans can no longer do without«
telefonica.de/umfrage-zum-digitalen-leben

Unlimited at last

Previously unseen on the German mobile telecommunications market: a genuine flat-rate data tariff that allows customers to use their everyday apps without limits. This is the exact customer demand that Telefónica Deutschland is fulfilling with O_2 Free. Users can carry on surfing, streaming and chatting[1] even after they have used up their high-speed allowance. In other words, O_2 Free is more than just a new tariff. It is a product that is revolutionising the German market. To create it, Telefónica Deutschland bundled the expertise of various departments – always with a focus on customers and their needs.

O_2 Free

Benefits for customers



Campaign: With O_2 Free , you'll never have to worry about running out of steam again.
Unlimited surfing and streaming – at last: **telefonica.de/kampagne-o2-free**

1 With O_2 Free, users can carry on surfing without limit on the O_2 2G/GSM and 3G/UMTS network with speeds of up to 1,000 Kbit/s (average 994 Kbit/s) even after they have used up their high-speed data allowance (HD video streaming and internet applications with similar or higher bandwidth requirements subject to restrictions; upload speed up to 1,000 Kbit/s, average 945 Kbit/s).

Name : Zoé
Job : Office manager
Age : 27

»I simply have to keep moving. Even as a child I had no interest in sitting still. Whether running, taking a cycle trip out of town or heading up into the mountains for a weekend hike, physical activity clears my mind. And I love pushing myself to the limit. I always keep an eye on my fitness and food apps. I can't afford to run into problems with data limits.«

Name : Laura and Ben
Job : Banker and architect
Age : 27 and 31

Laura and Ben have long used their smartphones to find out the latest traffic information. Traffic jams are to be avoided at all costs. They love how well it all works in real-time. But wouldn't it be even better if the information could be used for intelligent traffic control? Then there would be no jams in the first place. Come to think of it, if there was more communication between "things" as well as people, wouldn't that solve more problems and open up new opportunities? The media is very keen to talk about the "Internet of Things". For Ben, the actual benefit is what really matters. Like being able to locate his bicycle if it gets stolen.

We help other companies to fully exploit the opportunities presented by digitalisation

NICOLAUS GOLLWITZER
is responsible for Telefónica NEXT's development and growth as its CEO since 1 January 2017

»Data analysis« (ADA) and the »Internet of Things« (IoT) are the digital growth areas of the future. In early November 2016, Telefónica Deutschland bundled these fields in a new subsidiary, Telefónica Germany NEXT GmbH. CEO Nicolas Gollwitzer explains how Telefónica NEXT is helping cities, transport companies, retailers and other companies to take advantage of the opportunities presented by digitalisation.

Why did Telefónica Deutschland decide to spin off the cutting-edge fields of ADA and IoT?

Telefónica Deutschland deliberately opted to form a new company that can operate with all the agility of a start-up. Thanks to highly streamlined structures and the creative environment of Berlin, we can develop and test new digital products at great speed while simultaneously benefiting from the expertise of a leading global telecommunication provider and its experience with end customers and mass-market products. This combination represents a real competitive advantage.

Is data analysis not ultimately all about selling customer data?

We do not sell our customers' data. We analyse data that is fully anonymised using a patented, TÜV-certified method and focus on the added social and economic value offered by this analysis in vital areas such as mobility. For example, we have conducted research projects in Nuremberg and Stuttgart to investigate how mobile data analysis can be used to improve traffic control and reduce air pollution. In-store sales can benefit from the analysis of movement flows, too. Data analysis helps all of us to improve the quality of life.

As well as data analysis, you are advancing developments for the »Internet of Things« ...

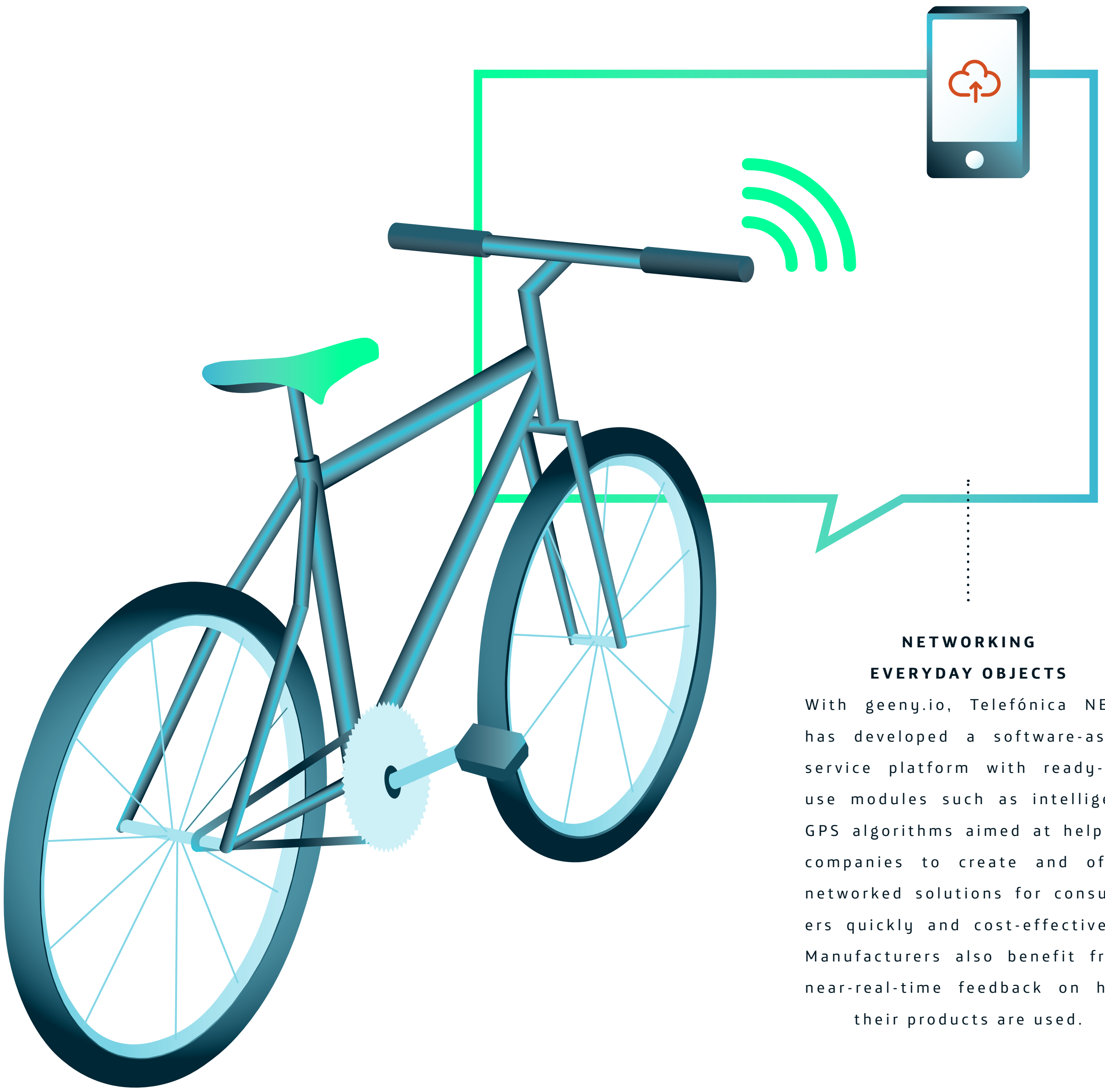
... with a particular focus on the consumer. To date, the »Internet of Things« has mainly conquered industry, connecting devices and machines. But our geeny.io platform makes it easy for companies to quickly develop new and intelligent consumer IoT applications to keep their customers happy. We can handle all commercial and technical matters if required, leaving companies free to address their core competencies and their customers.

What kind of applications are created using geeny.io?

It can be anything from intelligent tracking services, for example for dogs, through medical care and digital price tags to smart skis. The potential for solutions is vast. geeny.io is our contribution to enabling consumers to freely create their own IoT world of apps and smart devices while retaining full control over their personal data. We believe this is the key to business success with end customers.

You have been the CEO of Telefónica NEXT since 1 January 2017. What are your plans for the company?

The team embarked on an exciting task in 2016. We see ourselves as a partner of business, helping other companies to fully exploit the growth opportunities presented by digitalisation. With Telefónica NEXT, we are working on combining data analysis with IoT applications and a targeted approach to the customer. This enables our partners to gain an end-to-end understanding of their customers and their requirements so that they can tailor their products accordingly. It is our firm belief that »Data Analytics« and IoT will significantly enrich the lives of consumers in the future.



NETWORKING EVERYDAY OBJECTS

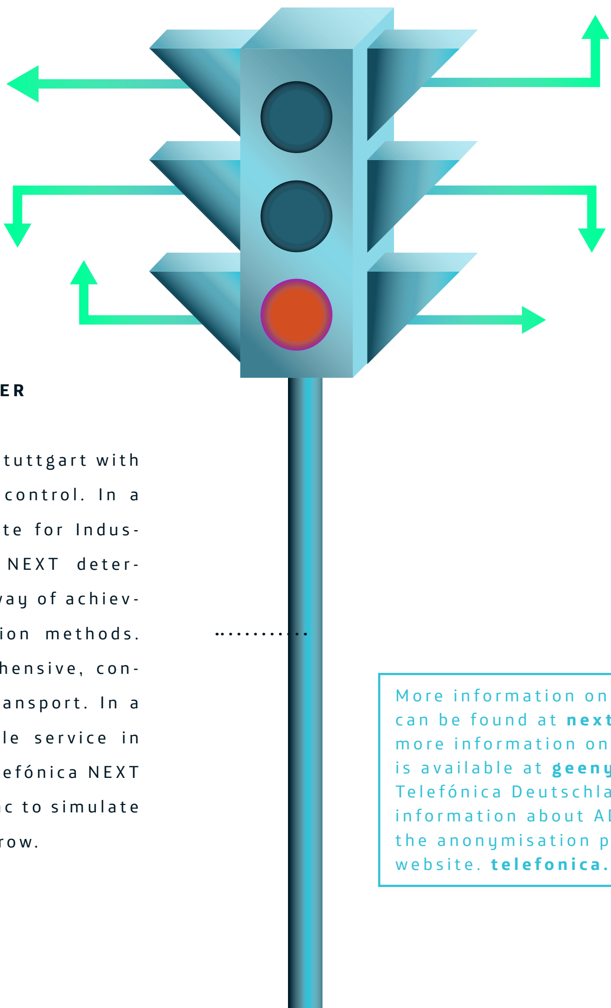
With geeny.io, Telefónica NEXT has developed a software-as-a-service platform with ready-to-use modules such as intelligent GPS algorithms aimed at helping companies to create and offer networked solutions for consumers quickly and cost-effectively. Manufacturers also benefit from near-real-time feedback on how their products are used.

SMART DATA ANALYSIS REDUCES AIR POLLUTION

In a pilot project in Nuremberg, Telefónica NEXT investigated whether experts can calculate air pollution more effectively using mobile data than with conventional methods. Mobile data is created when mobile devices communicate with mobile cell sites while the user makes calls or surfs the internet. Smart analysis of this data allows traffic flows to be recorded and pollution levels on the respective streets to be derived accordingly.

IMPROVED SHOPPING EXPERIENCE

Telefónica NEXT helps retailers to better understand their customers and make the shopping experience more digital. For example, mobile data is used to analyse the customer flows around a branch. This allows retailers to interact with their customers more effectively, for example by designing their shop windows accordingly or changing their opening hours and improving their position in relation to online retailers.



MOBILE DATA FOR BETTER TRAFFIC PLANNING

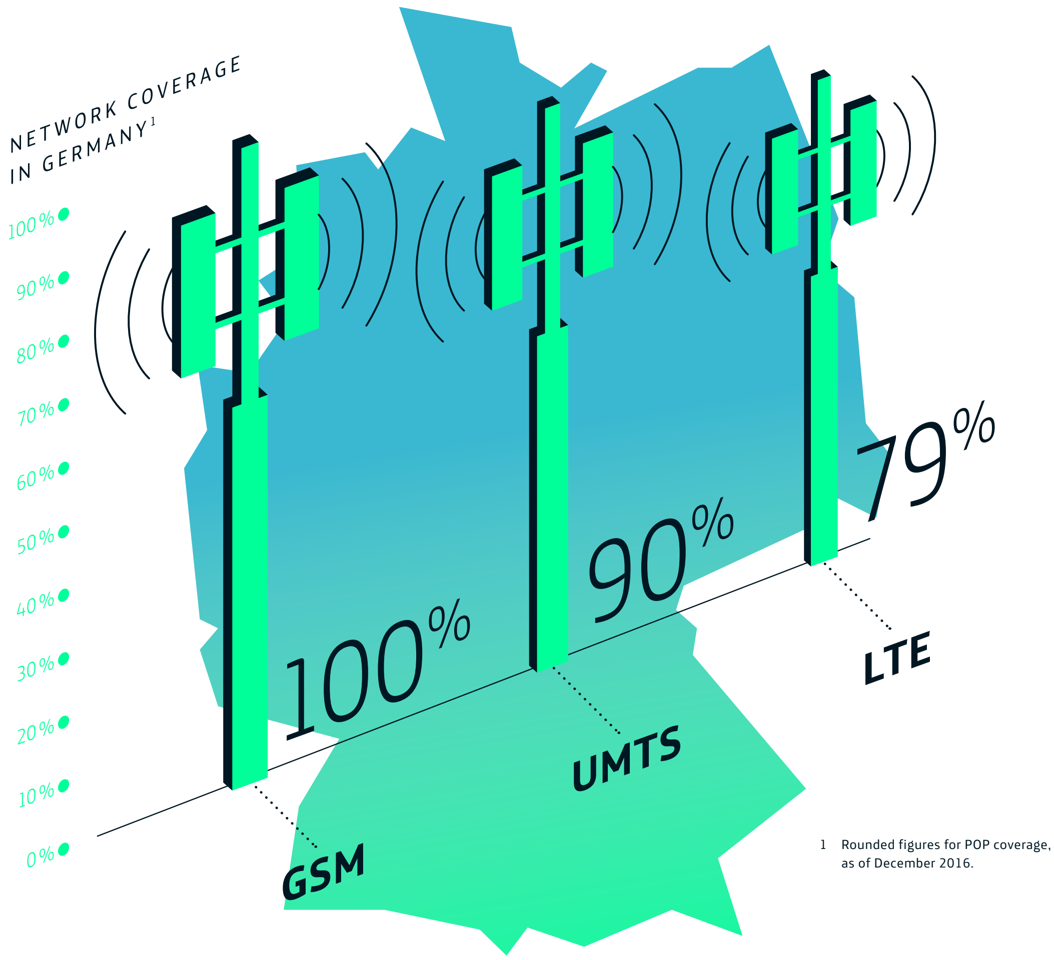
Traffic jams present big cities like Stuttgart with the challenge of improving traffic control. In a project with the Fraunhofer Institute for Industrial Engineering IAO, Telefónica NEXT determined that mobile data is a better way of achieving this than the existing collection methods. The reason: mobile data is comprehensive, continuous, and covers all means of transport. In a study on the potential of a shuttle service in Hamburg, anonymised data from Telefónica NEXT also helped the ride-sharing app flinc to simulate the urban traffic of tomorrow.

More information on Telefónica NEXT can be found at **next.telefonica.de**; more information on the Geeny platform is available at **geeny.io**
Telefónica Deutschland has compiled information about ADA, data usage and the anonymisation process on a dedicated website. **telefonica.de/ada**

Name : Marco
Job : Electrician
Age : 51

As an electrician, Marco finds himself moving between different building sites. His job is to ensure that everything is wired up correctly. Not always the easiest task, especially when customers change their specifications right up until the last minute. While his foreman still carries the architects' drawings in his bag, Marco prefers to use the digital version. He appreciates this advance, not least since it shows that digitalisation also has something to offer the manual trades. As long as the network is good enough, of course – especially out in the countryside.

The right network at the right place



1 Rounded figures for POP coverage, as of December 2016.

Being online anytime, anywhere, requires one thing above all else: a cleverly designed mobile network that provides the right bandwidth at the right place. This is precisely the goal Telefónica Deutschland has set itself, and its planning is geared towards achieving this. The company is making good progress with the expansion of the fourth-generation network. It already provides 79 percent of the German population with high-speed LTE mobile access. Where LTE has yet to be rolled out, the third-generation UMTS technology remains a reliable workhorse for data and telephony. Telefónica Deutschland boasts the densest UMTS network in cities and market-leading coverage of around 90 percent of the population. And the GSM network is near-comprehensive.

This tight-knit mobile coverage is made possible by one of the most extensive network remodelling projects ever undertaken in Europe. Following the merger of Telefónica Deutschland an E-Plus, the company is integrating the O_2 and E-Plus networks in order to increase network availability for its customers. A huge challenge, not least since it involves combining several standalone systems into a single system without any downtime. Customers are successively enjoying improved accessibility and faster data transfer speeds in more and more regions.

It also includes workers like Marco the electrician. As well as staying in contact with customers and colleagues, they can now rely on their mobile data connection to access their company's digital documents in near-real-time. Wherever they may be.

Name : Gregor
Job : Executive consultant
Age : 44

»As a corporate consultant, I am on the road all the time. It is therefore essential that I can work from any location and that my customers can reach me at any time. And the same is true for my employees. I am not especially interested in the technology itself, as long as it is simple and practical – and it works. I notice the same thing when it comes to my customers. Many of them call me on my fixed line, so it is important that those calls are diverted to my smartphone so I can answer them wherever I may be.«

Mobile working improves job satisfaction

Finishing a customer presentation in the taxi on the way to the airport. Making calls during the journey. All of this is standard procedure for many people in business. A representative survey conducted by Bitkom Research in 2016 found that one in three German businesspeople uses a mobile device with internet access for their work. Service providers are especially keen on the possibility of working from any location. Insurance companies, for example, or IT companies and consultancies, where half of the workforce is mobile.

But other industries are catching up. This was the result of a survey involving HTW Berlin University of Applied Sciences and the German Association for People Management (DGFP). Nursing staff are using apps in outpatient dementia care, lorry drivers are using special tools to manage their driving time, and factories are using mobile solutions to control machines. The added value for companies is about more than just increased efficiency. According to the survey, mobile forms of work have improved job satisfaction and performance as well as the quality of work. In other words, companies have good reasons to invest in their mobile infrastructure and find the right solutions for their operations.

O_2 Business

Making the office mobile

DIGITAL PHONEB BY O_2

Businesspeople can take calls to their fixed line on their smartphone without the caller noticing. The mobile device functions as an integrated extension of the virtual telephone system. Flat rates to all German networks, simple administration via a web portal and maintenance and updates are included. There are more than 160 innovative functions in all.

O_2 ALL-IP

Telephone system, internet access and telephone connections all come from a single source. The customer has a single point of contact and receives one easy-to-understand monthly bill. Companies also benefit from future-proof telecommunications technology and are ideally prepared for ISDN deactivation.

INTERACTIVE SALES APP

Telefónica Deutschland's sales staff have dispensed with stacks of paperwork. They work together to prepare a transparent offer that is tailored to the customer's requirements. This can then be converted into an order digitally and finalised on the tablet with a digital signature.

DIRK GROTE
Director B2B at Telefónica Deutschland

» Our innovative products for business customers are straightforward, tailored to our customers' needs, and offer business-class service. This allows us to optimally support companies in their day-to-day business, from service offices to corporations.«

Customer needs determine the product range

The example of a small family underlines the differences in how people use mobile telecommunications nowadays. Many people use the mobile network for more than just making calls. They also want to transfer large volumes of data, such as photos or videos. The fact that more than half of all YouTube hits now come from mobile phones speaks volumes. Some people are happy to make do with low data volumes for mobile internet. Others use their mobile device solely for making calls. And for some, simply being contactable is enough. For certain users, there is another important aspect: close relations in other countries, like Turkey in Jasmin's case.

In other words, today's society places a wide range of demands on telecommunications providers. With this in mind, Telefónica Deutschland has a carefully coordinated tariff portfolio that is systematically tailored to the different preferences of the respective customer groups. Some of these products are based on our own brands. Others are realised by partner companies using our network. The result is a comprehensive range which offers the right product for each and every type of use.

Like many of our customers, Nils uses the premium O_2 brand. As well as allowing him to choose between different tariff options including fixed line telephony, this gives him comprehensive service, a loyalty programme and optional add-ons aimed at making his life easier. Those who are primarily concerned with simple tariffs at an attractive price can use the products of the Blau brand or the partner brands ALDI TALK and TCHIBO Mobil. In our example, this allowed Jasmin's mother to find the right tariff for her.

Jasmin herself is in good hands with AY YILDIZ, the market leader in the German-Turkish target group. Ortel has attractive mobile offers for other regions of the world. The Telefónica brand offers the right tariff for people with family or friends in more than 120 countries, enabling them to communicate and stay connected across national borders.

»Whatever our customers need, our extensive range has the right product for them. This is also thanks to our external partner brands, whose tariffs and products optimally supplement those offered by our own brands,« says Alfons Lösing, Managing Director Wholesale and Partnering at Telefónica Deutschland. And Kai-Uwe Laag, CEO of Telefónica Germany Retail GmbH and Director Online of Telefónica Deutschland, adds: »It goes without saying that we are pleased with customer growth across all our brands. We have invested extensively in the service range and customer service of our premium O_2 brand in particular. Our success is illustrated by the positive development in terms of customer retention in this segment.«

Name : Jasmin and Nils
Job : Educator and photographer
Age : 32 and 34

Jasmin and Nils got married recently. Their baby boy Julian is sat in his buggy. As a freelance photographer, Nils finds himself on the road a lot. He cannot live without mobile internet. As well as sending his photos to the editorial office, he wants to watch video clips of Julian. Since the baby came into their lives, Jasmin has spent even more time on the phone to her relatives in Turkey. She also bought a mobile phone with a prepaid card for her mother so that she can get in touch with her more easily to discuss the ups and downs of parenthood.

Name : Manuel
Job : Musician
Age : 35

When Manual recently lost his credit card and needed to get it blocked, all it took was a single click on his smartphone. Manuel likes mobile banking because he often only remembers to pay his bills at the last minute. Now he can do this anywhere, any time. And he doesn't have to be at home in time to see his favourite team play that all-important match – nowadays he can simply stream the game on his phone. Wherever he may be.

Partnerships for the optimum customer experience

Like Manuel, many people use their smartphones for more than just communication. They are increasingly using products that allow them to live a mobile, flexible life. To ensure the optimum digital customer experience, Telefónica Deutschland also relies on strong partners. For example, the company has developed the first fully mobile bank account in conjunction with Fidor Bank. Other examples include the cooperation with Sky Deutschland and TV Spielfilm in the area of video streaming, Napster for mobile music and Electronic Arts for the Games Flat.

Banking Reloaded
O_2 Banking was launched in July 2016. In this interview, the project team and cooperation partner Fidor explain how the application was developed and why it caused a sensation in the banking industry and the media.

How did the cooperation with Fidor Bank come about?

FERNANDO BURGOS, DIRECTOR OF INNOVATION AT TELEFÓNICA DEUTSCHLAND: We wanted to be the first mobile provider to uniquely combine mobile communications and banking to create something entirely new. To this end, we searched for a strong partner. Fidor Bank AG is a direct bank licensed in Germany and an expert in the field of banking. We believe this makes for an ideal match.

MATTHIAS KRÖNER, FOUNDER AND CEO OF FIDOR BANK AG: When you came to us with the idea for O_2 Banking, we were immediately impressed. However, we were sceptical as to whether a telecommunications group would be able to stir up the young, dynamic mobile banking market. But we were positively surprised: you were not only innovative, but also flexible and fast-moving.

O_2 Banking boasts bank transfers using mobile numbers, small loans with instant approval, extensive security features and much more besides. Depending on how they use O_2 Banking, O_2 customers will receive an additional monthly data allowance of up to 500 megabytes.

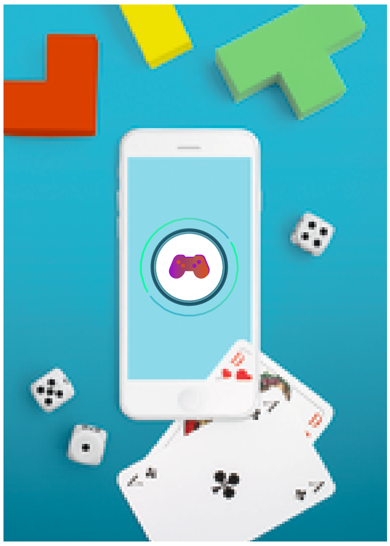
FLORIAN MOSER, FIDOR BANK AG: We jointly got the first prototypes up an running within just a few weeks, combining your mobile communications expertise with our banking know-how to ensure optimal digital customer benefit.

How was the team so sure about what customers wanted?

MARC MUMM, INNOVATION AT TELEFÓNICA DEUTSCHLAND: Having identified our customers' needs through surveys and feedback from test users, we continued to develop the app from a user-oriented perspective.

MATTHIAS KRÖNER: The result was O_2 Banking, a fully-fledged current account that is optimised for the mobile user experience. It boasts bank transfers using mobile numbers, small loans with instant approval, extensive security features, push notifications and much more besides.

MARC MUMM: O_2 Banking lets users do their banking quickly and easily on their smartphone, from opening an account and setting up standing orders through to transactions.



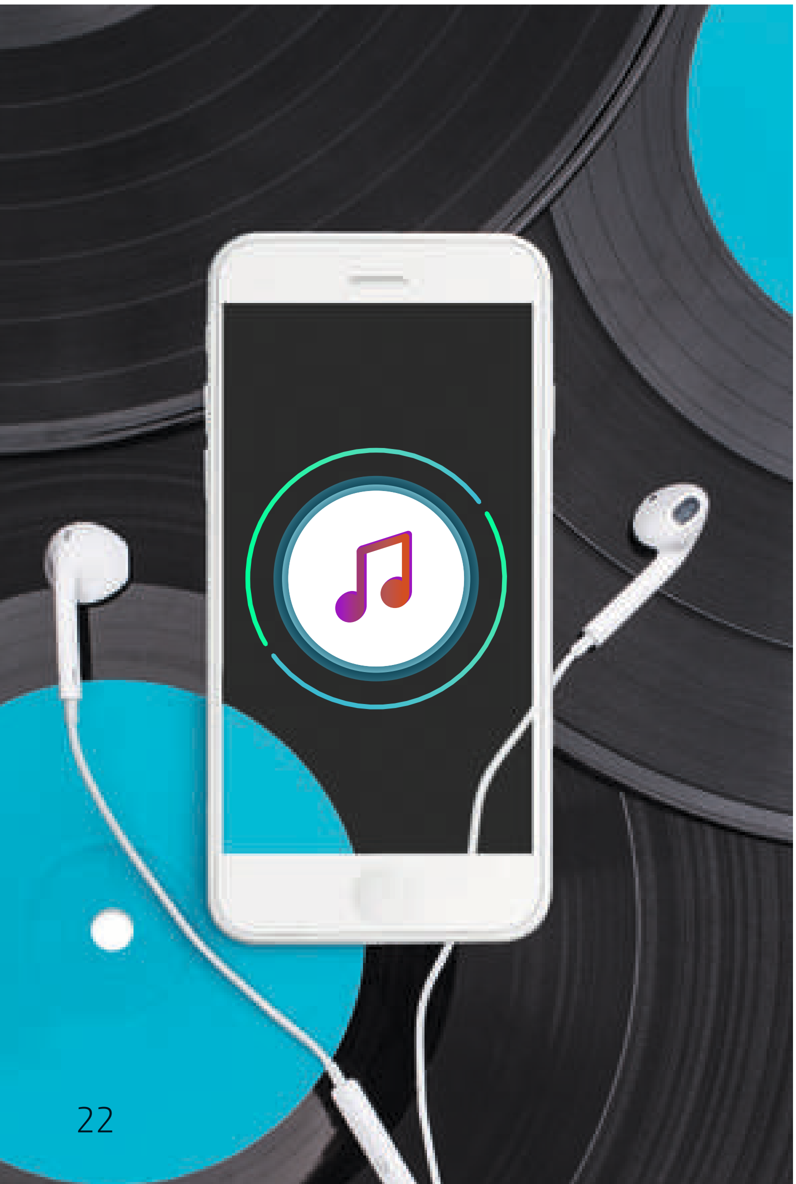
Thanks to the first Games Flat from Telefónica Deutschland coupled with Electronic Arts' extensive range, there are no more barriers to mobile gaming.

FERNANDO BURGOS: We are talking about the first product of its kind on the market. O_2 Banking sets itself apart from other mobile banking apps thanks to its features and user-friendliness. And O_2 customers who use the app get to enjoy an increased data allowance, thereby meeting our customers' demand for more high-speed data.

Many consumers are concerned about potential data theft, especially when it comes to sensitive data. How secure is the app?

FLORIAN MOSER: As the bank behind O_2 Banking, it goes without saying that security is a very important aspect for us. The product is transparent and meets the latest security standards.

FERNANDO BURGOS: Of course, protecting our customers is naturally also a top priority for us, which is why it was so important that we were able to get a reliable partner like you on board for O_2 Banking. As well as receiving positive feedback from customers, we have already won several awards after just a few months. This serves to reinforce our successful cooperation.



O_2 contract customers can test the Napster Music Flat tariff with 40 million songs, thousands of audio books and audio dramas free for 30 days. It then costs EUR 7.99 a month with no minimum contract.

Since the start of 2017, the flexible Sky Ticket has allowed O_2 customers to stream exclusive live sport and entertainment content anywhere, anytime. Thanks to the partnership with TV Spielfilm, O_2 customers with the TV & Video app also have free access to more than 50 TV channels.

More information can be found on the internet
telefonica.de/kampagne-o2-banking

Name : Christian
Job : Project manager in IT
Age : 42

»Thankfully, files full of documents are a thing of the past when it comes to my work. And there are no more protracted coordination loops or approval processes by email with huge attachments that clog up your inbox. Thanks to digitalisation, we are increasingly using digital tools. It makes a lot of things easier – and more mobile, since I always have digital access to what I need, wherever I may be. You have to be open to new ideas. And I am looking forward to seeing the next changes in terms of how we live and work.«

Digitalisation from within

Long searches for suitable analyses or simply not knowing which colleague is the best expert for a tricky subject can cost valuable time. On its way to becoming the OnLife Telco, Telefónica Deutschland is increasingly digitalising internal workflows in order to facilitate cooperation within companies and allow employees to quickly develop innovative mobile services for customers. Data-driven work and the digital connection of knowledge play an important role. And with a view to services, Telefónica Deutschland is forging ahead with the digitalisation of brands and their channels. The guiding principle: what the customer wants and needs.

GEORG LUDWIG
Social Media

» The Digital Collaboration Center (DCC) gives us a real-time insight into what our customers want and how we can improve our digital customer service. For example, we can offer rapid solutions to questions or problems via our social media channels as a genuine alternative to the hotline.«

ELENA OBIOLS
Human Resources

» At HR, it is important for our employees to possess digital skills and have access to all of the information they need for their work. We are developing our employees' digital skills through a range of initiatives. Personally, I am a big fan of innovative formats for introducing and exchanging new knowledge within the company. One example is the DigitalBrain, where employees respond to questions from other employees and an algorithm identifies the best experts for each question.«

Data-driven work

The Analytical Insights Center (AIC) prepares, analyses and interprets the essential company data of Telefónica Deutschland. All employees have access to the main part of the AIC and are subject to corresponding confidentiality obligations. Data may only be used for business purposes. There is no access to personal data. The knowledge obtained from company and market data and analyses allows employees to make fact-based decisions directly. The company also operates a Digital Collaboration Center (DCC), which actively gathers data on defined topics, analyses it, compares it with predetermined objectives, and develops prioritised decision-making options.

DigitalBrain

The DigitalBrain is a multi-award-winning knowledge management system that is fully integrated within the intranet. Anyone can ask questions, submit responses and give ratings, whatever their hierarchical level, profile and location. Like GPS, the Brain seeks out the right expert. Like in a neural network, the algorithm continuously learns and remembers which colleagues have provided good assistance in the past

The O_2 brand as an example of digital customer service

Telefónica Deutschland aims to offer customers the best service experience with a mix of digital channels and personal contact. The Help section on o2.de is the first port of call for all customer issues. Customers can find out about standard topics such as renewing contracts and buying data packages. More complex issues can be dealt with in the chatroom or by calling the hotline. The O_2 voice portal on the hotline automatically routes callers to the right expert for their issue. The O_2 community on o2.de also allows customers to address their questions to O_2 social media agents and other community experts.

ESTHER BAGE
Internal Communications

» The DigitalBrain has helped us to significantly improve internal communication within the company. There is so much knowledge in the company, and it can be difficult to connect this knowledge quickly and simply. The Brain connects employees from different areas in an entirely new way.«

TORBEN BLÜMLEIN
Business & Market Intelligence

» Our Analytical Insights Center (AIC) combines the knowledge gained from data on companies, markets and competitors. It is available to all employees. We hold workshops to show our colleagues how to use the tool. As well as simplifying our processes, this data pool allows us to take decisions more quickly.«

SIMONE HAAF
Innovation

» As a marketing manager, I frequently rely on competitive and social media analyses. Finding the information I need often used to be a time-consuming process. The Analytical Insights Center (AIC) has made things a lot easier. I have rapid access to the required data and all of the insights that I need for my work.«

Customers retain control over their data

According to recent studies, many people in Germany are concerned about protecting their personal data and privacy. Telefónica Deutschland takes these concerns seriously and therefore places great emphasis on transparency and dialogue. The company portal contains comprehensive information on data protection. And Telefónica Deutschland regularly discusses the latest hot topics and digital trends with experts, opinion leaders and representatives from the worlds of business and politics at the Telefónica BASECAMP in Berlin. Examples include security risks on social networks. An event with the philosopher and Harvard professor Michael Sandel addressed the topic of privacy. Telefónica Deutschland is committed to shedding light on the opportunities and risks in equal measure with a focus the needs of the customer.

47.9%

of those surveyed save their contact data and private addresses.

29.8%

save direct access (without separate login) to private user accounts (e-mail, Facebook, cloud).

26.8%

deactivate Bluetooth, Wi-Fi and NFC connectivity when they are not using it.

25.4%

said they had no sensitive data on their smartphone.

CONTRIBUTING TO YOUR OWN SECURITY

Consumers themselves can help ensure the security of their personal data. For example, by not saving sensitive data on their devices or by shutting off connectivity when they do not need it as indicated by an online survey by the German Federal Office for Information Security (BSI) in 2016.

Customer protection is also a top priority for the company. All employees are obliged to comply with data and telecommunications secrecy and the principles of the Telefónica Data Protection Policy. In addition, personal data is secured against unauthorised access using state-of-the-art encryption and login procedures. And the data created when mobile users make calls or surf the internet is protected by telecommunications secrecy. As a matter of principle, this traffic data may only be used to provide the respective service. However, this data is also used to develop applications that are extremely beneficial for society and business alike. »This is why Telefónica Deutschland has developed a patented three-phase anonymisation process in coordination with the German Federal Commissioner for Data Protection, which has been examined by external experts,« says Markus Frowein, Data Protection Officer at Telefónica Deutschland. »Nothing can then be traced back to individual users.« Anyone who still wishes to prevent their data from being used can withdraw their consent on the company website, where they can also view and edit their inventory data. In this way, the company ensures that customers retain sovereignty over their data.

Name : Angelika
Job : Artist
Age : 39

» As an artist, the trend towards digitalisation acts as inspiration for my work. The way in which the boundary between the real and virtual world is increasingly disappearing, for example. But I also ask myself: if more and more aspects of our lives are becoming digital, is our privacy guaranteed? And if I use my phone to do banking or make purchases, how secure is my account data? «

Name : Fritz and Leo
Job : Pensioner and school pupil
Age : 65 and 12

At first, Fritz was thoroughly confused by his grandson's tablet. What are all those apps about? And what are young people writing and sharing the whole time? Fritz felt excluded from a world that clearly fascinated his grandson. He became curious when a friend of the same age began sending photos from his latest city break and chatting with his family. At the same time, he worries about what impact social media is having on Leo. Both are faced with the challenge of navigating the digital world.

We are committed to digital participation and sustainable development

ESSAY BY VALENTINA DAIBER

Director Corporate Affairs and member of management of Telefónica in Germany

Do you sometimes have the same feeling? What used to seem like science fiction until very recently has become a reality: using a smartphone to navigate through everyday life, storing information in a cloud. As a telecommunications company, we are driving this development because we believe in the significant opportunities it presents. Thus we see it as our social responsibility to enable everyone to participate in the digital world.

»Everyone should be able to participate in the digital world.«

Five years ago we launched the Think Big project, in which we work with the German Children and Youth Foundation (DKJS) to develop young people's digital skills. To date, more than 93,000 young people have realised their own project ideas using digital technologies and helped to shape the society in which they live. However, we are also committed to ensuring that older people share in the benefits of digitalisation. Working in cooperation with the Digital Opportunities Foundation, the »Tablet PCs for Senior Citizens« project provides retirement homes around Germany with tablet PCs including free flat-rate internet. We also offer the corresponding training.

However, »strengthening life in the digital world« is just one of the three priority areas of our corporate responsibility strategy. With »responsible business« and »environmental and climate protection«, we also address issues with direct relevance for our business activities. If nothing else, dialogue with employees, customers, suppliers, shareholders and non-governmental organisations shows us how important these issues are.

»Responsible business« means focusing on compliance standards, our supply chain and our customers and questioning our actions as an employer. Our goal is for our stakeholders to perceive us as a fair and trustworthy partner. When it comes to »environmental and climate protection«, we are committed to saving energy in our own business operations and services by using digital solutions and analysing mobile data, purchasing only green electricity, and reducing our CO_2 emissions.

»Our goal is to be perceived as a fair partner.«

I am certain that we can harness digital technologies to overcome the challenges facing our society and drive sustainable development. Together with you, our stakeholders, we intend to take a stand for people and the environment.

More information can be found on the internet: **telefonica.de/cr**

Name: Vera
Job : Lawyer
Age : 55

»I was fascinated by the stock market long before the dotcom bubble. I know from experience that a cool head, reliable information and a long-term focus are solid foundations for any investment decision. My investment needs to have good prospects. Everyone needs telecommunications, for example. Although competition is tough, I believe in the strength and innovation of the major providers.«

Letter from the Management Board

Dear shareholders of Telefónica Deutschland, Ladies and Gentleman,

In 2016 we have made significant progress again towards our vision of becoming Germany's Leading Digital OnLife Telco. We continued to promote the integration of E-Plus, achieving important milestones such as completing 80 % of the employee restructuring programme, the migration of E-Plus and Base customers to the O_2 brand, the further reduction of our shop and facility footprint and the start of the physical integration of the two LTE networks. As a result, we delivered the targeted synergies and are now increasingly focussing on the longer-term strategic transformation of our company.

At the same time, we have kept the momentum in a dynamic market environment across different segments, repositioned our core premium brand O_2 while also leveraging the strong performance of our partners as well as significant improvements in our network quality. The latter has been confirmed by various independent customer-survey based tests.

With the launch of our new premium portfolio O_2 Free in October 2016, we have entered into a new era in mobile telephony where »offline« no longer exists. We offer »more-for-more«, i.e. more content at higher prices, and continue to develop our products and services to add value for our customers. We have introduced digital offers such as O_2 Banking, the O_2 TV & Video app as well as our cooperation with Sky for exclusive, unbundled access to valuable content.

In parallel to our core business, we are driving the expansion of the new growth areas »Advanced Data Analytics« and »Internet of Things«, which are crucial for the successful transformation of Telefónica Deutschland. As such, we have bundled these digital activities in the newly founded Telefónica NEXT, based in Berlin. Telefónica NEXT aims to be an industry partner, offering other companies business solutions to allow them to make use of digital growth opportunities.

Following a successful 2016, we feel that we are well positioned to implement our vision for the strategic transformation of the company over the next three years.

On behalf of the entire management team we would like to thank all of our employees for their hard work and dedication throughout the year, which was instrumental to our success.

Finally, we would like to thank our shareholders for the trust placed in us. We would like to reiterate our dividend policy with annual dividend growth over the next three years, starting with a proposal of EUR 0.25 per share for the financial year 2016. We remain committed to our overall strategy, the integration synergies and our other financials targets, and are looking forward to pushing ahead with the strategic transformation of our company towards becoming the Leading Digital OnLife Telco.

Yours sincerely,
The Management Board

Strategy

1 / 4

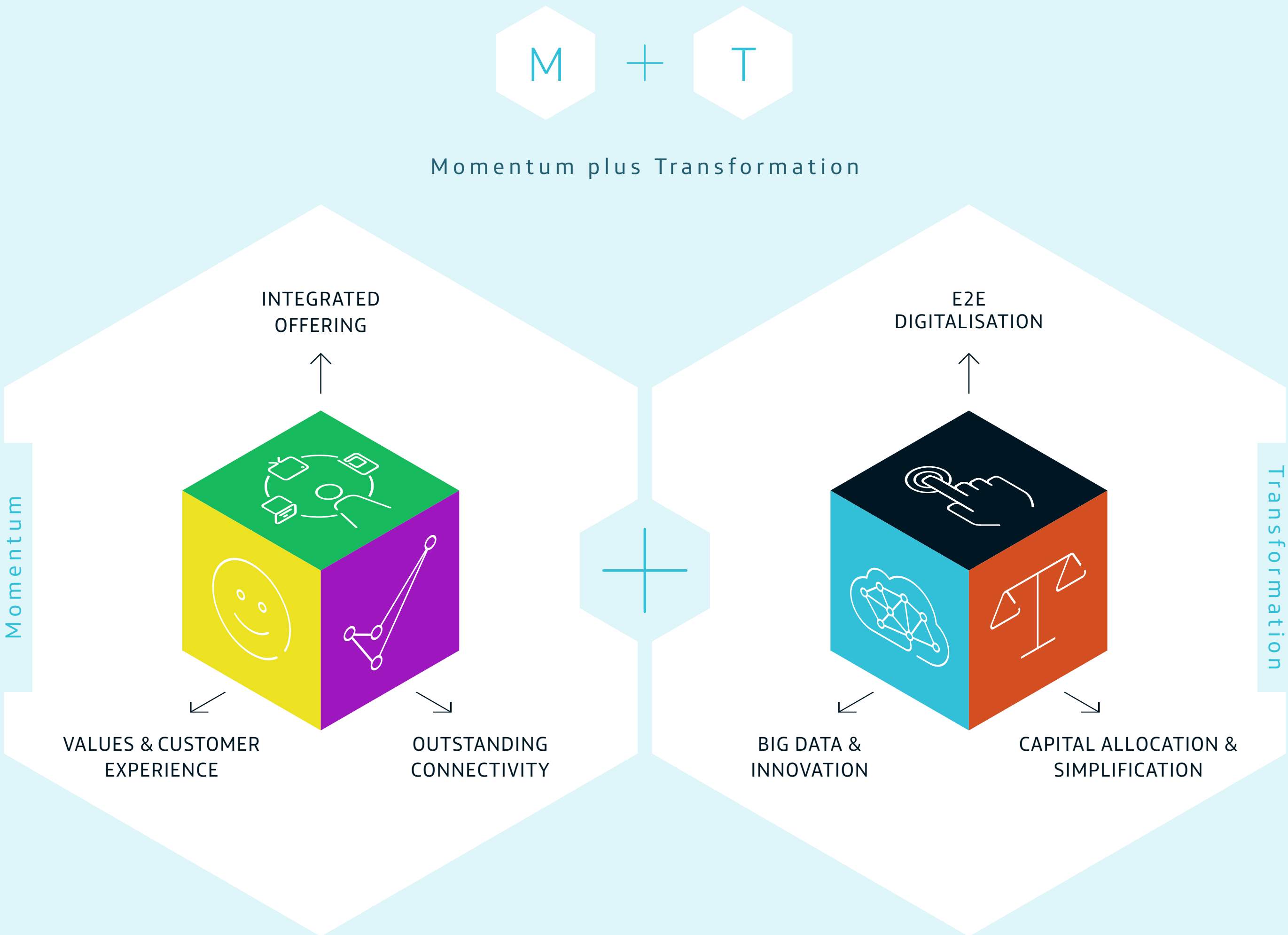
Why should I invest in Telefónica Deutschland?

Telefónica Deutschland emerged from the merger of Telefónica Deutschland and E-Plus Group in 2014 as the German mobile network operator optimally positioned to benefit from the mobile data monetisation opportunity. The German market still lags behind other European markets from a data usage perspective, and we are the only mobile pure-play telecoms investment which enables investors to partake in and benefit from the data growth we expect in coming years. Telefónica Deutschland is also strongly positioned in both the premium and non-premium segment of the German market via own brands and partners owing to its successful multi-channel distribution strategy. In addition, we have successfully reached each of our synergy milestones in the last two years and are on track to achieve our upgraded total target of approx. EUR 900 million Operating Cash Flow synergies by year-end 2019. Furthermore, the integration process presents us with an opportunity to optimise and transform our existing business with a focus on simplification, automation and digitalisation, to become the leading digital OnLife Telco in Germany. Most importantly, we pledge to share our success with our shareholders and have committed to a high pay-out ratio in relation to Free Cash Flow, with a growing dividend trajectory over three years.

Strategy

2 / 4

Strategy and equity story: Reasons to invest in Telefónica Deutschland



During the first two years of the merger process the corporate strategy of Telefónica Deutschland has been based on the concept of »MIT«: Momentum, Integration and Transformation. We maintained our market momentum in a challenging and dynamic environment, while also executing the integration of E-Plus Group and Telefónica Deutschland in a rapid and effective manner. In parallel, we have developed our targets and roadmap for transforming Telefónica Deutschland into Germany's Leading Digital OnLife Telco.

Having already successfully completed a majority of integration milestones, our focus is now shifting from integration to transformation. The focus of our corporate strategy thus narrows to *»M+T«: Momentum and Transformation*. The implementation of this strategy takes place in six dimensions: *Values and Customer Experience*, *Integrated Offerings* and *Outstanding Connectivity* form cornerstones of *»Momentum«, while End-to-End Digitalisation, Capital Allocation and Simplification* as well as *Big Data and Innovation* are key to our »Transformation« efforts.

Momentum

Maintaining momentum in the German mobile market will remain the first operational priority of Telefónica Deutschland going forward. Since the merger, the German mobile market has become one of the most attractive telecommunications markets in Europe with stable pricing in the premium segment and significant potential for future data growth. Our own traffic has grown 51 % year-on-year in 2016, and even at around 1.7GB average LTE data usage in the fourth quartern, our O_2 LTE customers still lag behind other Europeans from a data usage perspective. We endeavour to monetise the expected data growth through competitive products and a multi-channel distribution strategy in the premium and non-premium segments.

In our effort to attract new customers and develop our existing customer base through cross- and upselling as well as customer retention strategies we focus on *Integrated Offerings*. We follow a mobile-centric approach, combining various mobile products and added-value services to encourage our customers to use their mobile handsets as a digital hub of life. Such products include our O_2 TV & Video app, our pay-TV cooperation with Sky Deutschland and our O_2 banking offering. Through this approach we stimulate data usage and reduce churn. We also continue to offer fixed-line services as a complementary product and have successfully rebranded our converged offer as O_2 Blue One.

In the design of our go-to-market strategy we prioritise *Values and Customer Experience*. In October 2016 we relaunched our premium portfolio as O_2 Free, a unique product combining the benefits of high-speed 4G bundles with unlimited access to 3G at speeds of 1 Mbps. The removal of the data »ceiling« was greeted with an encouraging customer response. We have also continued to optimise our retail network, with a range of concept stores as well as digital self-care facilities. We aim to closely interconnect products and services through an omni-channel approach, enabling and educating customers to choose different channels of interaction as they see fit, thus ensuring digital inclusion.

Outstanding Connectivity through the development of a nationwide high-speed mobile network is the backbone of our go-to-market strategy. Having already enabled 3G national roaming in 2015, we started the 4G network integration in July 2016. Over the next 2 years we will consolidate the legacy networks, roll-out LTE and incorporate the spectrum we acquired in the 2015 multiband auction. At the same time, we are already looking ahead to the development of future technological standards and their use cases with 4.5G trials in cooperation with other operators and hardware vendors.

» We want to encourage our customers to use their mobile handsets as a digital hub of life. «

Highlights
Financial year 2016

At the end of December 2016, Telefónica Deutschland had over 49.3 million customer accesses, up 2.0 % year-on-year driven mainly by an increase in mobile accesses (+2.9 % to 44.3 million) on the back of good operational momentum and a strong contribution of the partner business.

As expected, mobile service revenues (MSR) declined 1.7 % year-on-year for the period January to December, reflecting primarily increasing competitive dynamics in the non-premium segment as well as headwinds from regulatory effects; excluding regulatory effects MSR decreased by 1.1 % year-on-year.

Operating Income before Depreciation and Amortisation (OIBDA) and before exceptional and special effects increased 3.8 % year-on-year in 2016, with in-year savings from integration activities amounting to approx. EUR 150 million.

Capex rose 6.7 % year-on-year in 2016. Telefónica Deutschland continued to invest in the rollout of the LTE network and network integration as well as witnessing higher software investments as a result of the migration of E-Plus customers to the O_2 brand.

For a detailed view of the financial outlook for 2017, please refer to the Group Management Report, pp. 59.

Mobile service revenues

In million EUR

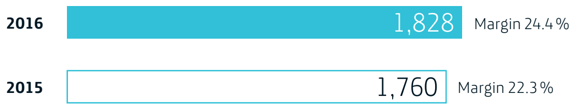
-1.7 %

(-1.1 % without regulatory effects)

OIBDA/OIBDA Margin excluding exceptional and special effects

In million EUR

+3.8 %



Mobile accesses (postpaid/prepaid)

In Thousand

+2.9 %

Summary financial outlook 2017

Base line 2016	Outlook 2017
MSR: EUR 5,437 million	MSR[1]: Slightly negative to flat year-on-year
OIBDA before exceptional effects[2]: EUR 1,793 million	OIBDA before exceptional effects[2]: Flat to mid-single-digit percentage growth year-on-year
CapEx: EUR 1,102 million	CapEx: Around EUR 1 billion
Dividend[3]: EUR 0.25 per share	Dividend: Annual dividend growth for three years

1 The impact from regulatory changes in the form of the termination rate effects and the glide path of the EU Roaming Regulation are excluded from the MSR outlook.
2 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.
3 For 2016: Proposal to the Annual General Meeting 2017.

Strategy

4 / 4

Transformation

Transforming Telefónica Deutschland into Germany's Leading Digital OnLife Telco will be our key priority over the coming years. The long-term strategic transformation will be driven by the core principles of digitalisation, simplification and automation.

We will transform back office and front-end processes to establish *E2E Digitalisation*. Digitalisation is a strong lever to increase customer satisfaction while also supporting our focus on cost leadership. During 2016 we developed and launched our Digital Collaboration Centre, a comprehensive system of intelligent self-diagnosis and early warning tools, which enables real-time decision-making from a marketing and Capex-planning perspective. We also launched our Analytical Insights Centre, a central data portal which empowers our employees by giving them access to information beyond the confines of their own workspace, thus supporting information-sharing and faster results generation.

» Transforming into the leading digital OnLife Telco will be our key priority over the coming years.«

To enable a leaner and more agile organisation, we also take a disciplined approach in the areas of *Capital Allocation and Simplification*. Having already completed the optimisation of our brand portfolio and the associated customer migration, we now push for the simplification and automation of our CRM and HR systems, among other projects. We also continuously look for opportunities to optimise Capex efficiency and monetise our existing asset base, e.g. in the form of the sale of passive tower infrastructure to Telxius, the infrastructure company of Telefónica S.A., for EUR 587 million in 2016.

As part of our transformation efforts, we also focus on *Big Data and Innovation* and thus the potential growth areas of Advanced »Data Analytics« and the »Internet of Things« to enable opportunities beyond connectivity. In 2016 Telefónica Deutschland founded Telefónica NEXT to provide businesses and public institutions with actionable consumer insights to better address their customers' needs. Certified anonymisation algorithms enable us to use our data pool in a targeted manner to support e.g. projects to improve traffic management, air pollution and public transport.

While realigning the business with a special focus on transformation, Telefónica Deutschland will also continue to execute the integration programme and complete the outstanding workstreams. In 2017 our primary focus will be on the network integration; however, we will also push ahead with employee restructuring and infrastructure optimisation among other initiatives to reach our updated target of approx. EUR 900 million operating cash flow synergies in 2019.

In summary, Telefónica Deutschland is a key mobile player in one of the most attractive mobile telecommunication markets in Europe, with major potential for future mobile data growth and its monetisation. Within this market, our company is the only mobile pure-play investment with a strong presence in retail and wholesale. We intend to lead this market with a rational commercial approach, offering our customers the benefits of a growing integrated network and a range of value-added services and content.

» Our primary focus for 2017: the network integration for a better net expercience.«

Moreover, we are also beneficiary and driver of digitalisation. The integration process has afforded us the opportunity to rethink existing mechanisms and embrace simplification and automation, and to thus transform our business beyond integration into Germany's Leading Digital OnLife Telco. The resulting synergies and operational efficiency will drive profitability and FCF generation in years to come. Owing to our confidence in the operational momentum as well as the expected FCF trajectory, Telefónica Deutschland has committed to growing its dividend for three consecutive years, starting with a proposal of EUR 0.25/share in 2016.

Investor Relations

1 / 3

As investor relations we endeavour to provide fast, effective and consistent communication between the company, the financial community and other stakeholders, to allow interested parties to follow and understand our company's strategic and operational development. Our primary operating objective is to proactively inform and educate investors to enable them to make realistic assumptions about the fair relative valuation of the company.

Economic and capital markets environment

In a difficult global economic environment, the German economy proved resilient in 2016 and showed robust GDP growth of +1.8 %, driven by strong domestic demand and consumer confidence.

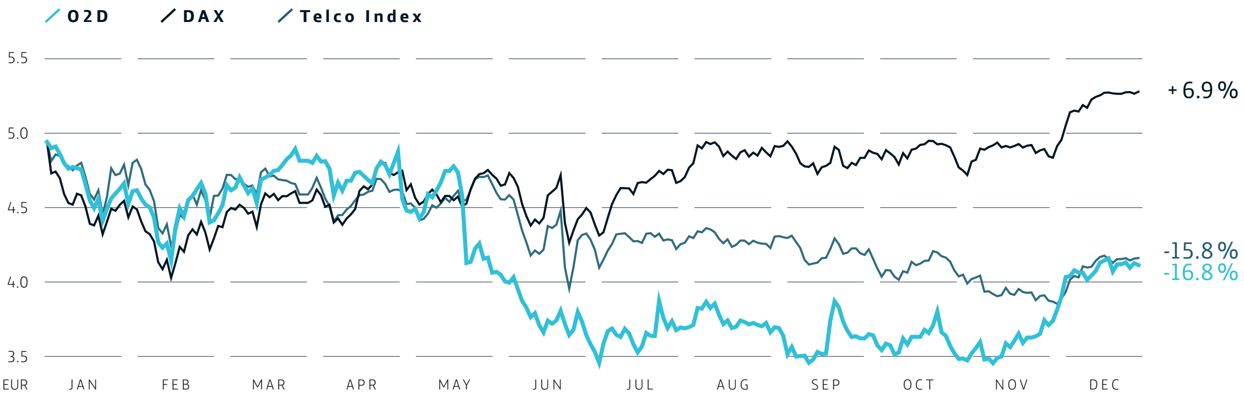
Geopolitical events such as the Ukraine crisis, ongoing fighting in the Middle East, Brexit and the US presidential elections as well as terrorist attacks in Paris, Brussels and Istanbul, were dominant drivers of capital markets in 2016. To respond to low inflation in the euro area and stimulate the economy, the ECB reduced interest rate and extended its bond purchase programme in March.

After hitting an early low in February, the DAX gradually rose over the year, with an intermittent soft spell after the Brexit vote, reaching its annual high in December and ending 2016 up 6.9 %. In contrast, the Stoxx 600 suffered visibly from the above-mentioned drivers and ended the year down 1.2 %. The European telecommunications sector was among the weakest industry groups with a decline of 15.8 %, as a result of regulatory headwinds and failed M&A.

Telefónica Deutschland started 2016 with an intra-day high of EUR 4.91 and had its intra-day low of EUR 3.33 at the beginning of July. Performance was largely in line with sector and markets in the first four months of the year. Thereafter the share retreated, primarily driven by concern around pricing pressure in the non-premium segment. After the release of the preliminary results for the third quarter of 2016, sentiment recovered and the share rallied towards year-end, with concerns around market dynamics easing as investor focus shifted back towards business fundamentals, synergy execution and dividend yield. The share closed 2016 down 16.8 % at EUR 4.07, broadly in line with the sector.

Share price performance 2016

1 January to 31 December, rebased



Investor Relations

2 / 3

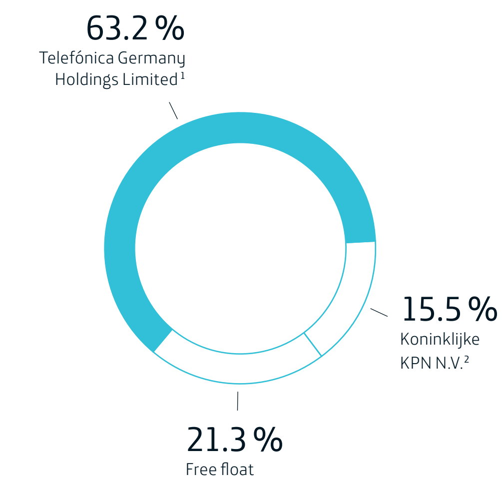
Share data

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	Telecommunicatons

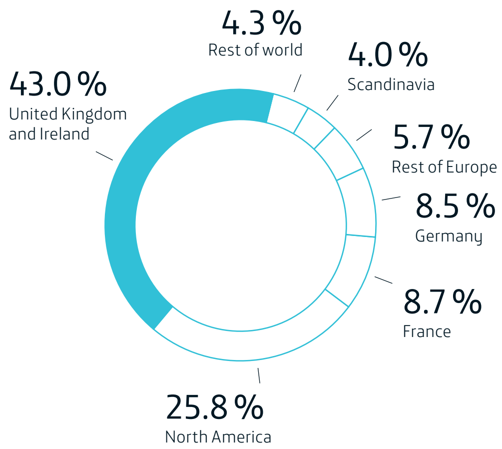
Closing price

	2015	2016
XETRA closing prices		
Closing price on 31.12.	EUR 4.891	EUR 4.070
Performance	+10.81%	-16.79%
Year high	EUR 5.856	EUR 4.861
Year low	EUR 4.352	EUR 3.415
Trading volumes		
Average daily trading	2,135,501	2,593,696
Number of shares outstanding 31.12.	2,974,554,993	2,974,554,993
Market cap at 31.12.	14,548,548,471	12,106,438,821
Weight on TecDAX	7.79 %	6.15%
Dividend	EUR 0.24 per share	EUR 0.25 per share proposed

Shareholder structure of Telefónica Deutschland



Geographical distribution of free float[3]



1 Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.
2 According to the voting rights notification dated 20 October 2014, Koninklijke KPN N.V. now holds its shares directly.
3 Source: Ipreo, October 2016.

Investor Relations

3 / 3

Telefónica Deutschland shareholder remuneration policy

We maintain an attractive shareholder remuneration policy which includes a high payout ratio in relation to free cash flow. During the integration process we will consider the generation of future cash flows from synergies when making dividend proposals.

At the same time, we continue to place great emphasis on financial flexibility and a conservative financing policy. Against this backdrop, we want to keep our leverage ratio (net financial debt / OIBDA) at or below 1.0x, which is subject to regular review.

On 27 July 2016, the Management Board of Telefónica Deutschland announced its intention to grow the dividend annually for the next three years, starting with a cash dividend proposal for the financial year 2016 of EUR 0.25 per share to the next Annual General Meeting, scheduled for 9 May 2017.

Telefónica Deutschland Investor Relations activities

We aim to facilitate a close dialogue between Telefónica Deutschland and the capital markets community, including retail and institutional investors, financial analysts and other market participants. In 2016 the Management Board and the IR team attended 326 investor meetings (2015: 296) in Europe, North America and Asia. Altogether, the team spent 14 weeks (2015: 9 weeks) of the year on the road.

For further information about our company or the Telefónica Deutschland share, please see our contact details below.

Telefónica Deutschland 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

Since 2013, Telefónica Deutschland holds a long-term issuer credit rating by rating agency Fitch, which is subject to regular evaluation. Fitch confirmed the BBB rating with a stable outlook on 26 January 2016.

Financial Calendar 2017

(ALL DATES PRELIMINARY AND SUBJECT TO CHANGE)

22 February
Q4-2016 – Preliminary results

5 May
Q1-2017 – Preliminary results

9 May
Annual General Meeting

26 July
Q2-2017 – Preliminary results

25 October
Q3-2017 – Preliminary results

Contact

TELEFÓNICA DEUTSCHLAND GROUP
INVESTOR RELATIONS

Telephone
+49 (0)89 2442 1010

Email
Institutional investors:
ir-deutschland@telefonica.com

Retail shareholders:
shareholder-deutschland@telefonica.com

Web
www.telefonica.de/investor-relations

Published by
Telefónica Deutschland Holding AG
Georg-Brauchle-Ring 23–25
80992 Munich, Germany
Tel. +49 89 2442 0
www.telefonica.de

Responsible for content
Peter Mentner,
Director Communications & Public Relations

Project management
Stefanie Seidlitz, Project Manager
Corporate Communications
Guido Heitmann, Head of Corporate Communications

Edited by
Katja Hauß, Senior Manager Corporate Communications

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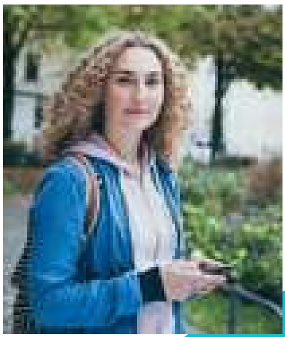
#ShapingDigitalLives

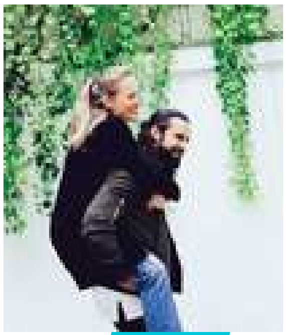
Telefónica Deutschland Holding AG
Georg-Brauchle-Ring 23–25
80992 Munich, Germany
Tel. +49 89 2442 0
www.telefonica.de

Name: Isabell
Job : Student
Age : 21



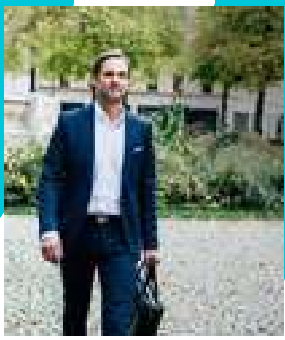
Name: Zoé
Job : Office manager
Age : 27

Name: Laura and Ben
Job : Banker and architect
Age : 27 and 31

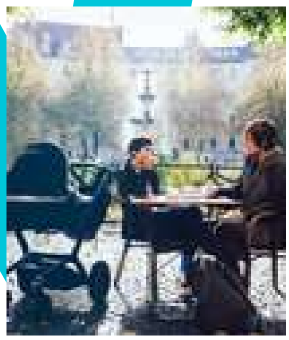


Name: Marco
Job : Electrician
Age : 51

Name: Gregor
Job : Executive consultant
Age : 44



Name: Jasmin and Nils
Job : Educator and photographer
Age : 32 and 34



SHAPING DIGITAL LIVES

Name: Manuel
Job : Musician
Age : 35

Name: Christian
Job : Project manager in IT
Age : 42

Name: Angelika
Job : Artist
Age : 39

Name: Fritz and Leo
Job : Pensioner and scholar
Age : 65 and 12

Name: Vera
Job : Lawyer
Age : 55

Annual Report
2016

Deutschland

Contents_

A

pp. 4–70

Combined Management Report_

B

pp. 71–155

Consolidated Financial Statements_

C

pp. 156–177

Further Information_

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

This report combines the Group Management Report of the Telefónica Deutschland Group, consisting of Telefónica Deutschland Holding AG (also referred to as Telefónica Deutschland) and its consolidated subsidiaries (together referred to as the Telefónica Deutschland Group or the Group), and the management report of Telefónica Deutschland Holding AG.

Combined Management Report_

for the financial year 2016

A

pp. 4–70

Combined Management Report_

Telefónica Deutschland Group at a Glance_

Significant Events and Transactions in the Financial Year

Annual General Meeting and dividend

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

In addition, the Annual General Meeting resolved on a new Authorised Capital 2016/I of EUR 1,487,277,496, cancelling the former Authorised Capital 2012/I, and resolved on a new authorisation to buy back own shares of 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, cancelling the previous authorisation to buy back own shares dated 5 October 2012.

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

Changes in the Supervisory Board of Telefónica Deutschland

Antonio Manuel Ledesma Santiago left the Supervisory Board of Telefónica Deutschland with effect from 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 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.

Christoph Braun has been a member of the Supervisory Board of Telefónica Deutschland as successor to Imke Blumenthal since 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

Changes in the Management Board of Telefónica Deutschland

Thorsten Dirks left – as mutually agreed – the Management Board and as CEO by the end of 31 December 2016.

The supervisory board had approved an early termination of his contract on 21 November 2016 per Thorsten Dirks' request, and has announced it accordingly.

The supervisory board appointed Markus Haas as CEO of Telefónica Deutschland Holding AG with resolution on 11 December 2016 effective as of 1 January 2017.

Rachel Empey, in addition to her previous responsibility for Finance and Corporate Strategy, has also been responsible for the areas of Transformation &Integration, Business Intelligence, Innovation and Telefónica Germany Next GmbH (Telefónica NEXT) since 1 January 2017.

Sale of passive tower infrastructure to Telxius S.A.

Based on a decision by the governing 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 these network towers without restrictions imposed by operating lease agreements.

Framework social plan

Upon completion of the restructuring programme and the related reduction of around 800 full-time equivalents (FTEs) in 2015, another 500 FTEs were given clarity about their employment situation by the middle of 2016 as per an agreement with the worker's council. The company continues to aim for a reduction of around 1,600 FTEs in total by 2018.

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 50 million had been utilised as of 31 December

2016. It serves general business purposes and has a term of five years. The loan term can be extended to no later than March 2023.

Financing agreement signed with European Investment Bank (EIB)

On 13 June 2016, the Telefónica Deutschland Group signed its first financing agreement with the EIB in the amount of EUR 450 million, of which EUR 250 million had been utilised as of 31 December 2016. The facility is intended 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.

Financial Overview

(Euros in millions)	2016	2015	% Change
			1 January to 31 December
Revenues	7,503	7,888	(4.9)
Mobile service revenues	5,437	5,532	(1.7)
Operating income before depreciation and amortisation (OIBDA), before exceptional and special effects[1]	1,828	1,760	3.8
Operating income before depreciation and amortisation (OIBDA)	2,069	1,804	14.7
OIBDA margin	*27.6 %*	*22.9 %*	*4.7 %-p,*
Operating income	(50)	(263)	(81.1)
Profit for the period	(176)	(383)	(54.0)
Basic earnings per share (in euros)[2]	(0.06)	(0.13)	(54.0)
CapEx[3]	(1,102)	(1,032)	6.7
Operating cash flow (OIBDA-CapEx)[4]	967	670	44.4
Free cash flow pre dividends and spectrum[5] and pre-acquisition of E-Plus net of cash acquired	1,408	700	101.2
Free cash flow pre dividends and spectrum[5]	1,408	832	69.2
Total accesses as of 31 December (in thousands)	49,346	48,363	2.0
Mobile accesses (in thousands)	44,321	43,063	2.9
Postpaid (in %)	46.3 %	44.3 %	2.0 %-p,
Total ARPU (in EUR)	10.3	10.7	(3.7)
Postpaid churn excl. M2M (in %)	1.6 %	1.9 %	(0.3 %-p,)
Non-SMS data over total data revenues (in %)	76.9 %	71.6 %	5.3 %-p,
Employees as of 31 December	9,476	9,464	0.1
Net financial debt as of 31 December[6]	798	1,225	(34.8)
Leverage as of 31 December[7]	0.4x	0.7x	(36.4)

1 As of 31 December 2016 exceptional effects include restructuring expenses of EUR 89 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 (EUR 15 million) was registered.
As of 31 December 2016 special effects consist of the impact which the Telxius deal had on OIBDA (EUR -23 million) 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 million for the years 2016 and 2015.

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

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

5 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.

6 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 245 million in 2016 and EUR 321 million in 2015; non-current: EUR 77 million in 2016 and EUR 157 million in 2015), positive fair value hedges for fixed interest financial liabilities (current: EUR 2 million in 2016 and EUR 2 million in 2015; non-current: EUR 12 million in 2016 and EUR 12 million in 2015) as well as loans to third parties (current: EUR 4 million in 2016 and EUR 1 million in 2015; non-current: EUR 0 million in 2016 and EUR 1 million in 2015).
Current and non-current net financial debt include bonds, promissory notes and registered bonds issued (EUR 1,422 million in 2016 and EUR 1,420 million in 2015), other loans (EUR 298 million in 2016 and EUR 501 million in 2015), finance lease payables (current: EUR 15 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 million 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.
The present value of pending payments for spectrum amounting to EUR 110 million (including capitalised costs of borrowed capital) are shown under trade payables against third parties in the Consolidated Statements of Financial Position and are therefore not included in the net financial debt calculation.

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

Basic Information on the Group_

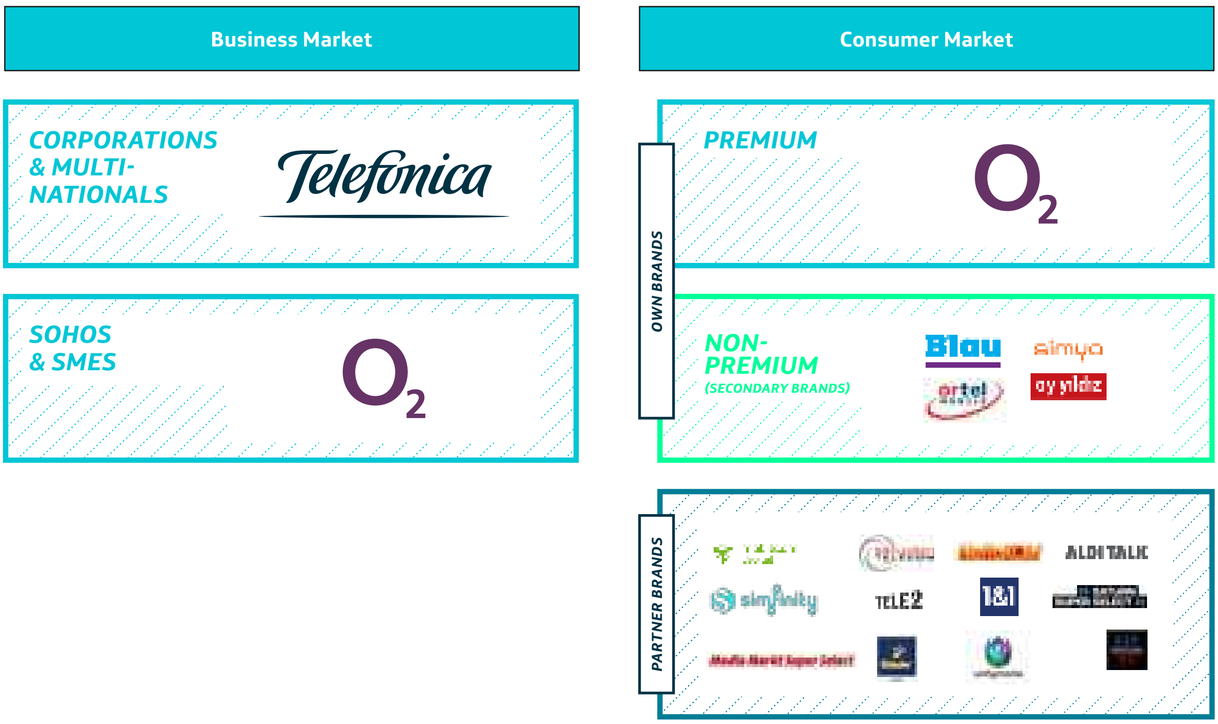
Business Activity

Telefónica Deutschland Group is one of the leading integrated network operators in Germany./We successfully address all market areas with a focused multi-brand strategy./Telefónica Deutschland Group 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./We have launched Telefónica NEXT to drive innovation in advanced data analytics (ADA) and Internet of Things (IoT) space.

With over 49 million customer accesses as of 31 December 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 44 million mobile customer accesses as of 31 December 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 & customer needs

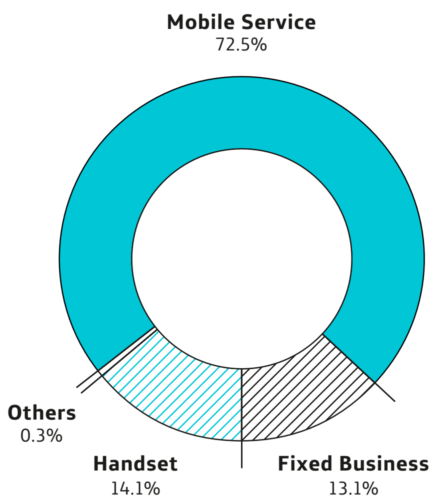
G 01 — Our brands



Our marketing and sales approach follows a consistent and focused multi-brand strategy in order to address the whole range of customer types with our products and services. With our premium brand O_2, 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 large groups of customers that we do not target with our O_2 brand. Our secondary brands include Blau, AY YILDIZ and Ortel Mobile. We also count on brands from joint operations and strategic partnerships such as TCHIBO mobil and ALDI TALK in cooperation with MEDIONmobile. Our multi-brand approach enables us to address the whole spectrum of customers with tailored product offerings, sales and marketing, thereby increasing our potential revenue.

G 02 — Revenue Structure FY 2016

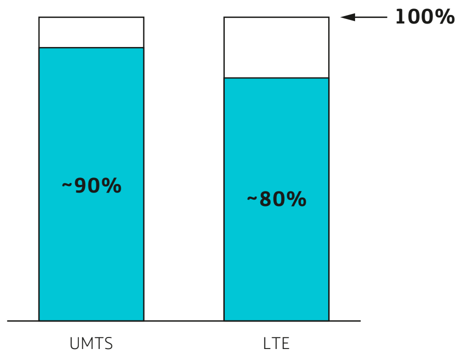


Mobile Service is the main revenue stream
As the market leader for mobile services in Germany, we operate a state-of-the-art network. We provide a high-quality network experience particularly in urban and suburban areas. The combined UMTS network infrastructure now reaches around 90 % of the population in Germany. Our customers benefit from the combined strength of the O_2 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 has also further continued the deployment of its LTE network. By the end of 2016, the company achieved a nationwide LTE coverage rate of approximately 80 %.

In 2016, the mobile service has been the main revenue stream for Telefónica Deutschland Group with EUR 5,437 million (72.5 % of total volume).

G 03 — Network Coverage
Outdoor population coverage in %



Fixed Business: Full service offers based on future proof infrastructure
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 of the fixed infrastructure, currently covering over 25 million households with high-speed VDSL internet access.

In addition, Telefónica Deutschland Group benefits from all Deutsche Telekom's future network improvements such as an increase in VDSL coverage and higher speeds based on new technologies like 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_2 My Handy" model. Here, the customer can choose whether to pay the entire price upfront or to make a down payment and pay the remaining purchase price in 12 or 24 monthly instalments. For the customer this approach provides price transparency with regards 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, as a result, smartphone penetration continues to grow, reaching around 60 % 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 order to make our offers related to smartphone packages more attractive to customers, we have expanded our portfolio with additional services and products, including smartphone insurance services, antivirus protection or state-of-the-art add-on products such as the latest digital lifestyle devices like smartwatches or TV extenders as well as protection cases, selfie sticks or digital add-on products for outdoor sports. Good examples are 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) or the Adidas MiCoach Smart Ball. The eSIM 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 a lower energy consumption. Furthermore the eSIM standard increases flexibility for consumers and is an enabler for the future development of the IoT business.

In 2016, sales of smartphones and tablets slowed down and revenues declined versus 2015, in line with overall market trends of longer handset lifecycles and new customers using lower-priced handsets. The handset business contributed 14,1 % to group revenues in 2016 with EUR 1,061 million.

Our Market Areas

We are improving the market position of our premium brand O_2, 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 approach. 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.

Private Customers: Value Management & Sustain Leadership

The O_2 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 like our in October launched proposition O_2 Free (› GOALS AND STRATEGY). On the back of their growing 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 messenger services, music streaming or playing games. New innovative or even game changing additions to our product portfolio are the O_2 Banking proposition, the O_2 TV & Video App and our partnership with Sky, which will give O_2 customers affordable access to exclusive sports events, movies and series starting in January 2017 (› GOALS AND STRATEGY).

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_2, for example with our innovative products like "O_2 Free Business" or "O_2 Unite". "O_2 Unite" offers our customers a drastic cost reduction by pooling SMS, minutes and data volumes 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, flatrates and flexible adaptation of number of licenses 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. In 2016, we have finalised the business customer migration from BASE to O_2. This will enable us to continue our focus on growth, especially among SME customers.

An important lever to increase our share among SME customers in fixed-line products is our All-IP offer. This is a scalable and flexible offer for Business customers. It is an opportunity especially for companies with their own in-company telephone systems that face the shut-down of Deutsche Telekom's ISDN infrastructure platform in 2018. O_2 offers a flexible product portfolio ensuring cost efficiency for customers as they can keep their central equipment and obtain high quality services.

Within the business customer market area we offer our machine-to-machine-communication (M2M) managed connectivity services. This business line currently contributes to mobile service revenues to a minor extend. However, in the future we expect significant growth.

The managed connectivity, part of the IoT, is a very dynamic market with an expected double digit annual growth in customer base[1]. Telefónica Deutschland Group continues to successfully expand its customer base with significant customers in 2016, such as Next Kraftwerke GmbH which has a business model focusing on a virtual platform for energy generation and optimisation of energy consumption. We also offer our internally developed award winning platform Smart M2M to simplify the management of IoT devices.

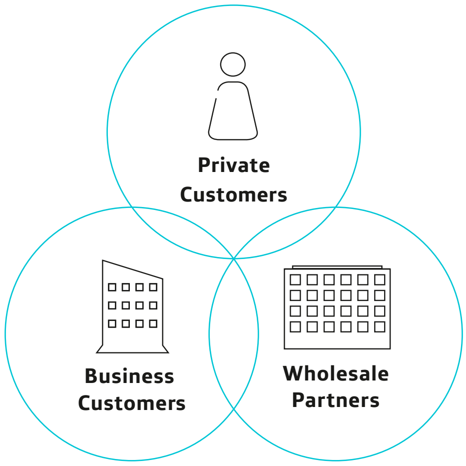
Wholesale Partners: Maintain Leadership

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. However, we will phase out this model by 2019 as part of the transition to the next generation fixed network of Telekom Deutschland GmbH.

In this context, we offer value added services, such as billing services or the administration of phone numbers as well as a network protocol to establish a network connection (e.g. voice over IP), known as SIP accounts. This comprehensive portfolio enables our whole-sale partners to independently serve their consumers and, at the same time, gives us the opportunity to increase our range and leverage economies of scale.

G04 — Main Market Areas



New Growth Areas: Internet of Things (IoT) and Advanced Data Analytics (ADA)

In 2016, we have created Telefónica Germany Next GmbH (› GOALS AND STRATEGY). This is a subsidiary of Telefónica Germany GmbH & Co. OHG, driving innovation in the use of data analytics and the IoT space. The company combines the strengths of Telefónica Deutschland Group (the biggest mobile network operator in Germany) and the agility of a start-up company.

With Telefónica NEXT, we address the great economic and social potential of the IoT (with a focus on B2B2C solutions) and ADA. We develop solutions that contribute to the digital transformation of our economy by helping our partners to make their products smarter, better understand and approach their customers, as well as improve their internal processes.

1 Machina Research IoT Forecast May 2016.

Goals and Strategies

Our vision is to become the leading digital "onlife" telco in Germany./We are increasingly shifting the focus from integration to transformation./We strive to deliver the best customer experience with innovative offers based on real-time customer insights./We keep market momentum on the back of successful data monetisation and an excellent price-value performance ratio./We continue to improve our networks with the roll-out of LTE./Innovation, digitalisation and cost efficiency are key enablers to achieve these goals.

From integration to transformation: Our path to become the leading digital "onlife" telco in Germany

Based on the significant progress during our first year as a merged company, our strategy has further evolved in 2016. We have consistently pursued our vision to become the leading digital "onlife" telco in Germany by 2020: a telecommunications company that goes beyond the provision of connectivity but plays a central role in the digital lives of its customers. The achievement of major integration milestones has enabled us to shift the focus increasingly to this fundamental transformation over the course of 2016. The business model of the "onlife" telco is based on the provision of data connectivity as well as the intention to leverage insights on how these data services are used. These insights enable us to address the needs of our customers with attractive products and services in real time. This transformation will enable us to keep our momentum in a challenging and highly competitive market.

Main integration milestones of 2016

Our corporate strategy so far has been based on three pillars: We keep the momentum, integrate quickly and transform the company. Due to the rapid integration process and the finalisation of major integration projects, our focus has now shifted to transforming the company while maintaining momentum in the market (M+T). The implementation of this strategy takes place in six dimensions: Values & Customer Experience, Integrated Offering and Outstanding Connectivity form cornerstones of "Momentum", while End-to-End Digitalisation (E2E), ADA & Innovation and Capital Allocation & Simplification are key factors for "Transformation".

G 05 — Main integration milestones

Optimisation of Brand Portfolio & Customer Migration

- Brand portfolio: improving market positioning and generating efficiencies (O_2 as premium brand, Blau as main secondary brand and Base as online-only)
- Completion of customer migration in postpaid and prepaid areas

Network Consolidation

- Start of consolidation mobile sites in a region-by-region approach initiated
- Launch of 2G national roaming, improving coverage for voice and M2M devices

Other Infrastructure Consolidation

- Achievement of 2/3 of our total target on shop reductions
- Reduction of facility surface reaching 50% of total reduction targeted

Target Organisation

- Continued execution of second wave of FTE Leaver programme
- Leaver programme covers 80% of 1,600 total FTE reduction targeted until 2018

Customer Service & Sales Structures

- Creation of a new common customer service & sales structure
- Simplification and combination of previously independent customer service entities

IT Operating Model

- Simplification and optimisation of IT operations vie extended deal with Atos Deutschland
- Atos is from 1st July responsible for operations of IT systems and for the employees at the Service Operations department

We are shaping our transformation towards the leading digital "onlife" telco. Our target organisation is based on a network and IT factory providing connectivity and data analytics, and on market units packaging these raw materials into attractive services and products for our customers. In addition to our existing B2C, B2B and B2P market units, we are also stepping up our efforts in the new growth areas ADA and IoT. The latter have been integrated into our subsidiary Telefónica Germany Next GmbH. We are also driving the E2E digitalisation of all company areas and processes in order to offer our customers the best services in the most efficient way.

We are keeping the Momentum ...

Values & Customer Experience

We strive for the best customer experience by continuously challenging the traditional mobile industry. This is reflected in innovative propositions such as our new premium proposition O_2 Free, our commitment to our customers with the campaign pledge "Mehr O_2" and our principle of customer proximity through an excellent retail network and increasingly important online channels.

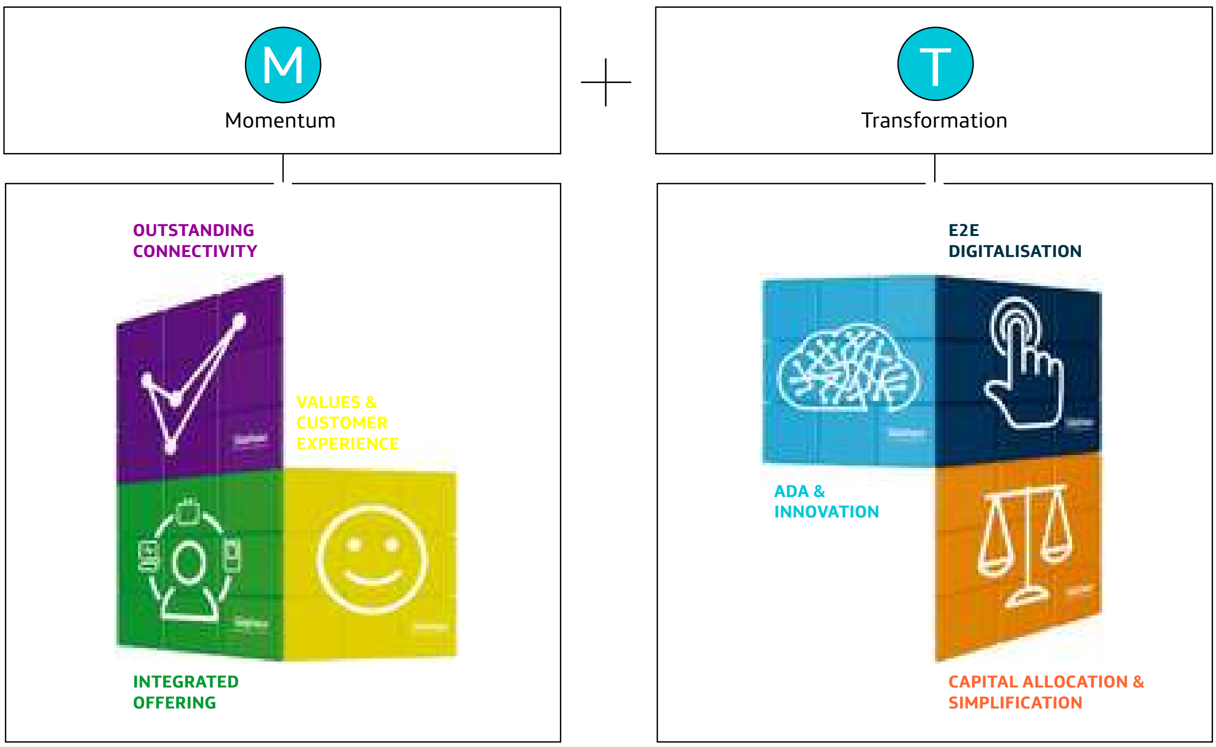
The launch of O_2 Free has been a major milestone in 2016 due to its innovative approach to the market. O_2 Free offers customers unlimited data connectivity based on a "more-for-more" approach while also offering an excellent price-performance ratio for our customers. This proposition is available to both consumer and business customers and clearly differentiates Telefónica Deutschland Group from the competition. It also helps us to monetise our strong network assets. The offer consists of 4G packages at our maximum LTE speed combined with unlimited 3G data at a speed of 1 Mbit/s, sufficient for streaming, messaging or surfing the internet after the high speed allowance is used up. In addition, we also offer the possibility for our customer base to upgrade their current O_2 Blue All-in tariffs to O_2 Free for just an additional EUR 5 per month.

With this unique proposition, we continue to support our focus on stimulating data usage and data monetisation while at the same time providing better products and services to more customers.

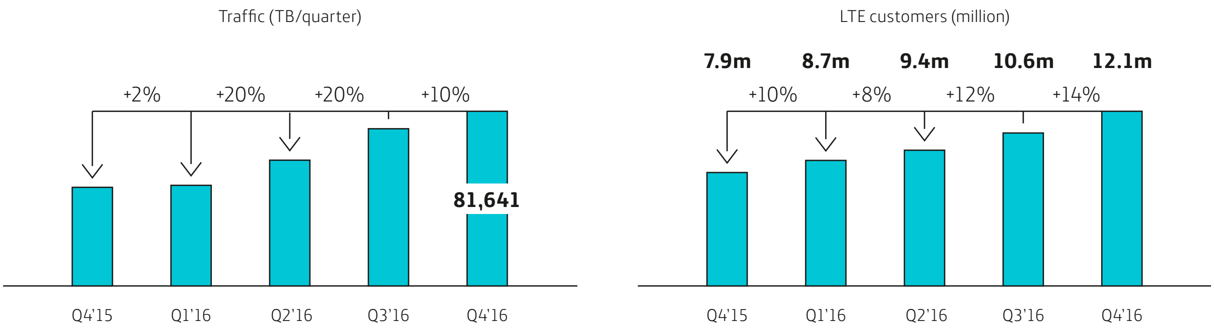
Data traffic revenues are one of the key components of our mobile service revenues. Our successful data monetisation strategy is validated by the dynamic growth of data usage. We have compensated the decrease in SMS revenues with other data revenues. The share of non-SMS data traffic revenues has grown 5.3 percentage points vs. previous year.

We have also expanded our LTE customer base (+53 % vs. 2015) further to almost 12.1 million customers as of 31 December 2016.

G 06 — Momentum + Transformation



G 07 — Data traffic/LTE Customer base



In the context of our focus on leveraging the existing customer base, we have launched "Mehr O_2" in mid-2016. This is an initiative to reward our existing customers for their loyalty with access to special offers and services. Depending on the status of the customer, this includes attractive benefits ranging from cinema tickets to a premium customer-service hotline or free SIM card replacements. This focus on our customer experience has been reflected in the improvement of our churn rate for postpaid & prepaid to an average of 2.3 % in 2016 (2015: average 2.4 %).

We have further enhanced the customer experience by upgrading services in our nationwide retail network. In 2016 we have increased the number of our concept stores. Our O_2 Gurus provide customers with useful insights and workshops on digital lifestyle. In line with these efforts, we have been awarded the first position in the category "shop advice" by the established consumer organisation "Stiftung Warentest" in 2016. We complement the retail store experience by expanding and enhancing the digital support for our customers. As an example, we offer access to our O_2 Gurus online by means of video chat or webinars on specific topics.

We also realise that a growing number of customers prefer enhanced digital interaction and self-care capabilities. Ensuring a seamless digital experience for our customers is therefore an important part of the transformation process. We are proactively increasing the share of digital customer contacts by improving our digital channels. We expect this to result in a significant reduction of our customer services cost over the next years. During 2016 we have experienced a significant increase in the share of customers acquired via digital channels.

A key element of our strategy is the further roll-out of our omni-channel approach. 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 collected from a store.

Telefónica Deutschland Group strives for digital inclusion. This means the enablement of all customers to access digital services, so that everyone benefits from the advantages of digitalisation. Smartphone courses for beginners provided by our O_2 Gurus are a case in point. Furthermore, we are also taking an active part in the public debate about the future of the digital world and the social and ethical dimensions of digitalisation. The Telefónica BASECAMP, which was opened few years ago, has clearly established itself as a digital hotspot and a centre for debate in the heart of Berlin. In event series such as Digital Masterminds, future.work or the UdL Digital Talk trends, opportunities and challenges of digitalisation are being discussed with multipliers, entrepreneurs, consumers, politicians and scientists.

Integrated Offering

We go beyond the provision of fixed and mobile connectivity by offering relevant digital services which address the real needs and preferences of our customers. During 2016, we launched the first propositions of our new digital business lines, Mobile Video as well as Mobile Banking. Our fixed-mobile converged offer has also been relaunched under the brand O_2 Blue One.

O_2 TV & Video 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. With this innovative offering, we address our customers' preference to access TV content independently of their device (smartphone or tablet) wherever and whenever they want. We continue to work on further upgrading this service in the near future, e.g. with a state-of-the-art recommendations engine.

We will further enhance our attractive content offer by expanding our cooperation with Sky Deutschland, which was established in 2016. O_2 customers will have special conditions to the flexible Sky Ticket offers. With the Sky Supersport daily, weekly or monthly ticket our customers will gain access to Bundesliga, UEFA Champions League and Europa League, as well as Formula1, handball, golf and other exclusive live sport events. With the Sky Entertainment or Cinema monthly tickets the customers will be able to enjoy during one month exclusive series, movies and entertainment at any time in the day. This cooperation reinforces our customer oriented offer with a unique proposition in the German market.

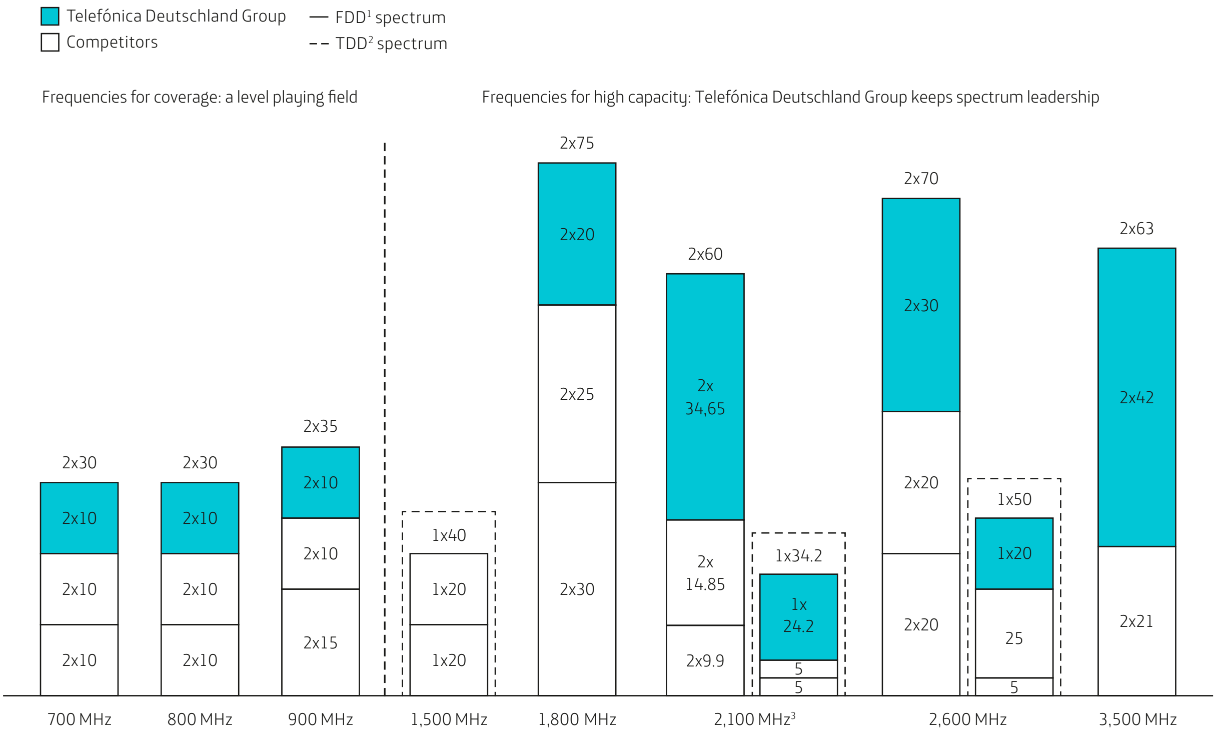
Another milestone has been the launch of O_2 Banking, the first mobile-only bank launched by a telecommunications company in Germany. O_2 Banking provides an outstanding digital experience: It enables the full usage of the smartphone as a bank account, e.g. by enabling money transfers using only the mobile number of the recipient instead of the IBAN. Further advantages are the quick and safe sign-up process, a free contactless Mastercard for ATM withdrawals and payments in shops or online, advanced security features and a financial planner. A smart and innovative feature of O_2 Banking is the additional data volume for customers who use it as their salary account or pay with the linked Mastercard regularly. O_2 Banking has been launched in cooperation with Fidor Bank AG, a direct bank registered in Germany specialised on providing financial services for millennials. Fidor Bank AG is part of BPCE Group. O_2 Banking ranks among the top applications by downloads for direct banking in the German Android Appstore. It has received multiple awards in 2016 for its innovation and customer orientation; such as the Innovation Award 2016 from bankenversicherungen.de and Frankfurt Euro Finance, the Diamond Star in the digital retail banking awarded by the German finance newspaper "Handelsblatt" and Euroforum and the Banking IT-Innovation Award 2016 from the Competence Centre "Sourcing in the Finance Industry" formed by the University of St. Gallen and the University of Leipzig.

Outstanding Connectivity

Our network is the most important asset to achieve the best customer experience. Telefónica Deutschland Group utilises a strong network which we continue to develop. Our network strategy is focused on providing reliable, high-quality network connectivity to support the everyday digital lives of our customers. We are therefore pressing ahead with the consolidation of our 4G networks, which we aim to largely complete by the end of 2018.

In line with this strategy, our network has received positive ratings in user-based network tests. According to the results of the Connect-"Netzwetter" test as of November 2016, based on direct user experience reported via app, Telefónica Deutschland Group offers the best combined 4G/3G cover-

G 08 — Frequency bands for mobile operators in Germany



1 FDD = Frequency Division Duplex.
2 TDD = Time Division Duplex.
3 So called "UMTS core band" also referred as 2 GHz by the Federal Network Agency.

age and shows the highest improvement in 4G amongst German mobile network operators.

We offer the customers of all our brands and partner brands the best UMTS network infrastructure in in terms of coverage according to the Connect-"Netzwetter" test. This has improved the user experience for mobile data services even in areas where our customers did not yet have LTE, and it has improved customer experience and satisfaction.

As we continue to consolidate our networks, one of the largest projects of its kind in Europe, we are also further expanding our 4G network. It reached a coverage of the German population of approximately 80 % at the end of 2016. Our strategy is to continue with this dual focus on network consolidation and LTE roll-out. In summary, we aim to operate an efficient network able to meet our customers' demands and to support our customer propositions. This means that in 2017 and 2018 we will continue to roll-out our LTE 800 MHz network and compared with 2015 to accelerate the roll-out of LTE 1,800 MHz. Customers will therefore benefit from even better coverage and higher speeds.

We are also in an excellent position with our spectrum portfolio. Telefónica Deutschland has access to 357.5 MHz of spectrum with a good balance between frequencies providing coverage (low frequencies) and those providing capacity (high frequencies). Compared with our competitors, we are in an excellent position to drive future network developments.

In terms of products, we have also launched a native version of our application for voice over wifi in 2016. With this application, customers are able to automatically use the wifi network to which they are connected for outbound or inbound calls. The product also offers a seamless transition from wifi calling to the mobile network without interrupting the call. We have thus been able to significantly improve customer experience by increasing indoor coverage in a seamless and simplified way.

We have also established a cooperation with leading industry players to define future communication networks. An excellent example is our cooperation with Huawei through which we reached transmission speeds in a lab environment of 1.2 GBit/s and 400 MBit/s in our trial area for "4.5G" in Munich. We continue working with Huawei on improving these results.

Furthermore, Telefónica S.A. Group is involved in the definition of the future 5G technology standards via its participation in international initiatives like NGMN (Next Generation Mobile Network), METIS2020 (a European Union research and development programme) and the 5GPPP Initiative.

... and we are transforming the company

E2E-Digitalisation

Digitalisation is a core lever to increase customer loyalty and satisfaction while sustaining our focus on cost leadership. This starts at the very beginning of the customer journey by enabling customers to manage their services via digital channels (e.g. online portal or application) and continues to the our back office, where all processes need to be digitalised to ensure maximum flexibility and efficiency.

After the relaunch of our portal and application during 2016, we will continue to further enhance our capabilities in online channels. In addition, we have developed two important enablers for our company transformation that rely on the use of data analytics for better and faster decision making: The Digital Collaboration Centre (DCC) and the Analytical Insights Centre (AIC).

The DCC is a comprehensive system based on artificial intelligence allowing us to optimise our business and our relationship with the customer. During 2016 we deployed the DCC for our own online business. This has contributed to better optimising our propositions by brand or geographical area, to improve our anticipation capabilities by means of intelligent self-diagnosis and early-warning tools, to enable real-time market tracking or to provide recommendations to the different decision-makers. We continue to work on the implementation of this system, including in areas outside of the online business.

With the introduction of the AIC, all employees of Telefónica Deutschland gain much wider and more structured company insights to manage their activities. The AIC is a centralised portal that acts as an information hub including information from internal periodic reports to real-time data feeds. The AIC is an excellent tool to empower employees – enabling what we call the "democratisation of data". It enables our employees to make informed decisions in shorter periods of time, speeding up processes and leading to faster result generation across the entire organisation.

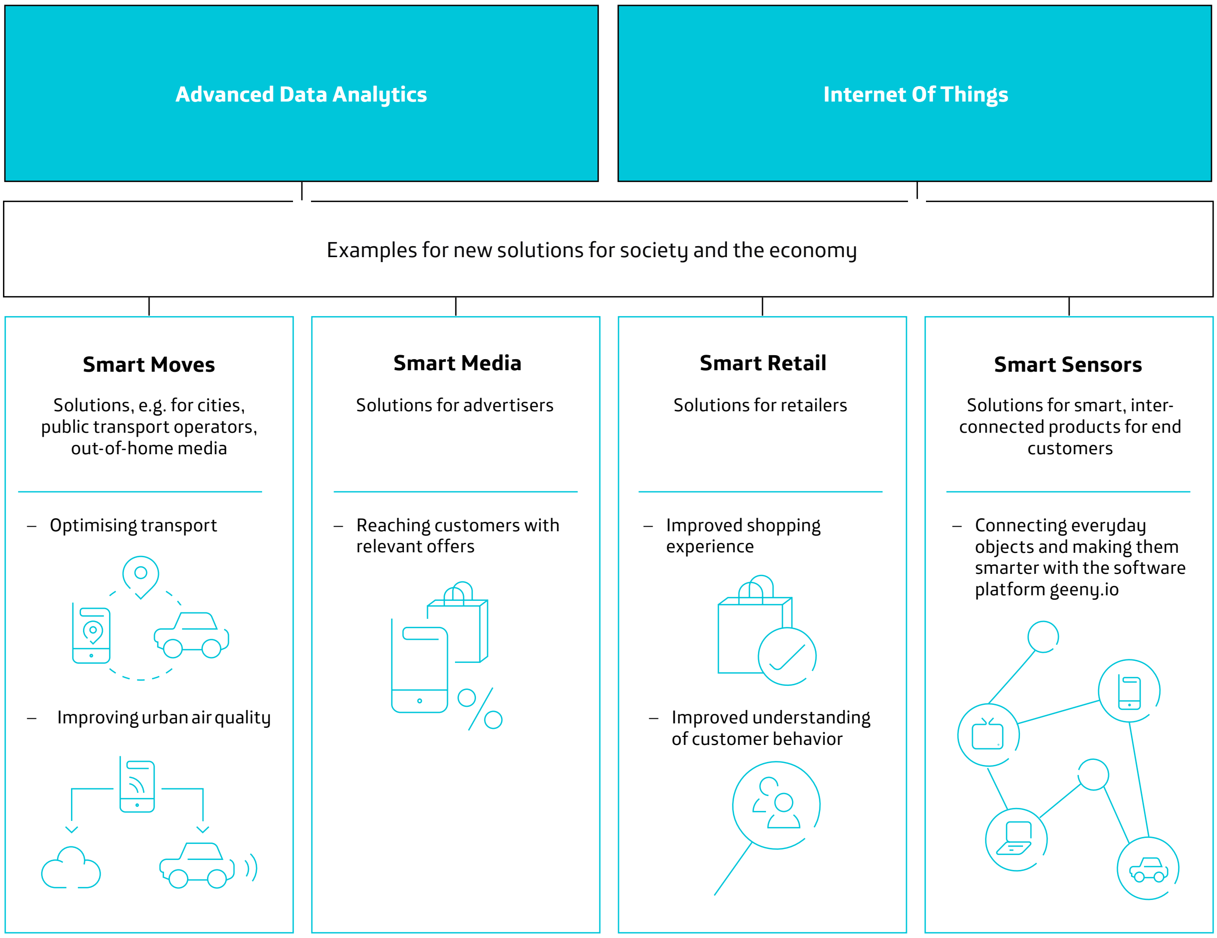
Data analytics leads to better business decisions, optimised capital allocation and increased revenues due to better insight-driven propositions and higher efficiency of upselling campaigns as well as reduced churn as a result of the early identification of potential switchers. In addition, we increase 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.

ADA & Innovation

A key enabler for our transformation to the leading digital "onlife" telco is the way we work, protect and manage the growing amounts of customer data in order to generate value for every member of society as well as to create new business opportunities.

Our focus on data is reflected in the creation of Telefónica NEXT. This is the main initiative to address the revenue potential in the areas of ADA and the IoT for business-to-business-to-consumer (B2B2C) solutions.

G 09 — Telefónica NEXT: Data-based growth areas
Telefónica Germany Next GmbH



Telefónica NEXT provides businesses and public institutions with actionable consumer insights, helping to better address their customers' needs and make internal processes more efficient. In the area of Smart Moves (formerly Mobility Insights) we leverage anonymised data from the largest mobile subscriber base in Germany to solve our partners' business questions. We are e.g. engaged with projects to improve transport planning in Stuttgart and Hamburg and to prevent air pollution in Nuremberg.

Furthermore, we help our partners approach their customers in more targeted ways, providing relevant offers when and where they are needed. Within our Smart Media (formerly Media Services) area, we combine location-based mobile messaging and mobile display advertising solutions.

We are also making consumer products smarter, by removing existing barriers of complexity and lacking interoperability in current IoT ecosystems. Within our Smart Sensors area, we created the Geeny cloud platform. In combination with a trusted partner ecosystem, Geeny provides support with all components needed for innovative IoT solution development, from ideation and concept design through developing, market testing and rollout. In 2016, we have developed a dog tracker as first end to end proof point for the platform. The product gives insights, among others, on the dog activities or location providing a valuable service beyond connectivity to the customer and works as show case to attract new customers to the platform.

With Smart Retail, we bundle ADA and IoT competencies to offer comprehensive solutions for retailers. We provide retailers with deep customer insights on in-store and out-of-store behaviour and enable targeted communication and customer interactions along the entire retail customer journey.

A prerequisite for the use of our customer data is ensuring data privacy and security. We ensure data security and privacy by various means such as our own developed Anonymisation Platform. Furthermore, our vision is to give data back to the customer. Our aim is to let our customers choose what data to share and ensure the highest possible transparency for the use of our customers' data. At this stage, our customers can choose whether to participate in the O_2 More Local service (part of Smart Media), by which they receive special offers based on their location.

As part of the Telefónica, S.A. Group, innovation is at the heart of our core values. Both companies, which were merged into the new Telefónica Deutschland, were known for innovation 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. This is best exemplified by the launch of O_2 Free and O_2 Banking as well as by our cooperation with Huawei, our role in the definition of the eSIM standard or Telefónica NEXT's platform Geeny.

Furthermore, we leverage "open innovation" approaches to drive innovation, including the acceleration of start-ups and investments into growth companies. These activities are conducted as part of the global Telefónica, S.A. Group initiative "Telefónica Open Future", which supports technological talent and entrepreneurship, helping to turn innovative ideas into successful businesses and thereby securing access to new business models.

Since 2012 we have been operating the Wayra Academy in Munich, which accelerates start-ups by allowing them to further develop their business models and bring them to market maturity. This includes cooperations and pilots with Telefónica Deutschland. Among the start-ups accelerated by Wayra are companies such as 5Analytics, which uses artificial intelligence to automate business processes, and People.io, which allows users to license their data for rewards. Multiple start-ups originating at the Munich-based academy, including NFWare, Zyncd and Netbeast obtained additional funding from external investors in 2016.

In addition to Wayra, we use the venture capital company Shortcut Ventures to support more mature growth companies. Shortcut Ventures invests in young entrepreneurs with new ideas and visions for the markets of tomorrow. They are provided with risk capital and direct personal access to relevant business expertise and the experience of an expert team. Shortcut Ventures holds a stake in these companies of up to 29 %. Examples of Shortcut Ventures' investments include So1 GmbH, Berlin, and SumUp Payments Limited, Berlin. So1 GmbH is the first company that enables brands to offer programmatic price promotions within So1's retailer network, while SumUp is the leading mobile point of sale (mPOS) system in Europe and Brazil enabling businesses to accept credit and EC card payments via their mobile device.

Capital Allocation & Simplification

We can only strive for the best customer and network experiences if we operate in an efficient manner. This means we require a lean organisation that is agile enough to quickly react to changes in customer demands and technologies. Digitalisation is a main lever to achieve this but first we need to ensure we have optimised our processes. For that reason we have also set our focus on simplification measures. This includes most of our integration initiatives, but also our focus on CRM and HR systems standardisation.

In addition, in 2016 we have supported our transformational plans with the sale of our passive tower infrastructure to Telxius, Telefónica S.A.'s infrastructure management company. This transaction, worth EUR 587 million, has generated resources that contribute to the development of our business and our investment capabilities.

Altogether, and combined with our digitalisation measures, we will be able to transform our company while providing an attractive return on investment for our investors and driving momentum in an attractive market.

Structure of the Telefónica Deutschland Group

This report combines the Group Management Report of the Telefónica Deutschland Group, consisting of Telefónica Deutschland Holding AG and its consolidated subsidiaries, and the management report of Telefónica Deutschland Holding AG.

Telefónica Deutschland Holding AG is a stock corporation (AG) under German law located in Munich, Germany.

Telefónica Deutschland 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: 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.

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 International Securities Identification Number (ISIN) is DE000A1J5RX9.

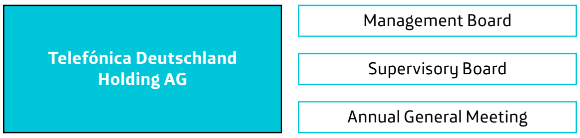
The share capital of the company is EUR 2,974,554,993, which is consistent with the prior year and is divided into the same number of no-par value registered shares, each accounting for a pro rata amount of share capital of EUR 1.00. In general each no-par value share grants one vote at the Annual General Meeting.

Telefónica Deutschland has an Authorized Capital 2016/I in the amount of EUR 1,487,277,496 as of 31 December 2016.

The share capital of Telefónica Deutschland Holding AG is conditionally increased by up to EUR 558,472,700 by issuing up to 558,472,700 new non-par value registered shares (Conditional Capital 2014/I).

Management and governing bodies
The company has the following management and governing bodies:

G 10 — Management and governing bodies



The powers of these bodies are established by the Aktiengesetz (AktG – German Stock Corporation Act), the articles of association of the company and the bylaws of the Management Board and the Supervisory Board.

Management Board
The members of the Management Board may be appointed by the Supervisory Board for a period of no more than five years and re-appointed without limitation, in each case for no more than five years. As of 31 December 2016, the company's Management Board comprised three members:

- Thorsten Dirks, CEO (Chief Executive Officer) (until 31. December 2016)
- Rachel Empey, CFO (Chief Financial and Strategy Officer)
- Markus Haas, COO (Chief Operating Officer)

Since 1 January 2017 the Management Board has comprised of two members (Markus Haas as CEO and Rachel Empey; › MANAGEMENT DECLARATION).

Supervisory Board
In accordance with section 11 (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 are employee representatives.

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

Management System

Telefónica Deutschland is managed using financial and non-financial performance indicators./The corporate strategy and key investment decisions are determined on this basis./The value of the company shall be increased for the benefit of our shareholders.

The Telefónica Deutschland Group is centrally managed by the members of the Management Board and the management at the level of Telefónica Germany Management GmbH.

The encouragement of entrepreneurial behaviour is one of the most important aspects of the company. Accordingly, we have enshrined a clear responsibility for results within the individual organisational units.

Our aim is to increase the value of our company for the benefit of our shareholders. We are also firmly convinced that the satisfaction of customers and employees makes a major contribution to achieving this value growth.

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

- Process for strategic goal setting
- Integrated budgeting and planning system
- Financial and non-financial performance indicators
- Monthly reporting to Management Board and Supervisory Board
- Continuous opportunity and risk management
- Leadership by target agreements at all levels of the organization

Strategic objectives are reviewed and redefined annually

As part of the annual planning process, the Management Board of Telefónica Deutschland reviews the corporate strategy. We develop long-term strategic goals for the positioning of the company on the German market as well as business plan with a typical time frame of three years as part of this process. Decisions are based on current market and competition analyses as well as market forecasts, which are compared with the corporate vision and the long-term strategic goals.

Through this systematic approach, we determine changes and opprtunities for growth and make investment decisions.

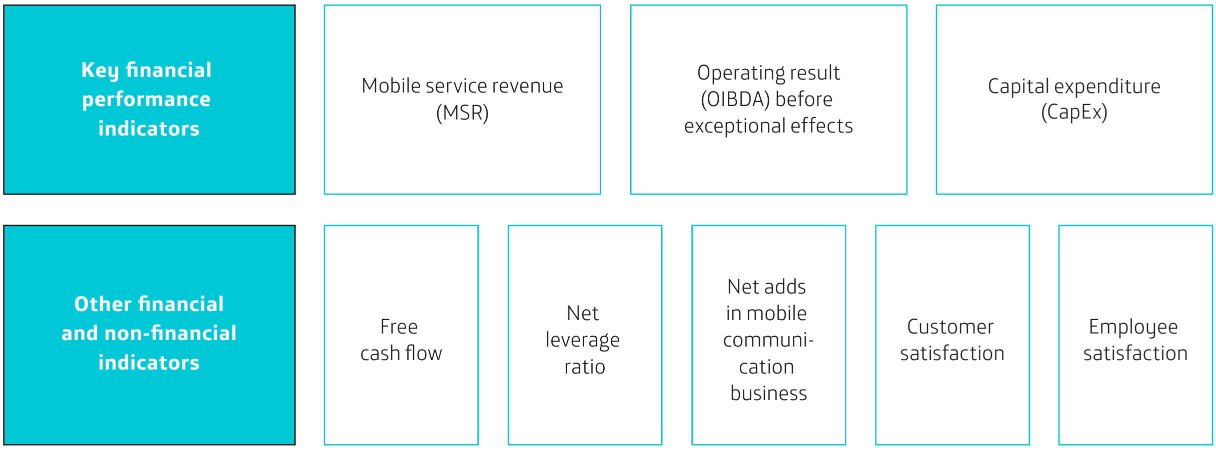
The corporate strategy as well as the identified opportunities and growth potential of the company are translated into concrete strategies for each organisational unit. In terms of the practical implementation of the strategies at the level of the organisational units, the relevant opportunities are prioritised in each case. Furthermore, concrete financial objectives are defined in the form of key performance indicators (KPIs) to measure the strategic implementation as well as the most important measures necessary in order to realise goals. Detailed budget planning for the next financial year is then prepared on the basis of the agreed multi-annual goals. The short-term priorities are defined at the same time.

Management system includes financial and non-financial indicators

We have established key performance indicators (KPIs) for the management of our strategic and operating goals. Financial and non-financial performance indicators are a component of the management system of the Telefónica Deutschland Group and reflect the interests of our various stakeholders.

The following finance-related monitoring parameters are particularly significant for our company's value-oriented monitoring and evaluation:

G 11 — Performance Indicators



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

Operating result before exceptional and special effects
We measure the profitability of our operating business on the basis of OIBDA before exceptional and special effects, e.g. the operating result before depreciation of property, plant and equipment and amortisation of intangible assets and before exceptional and special effects. OIBDA before exceptional and special effects as a fundamental monitoring parameter enables a comparison of the operating performance that was achieved in the individual reporting periods and businesses. The use of OIBDA before exceptional and special effects as a basic parameter is advantageous, as this variable eliminates potential differences that may result from variations in the tax positions (for example on a change of the effective tax rates or deferred taxes and their effect on individual periods or businesses), depreciation and other positions (for examples restructuring expenses). Exceptional and special effects result from an altered group structure or the integration of E-Plus Group. Exceptional effects have a direct impact on the result of operations (e.g. gains from sales of businesses/assets or restructuring expenses). These exceptional effects partly result from transactions in the previous period. The results from operations are adjusted for special effects relating to the transaction impact on the current financial year (e.g. higher operating lease expenses due to business transactions). This results in better comparability of reporting periods. Thus, OIBDA is often used to compare the business activity of telecommunications companies. However, as other companies may use a different basis of calculation for OIBDA, it is possible that our representation is not comparable with other companies.

Investment activity
Capital expenditure (CapEx) is comprised of the additions to property, plant and equipment and intangible assets. The investments in property, plant and equipment are primarily to expand the coverage and capacity of our network (particularly for LTE and UMTS) as well as product development. CapEx does not include payments for licences in mobile phone frequency usage rights. It predominantly serves to secure our future business activity.

Alongside our fundamental financial internal key performance indicators such as mobile service revenues, OIBDA before exceptional and special effects and CapEx, other financial and non-financial indicators are also observed.

Free cash flow
The internal monitoring parameter of free cash flow pre dividends and payments for spectrum as well as the acquisition of E-Plus is defined as the sum of the cash flows from operating activities and investment activities. Free cash flow implicitly provides information about the change in working capital. Working capital management is thus an essential element of the managing of free cash flow in the relevant reporting period.

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

Net leverage ratio
The net leverage ratio is defined as the quotient of the net financial debt and the operating result before depreciation and amortisation (OIBDA) before exceptional and special effects for the last twelve months. Net financial debt includes short and long-term interest-bearing assets and interest-bearing financial liabilities and cash and cash equivalents.

The net leverage ratio compares the net debt level with an operational success parameter (OIBDA before exceptional and special effects) and provides management with information about the company's debt reduction ability. We are actively monitoring the capital structure with the objective of keeping the net leverage ratio at or below 1.0x in the medium term (target level).

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

Net adds in mobile communications business
New customers in the period less those customers leaving the company are designated as net additional customers ("net adds"). A continually positive number of net adds leads to a growing customer base. A distinction is made between contractual customers (postpaid) and customers without a contractual commitment (prepaid). The number of net adds is influenced by various factors: More new customers can be won with a highly attractive product portfolio and a high level of customer satisfaction among existing customers leads to a lower churn rate. One of the goals of this performance indicator is to allow the evaluation of customer acquisition and retention measures.

Customer satisfaction
Customer satisfaction is among the most important priorities of our business. Accordingly, we continually strive for a better positioning of our brands in order to attract private, partner and business customers for our products. Our objective is to serve the most satisfied customers on the German telecommunications market with the most popular brands. This means that we always strive to create customer-oriented offers and provide outstanding services across all our customer interfaces. We are confident that high customer satisfaction values reduce termination rates and increase recommendation rates.

Employee satisfaction
Our employees are a key element of our success and our journey to become the leading digital “onlife” telco. Their commitment, their dedication and their engagement have shaped us to become the company we are today. We regularly carry out internal surveys to review the satisfaction of our employees and we use their feedback to improve and become a better company for them.

Budgeting and planning system defines specific targets

The integrated planning system is based on strategic and operating goals. The Telefónica Deutschland Group sets internal objectives for the group with regard to the most important performance indicators (› MANAGEMENT SYSTEM). To define a three-year plan, the anticipated market development as well as internal expectations with regard to progress in the areas of growth and efficiency evolution are discussed once a year. The first year of planning is depicted on a monthly basis in order to establish a detailed budget. For controlling reasons, the budget is updated twice a year. Alongside the results that have already been achieved and which are analysed as part of monthly reporting, current market developments and the additional opportunities or risks that are known at the relevant point in time are taken into account in the update. This prognosis is then used to introduce operational improvements and take advantage of new opportunities presenting themselves to the group.

Economic Report of the Group_

Overall Economic and Industry Conditions

The German economy is growing solidly./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.

Solid economic development in Germany
The German economy held its ground in a difficult global economic environment in 2016 and continued to develop positively. The strongest stimuli came mostly from the country's domestic strengths. According to initial calculations by the German Federal Statistical Office, gross domestic product (GDP) adjusted for calendar effects grew by around 1.8 % in 2016 compared to the previous year. The strongest stimuli came mostly from the country's domestic strengths. The positive outlook in terms of income and employment, low energy prices and the pension adjustment provided a considerable boost to consumer spending. On average in 2016, Germany's economic performance was rendered by a working population of nearly 43.5 million. This is the highest level since 1991.

Trends on the German telecommunications market bring growth potential
The telecommunications industry is a major trailblazer for digitalisation, a process that is advancing and changing the world for the long term. This is leading to various trends in the telecommunications market:

The use of mobile devices such as smartphones, tablet computers and wearables is extremely important. The smartphone has developed from a communications device into a universal mobile companion. 61 % of people cannot imagine life without a smartphone, and the figure for 14- to 29-year-olds is as high as 70 %. Numerous services and apps, such as messaging and surfing the Internet, are now considered to be indispensable by a majority of Germans. On the one hand, smartphones are replacing products like digital compact cameras, mobile navigation devices and mp3 players. On the other hand, they are driving development on the market as interconnection with other devices opens up new growth areas. The smartphone is establishing itself as the control centre for other networked devices, and the range of potential applications is growing with every passing year. For example, smartphones can be used for the wireless transfer of music to multi-room systems, or smart TVs can be operated using an app. Household devices can also be activated and controlled remotely by smartphone. Wearables introduce additional functions and intelligent sensors to the smartphone concept. More than 2.9 million smart watches and fitness trackers are expected to have been sold in Germany in 2016.

In addition to connecting people, the intelligent connection of things via the internet (IoT) offers numerous application and growth opportunities, such as Industry 4.0, connected cars, smart health, smart energy and smart cities. Another trend is data analytics, which is facilitating new insights as well as new business models.

Demand for mobile data services and increased competition drives market development
With 116 million customers (SIM cards) at the end of September 2016, the German mobile telecommunications market is the largest in the EU. The notional mobile penetration rate was 141 %, i.e. each German citizen had an average of 1.4 mobile SIM cards. The customer growth from January to September 2016 remained attributable primarily to the more valuable postpaid sector. Overall, postpaid customers accounted for 53.0 % of total connections as of the end of September 2016. This share had been 52.1 % at the end of December 2015.

The mobile telecommunications market continued to develop dynamically in 2016, driven primarily by the strong demand for attractive smartphones and smartphone tariffs. According to a survey by the industry association Bitkom, 76 % of German citizens aged 14 or older currently use a smartphone. One year ago, the figure was still just 65 %. However, a slowdown in the growth of the smartphone market can be observed, driven by its increasing saturation and the fact that smartphones are being used for longer. According to the German Association for Consumer and Communication Electronics (gfu), around 16.6 million smartphones were sold in the period from January to September 2016, equating to a drop of around 4 % compared with the previous year.

Mobile media use resulted in growing mobile data usage. According to Dialog Consult, 774 million GB of data were transmitted on mobile networks in 2016, or 31 % more than in 2015 (591 million GB).

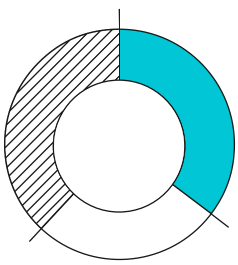
The increasing penetration of mobile end-devices with internet capability, such as smartphones or tablets, and the increasing use of mobile data services are also evident in the strong growth of revenues from mobile data in the German market: according to estimates by Analysys Mason, mobile data revenues increased by just under 7 % in 2016 compared with the previous year. By contrast, revenues from mobile telephony and SMS have fallen, driven by price decline, regulatory effects and changes in customer behaviour (› OVERVIEW OF THE FINANCIAL YEAR 2016).

Source: Company Data, Analysys Mason, Bundesbank, Bitkom, BMWi, Federal Statistical Office

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 mobile virtual network operators (MVNO). As of the end of September 2016, the Telefónica Deutschland Group had a market share of 38.0 % with around 44 million connections in total. It is therefore the largest German mobile telecommunications network operator in terms of number of customer connections.

G 12 — Market share in the mobile telecommunications market per customer (in %) at the end of September 2016



Source: Company Data/Quarterly Reports

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 5.6 % year on year; the customer base therefore grew to 31.7 million by the end of June 2016. This growth was driven in particular by cable and VDSL lines. The share of cable connections is now over 22 %, while VDSL also enjoyed strong growth. According to estimates by the market research company Analysys Mason, around 7.7 million customers were using VDSL at the end of 2016, 53 % more than one year earlier. 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 17 % compared with 2015 to 37.2 GB per connection.

Source: Analysys Mason, Dialog Consult/VATM Analyses and Forecasts, German Federal Network Agency

Regulatory Influences on the Telefónica Deutschland Group

As a provider of telecommunications services and an operator of telecommunications networks, the Telefónica Deutschland Group is required to meet certain regulatory requirements. As such, it is subject to supervision by the Bundesnetzagentur (BNetzA – German Federal Network Agency).

The key regulatory events affecting the Telefónica Deutschland Group in the year under review are discussed below:

Frequencies

BNetzA investigates frequency allocation in the 2 GHz range

Following its decision on 4 July 2014 on the frequency regulatory aspects of the Telefónica/E-Plus merger, the BNetzA is investigating the frequency allocation in the 2 GHz band. In early 2016, it started by consulting mobile network operators on the merger-related frequency allocation. On 7 March 2016, BNetzA expanded this consultation to include interested parties, which the Telefónica Deutschland Group also took advantage of until 15 April 2016. The investigation could result in reallocation in the 2 GHz band, although the Telefónica Deutschland Group does not consider there to be any justification for this. The investigation is expected to be concluded by the end of 2017 at the earliest.

BNetzA launches next steps in the further expansion of digital infrastructures

On 15 July 2016, the BNetzA published a “frequency compass” setting out the next steps in frequency regulation with a view to ensuring that new frequencies for the further expansion of digital infrastructures are provided on a needs-related basis. In addition to the frequency allocation investigation discussed above, the areas for action include the timely provision of the 2 GHz frequency allocations that are set to expire at the end of 2020 (UMTS frequencies) and other frequencies (e.g. 3.5 GHz), as well as the treatment of service providers, MVNOs and new market participants. The Telefónica Deutschland Group and other interested parties issued statements on these plans in good time. The BNetzA used the frequency compass to develop points of reference for the provision of frequencies for the expansion of digital radio infrastructures and opened these up for commentary from December 2016 to 1 March 2017, in which the Telefónica Deutschland Group will participate.

Telecommunications market

EU revises legal framework for telecommunications (telecoms review)

On 14 September 2016, the European Commission presented a proposal for a European Electronic Communications Code that would fundamentally revise the legal framework for the communications industry. The core aspects include extending the regulatory targets to include "encouraging investment in very high-capacity networks" and considerations on the regulation of OTT services. The proposal also contains regulations on frequency usage, access regulation and the future institutional framework. Although it sets out a right course of action, the proposal also involves uncertainties, meaning that a conclusive assessment of the opportunities and risks is not yet possible. The proposal will form part of the EU legislative process in 2017. The EU regulations are not expected to be finalised before 2018 and would then have to be implemented into national law.

EU issues new Payment Services Directive II

The EU has issued a revised Payment Services Directive II. It supersedes the Payment Services Directive I and must be implemented into national law by 13 January 2018. Particularly relevant areas for the Telefónica Deutschland Group are the revised provisions on billing for third-party digital goods via phone bills. In future, the exemption from payment services supervision in this area will apply for amounts only up to EUR 50 per transaction and a maximum of EUR 300 per month where no payment services licence is held. The new legislation also introduces reporting obligations to the German Federal Financial Supervisory Authority. These changes could result in adjustments to and restrictions on billing for such services, as well as implementation costs.

New net neutrality and transparency requirements under the Telecoms Single Market Regulation (TSM-R)

The TSM-R, which came into force in November 2015, contains provisions on net neutrality and transparency that have been required to be observed since 30 April 2016. BEREC, a body of European regulators, published guidelines for implementing the provisions on 30 August 2016. These provide for a restrictive interpretation of the provisions; among other things, this affects the regulations on bandwidth disclosures and involves sales risks. It remains to be seen how the BNetzA will apply these guidelines in its regulatory practice.

BNetzA issued transparency regulation

To strengthen the position of consumers, the BNetzA issued a regulation containing measures aimed at increasing the transparency of mobile and fixed line telephone and internet services. Among other things, 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. The regulation has been promulgated in December 2016. The provisions will come into force on 1 June 2017, in some parts, only on 1 December 2017.

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

The Gesetz zum besseren Informationsaustausch bei der Bekämpfung des internationalen Terrorismus (German Act for Better Information Sharing to Combat International Terrorism) came into force in late July 2016. This also amends section 111 of the Telekommunikationsgesetz (TKG – German Telecommunications Act), which stipulates which customer data must be collected and stored before a connection is activated. From 1 July 2017, this section will require the accuracy of the customer data collected to be checked by means of certain identification documents or other methods having been determined by the BNetzA in December 2016 before a prepaid SIM card is activated. The possibility that these regulations will entail considerable complexity in data collection and restrictions in sales opportunities for the industry cannot be ruled out.

Charges

The Telefónica Deutschland Group adjusts roaming tariffs

The TSM-R, which came into force in November 2015, sets out changes to the existing roaming regulation. It provides for an end to roaming charges for end customers on top of their domestic tariff ("roam like at home") in two phases. Since 30 April 2016, EU roaming is subject to the respective domestic tariff plus charges in the amount of the current maximum wholesale charges. 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. From 15 June 2017, providing that the wholesale roaming market is subject to new regulation, the domestic tariff plus charges in the amount of the maximum wholesale charges applicable at the respective date may only be charged above a fair use threshold that is still to be defined. The European Commission has published a corresponding proposal, which was finally adopted in December 2016. The wholesale roaming market also requires new regulation. In November 2015, the European Commission initiated a corresponding review of the wholesale roaming market in order to assess what measures are required to enable the elimination of roaming charges for consumers from 15 June 2017. The Commission submitted a report and a legislative proposal on this in June 2016, which was then amended several times. Having consulted several proposals for wholesale roaming caps, an agreement has been reached on 1 February 2017 on EU level, which still needs to be officially approved by the EU member states and the EU Parliament.

BNetzA prepares decision on MTR and FTR

The mobile termination rates (MTR) of 1.66 euro cents per minute expired at the end of November 2016. The regulatory decision for the new rates issued by the BNetzA on 30 August 2016 provides for a new cost benchmark for calculating the MTR in the form of Pure LRIC (LRIC = long-run incremental costs), which could lead to significant reductions. The Telefónica Deutschland Group has appealed the decision purely as a precautionary measure. In response to the rate application by the Telefónica Deutschland Group on 21 September 2016, the BNetzA defined new rates in a preliminary decision on 30 November 2016: The rates will be reduced to 1.1 euro cents per minute from 1 December 2016, 1.07 euro cents per minute from 1 December 2017 and 0.95 euro cents per minute from 1 December 2018. Before a final decision is taken by the BNetzA, the rates will be subject to national consultation and the European Commission will then be notified.

The current fixed termination rates (FTR) of 0.24 euro cents per minute expire at the end of December 2016. For the new rates, the BNetzA consulted nationally on drafts of a regulatory decision for Deutsche Telekom and for the alternative local exchange carriers and notified the European Commission accordingly. The drafts also provide for Pure LRIC as the new cost benchmark, which could lead to significant reductions. Applications for the approval of FTR from 1 January 2017 were submitted by Telekom Deutschland in September and by the alternative local exchange carriers – including the Telefónica Deutschland Group – in late October 2016. Preliminary rate approval for Telekom Deutschland was granted in December 2016 with significant price reductions, and the preliminary approvals for the alternative local exchange carriers are expected by mid-February 2017 at the latest, with the latter taking retroactive effect from 1 January 2017.

BNetzA takes final decision on local loop access for local vectoring

BNetzA has completed its proceedings on local loop access for local vectoring in consultation with the European Commission and took its final decision on 1 September 2016. This significantly increases the proliferation of vectoring in the Telekom Deutschland network, which will benefit the Telefónica Deutschland Group through the conversion of its own local loop access platform to future-oriented bitstream connections.

Overview of the Financial Year 2016

In 2016 we continued to drive momentum in an increasingly competitive environment./Executing integration according to the plan./Full year mobile service revenues, OIBDA before exceptional and special effects and CapEx in line with expectations./Further increased profitability.

In 2016, Telefónica Deutschland Group continued to drive momentum in an increasingly competitive environment in the German mobile market, in particular in the non-premium segment. We leveraged our investments in the O_2 brand and thus the premium segment with a clear focus on retention and the development of the customer base. The launch of O_2 Free at the beginning of the fourth quarter further enhanced our market positioning.

At the same time, we executed according to plan with the integration of E-Plus and delivered upon the synergies. 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 of the network integration and the finalisation of the migration of the postpaid and prepaid customer base of BASE and E-Plus to O_2. While progressing well with the integration we increasingly shifted our focus towards the digital transformation of the company and as such to simplification and automatization of our processes, digitalization and new business areas such as IoT and ADA.

As of the end of December 2016, Telefónica Deutschland Group's access base increased by 2.0 % year-on-year to 49.3 million on the back of a 2.9 % year-on-year growth of the mobile base, which stood at 44.3 million accesses. Mobile postpaid continued to show good momentum in the market (almost 1.3 million net additions[2] in 2016 compared to 0.7 million[3] in prior year). The postpaid customer base grew 7.6 % year-on-year to 20.5 million accesses as of 31 December 2016 on the back of an increasingly strong performance of the partner business. The mobile prepaid customer base was broadly stable year-on-year at 23.8 million accesses (-0.8 %).

As expected, mobile service revenues (MSR) declined 1.7 % year-on-year for January to December to EUR 5,437 mil-

2 Excluding reclassification of 172 thousand customers from prepaid to postpaid as part of the customer migration activities.

3 Excluding an impact from a business customer base harmonisation at the E-Plus Group Gruppe in the forth quarter 2015.

lion, 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 in the form of a cut of the European roaming fees and mobile termination rates within Germany.

Operating Income before Depreciation and Amortisation (OIBDA) in 2016 (EUR 2,069 million) benefitted from the 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 (› SIGNIFICANT EVENTS). It also continued to reflect the synergies, both from the roll-over effect from initiatives executed in prior year and the projects executed in 2016; as well as transformation-related Opex effects that peaked in the first half of the year.

In line with our expectations, OIBDA before exceptional and special effects in 2016 grew 3.8 % year-on-year to EUR 1,828 million in line with our expectations, with in-year savings from integration activities (OPEX and revenue) amounting to approximately EUR 150 million. The OIBDA margin increased by 2.0 percentage points year-on-year to 24.4 %.

As expected, CapEx grew 6.7 % year-on-year in 2016 to EUR 1,102 million. Telefónica Deutschland Group executed according to plan with back-end loaded CapEx phasing across the year.

Business development is further detailed in the following sections.

Results of Operations

Revenues decline to EUR 7.5 billion./Mobile service revenues down slightly as expected./Expenses decline due to the realisation of synergies./OIBDA before exceptional and special effects increases to EUR 1.8 billion.

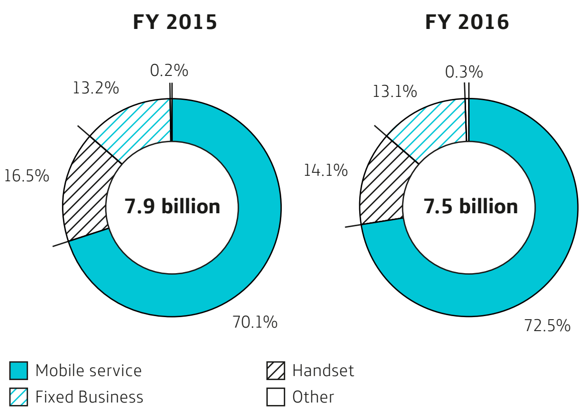
Decline in revenues

In the financial year 2016, our revenues declined by EUR 385 million or 4.9 % to EUR 7,503 million. This is due to the decrease in revenues from mobile business, especially handset revenues. The decline is mainly driven by the saturation of the market and extended purchase cycles for handsets by our customers. Mobile service revenues also decreased slightly. This was partially due to regulatory effects in connection with the reduction in mobile termination rates (MTR) and roaming charges (› REGULATORY INFLUENCES ON THE TELEFÓNICA DEUTSCHLAND GROUP). Furthermore, the reduction in mobile service revenues also reflects the increasingly competitive dynamics and the associated strength of the partner business, which resulted in a higher share of wholesale revenues. The positive effect from increasing demand for mobile data continued and therefore mobile data business (without SMS) further increased. This outweighed the decrease of the SMS revenue. Revenues from fixed business were lower due to the smaller DSL customer base and phasing of promotions.

T 01 — Overview 2016

(Euros in millions)	Base line 2015	Initial Outlook 2016 (year-on-year pct. growth)	Updated Outlook 2016 (year-on-year pct. growth)	Full Year 2016 (year-on-year pct. growth)	Evaluation
MSR	5,532	Slightly negative to broadly stable	Slightly negative	(1.7 %)	As expected
OIBDA before exceptional and special effects	1,760	Low to mid-single-digit % growth	Low to mid-single-digit % growth	+3.8 %	As expected
CapEx	1,032	% growth in the low tens	Mid to high single-digit % growth	+6.7 %	As expected

G 13 — Revenues (in % and Euros in billions)



Mobile service revenues down slightly

Our mobile service revenues amounted to EUR 5,437 million in the financial year 2016. In line with our expectations, this figure was down slightly by EUR 95 million or 1.7 % as against the previous year. Excluding regulatory effects, however, the year-on-year decrease would have been just 1.1 %.

The German market was increasingly demanding and competitive, which in part led to the downturn. However, a significant portion of the downturn can also be attributed to the company's shift form retail to partner business resulting in higher wholesale revenues. We retained our focus on customer retention measures and upselling mechanisms for our own brands. In addition, recognised strong growth in customer numbers for our partner brands in particular. Accordingly, our postpaid mobile customer base grew by 1.3 million net adds[4] to 20.5 million in the financial year 2016 (increase in the financial year 2015: 0.7 million)[5], which resulted in an increase in the share of postpaid customers in our mobile customer base of 2.0 percentage points to 46.3 %. Due to a lower price level in our partner business, the average revenue per user (ARPU) declined accordingly to EUR 10.3 compared with the previous year (2015: EUR 10.7). 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_2 Blue All-in" portfolio and the launch of the new O_2 Free portfolio and our customers' use of the data automatic and data upselling mechanisms (› GOALS AND STRATEGIES). Revenues from mobile data business amounted to EUR 2,992 million in financial year 2016. This represents an increase of EUR 152 million or 5.3 % compared to prior year. Revenues from mobile data business as a percentage of revenues from mobile services increased by 3.7 percentage points from prior year to 55.0 %. This is primarily driven by revenues from mobile data business excluding SMS, which increased by 5.3 % to a share of 76.9 % over total revenues from mobile data business.

Handset revenues down

Handset revenues are subject to fluctuation, as they depend on the launch of new mobile devices. In the financial year 2016, handset revenues amounted to EUR 1,061 million, EUR 239 million or 18.4 % 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).

Revenues from mobile business, comprising mobile service revenues and handset revenues, amounted to EUR 6,498 million in the financial year 2016. This corresponds to a year-on-year decline of EUR 334 million or 4.9 %.

Decelerated decline in revenues from fixed business

In the financial year 2016, revenues from fixed business amounted to EUR 981 million. This corresponds to a decline of EUR 62 million or 5.9 % compared with the previous year, whereas VDSL retail business momentum was strong. Slight growth in net adds was generated in the retail DSL business in general. We continued to benefit from spot trading opportunities in the carrier voice business, while wholesale DSL declined in line with expectations. DSL retail revenue contributed to the overall decline in fixed on the back of a broadly stable year-on-year customer base and the phasing of promotional effects.

Other revenues increase slightly

In the financial year 2016, other revenues increased by EUR 11 million year on year to EUR 23 million.

Growth in other income due to exceptional effects

In the financial year 2016, other income increased by EUR 237 million or 89.3 % year on year to EUR 502 million. The figures for both 2016 and 2015 included exceptional effects. In the financial year 2016, these included a one-time net capital gain from the sale of passive tower infrastructure to Telxius S.A. (› SIGNIFICANT EVENTS) In the financial year 2015, they included a non-recurring net gain on the disposal of yourfone GmbH in the amount of EUR 15 million and income from an agreement on the final purchase price for the acquisition of the E-Plus Group in the amount of EUR 104 million.

4 Not included: 172 thousand customers which were reclassified from prepaid to postpaid due to the migration of the customer base.

5 Excluding effects due to harmonisation of E-Plus Group's customer base.

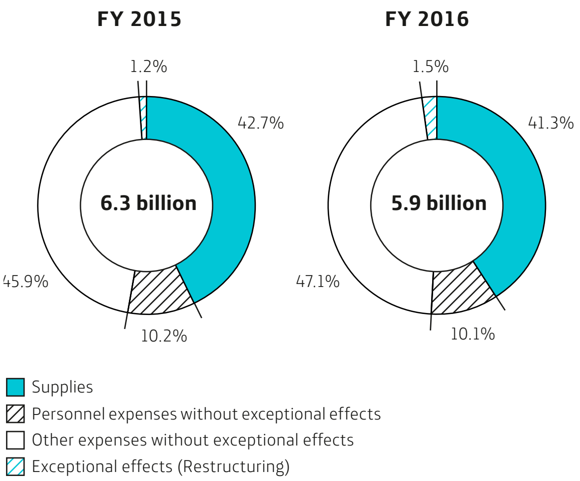
T 02 — Revenue Breakdown

(Euros in millions)	2016	2015	Change	% Change
	January 1 to December 31			
Mobile business	**6,498**	**6,832**	**(334)**	**(4.9)**
Mobile service revenues	5,437	5,532	(95)	(1.7)
Handset revenues	1,061	1,300	(239)	(18.4)
Fixed business	**981**	**1,043**	**(62)**	**(5.9)**
Other revenues	**23**	**12**	**11**	**92.4**
Revenues	**7,503**	**7,888**	**(385)**	**(4.9)**

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

In the financial year 2016, operating expenses, comprising supplies, personnel expenses and other expenses, decreased by EUR 413 million or 6.5 % year on year to EUR 5,936 million. The decrease in operating expenses is primarily due 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 the amount of EUR 89 million in total were recognised in both personnel expenses and other expenses.

G 14 — Operating Expenses (in % and Euros in billions)



Decline in supplies driven by lower revenues

In the financial year 2016, supplies amounted to EUR 2,452 million. This corresponds to a year-on-year decline of EUR 260 million or 9.6 % especially due to lower expenses for handsets sold as a result of the decreased demand for mobile devices. Additionally, the decline was driven by a decrease in expenses for interconnection services on the basis of lower voice communication as well as regulatory effects from reduced payments related to a cut in MTR and roaming charges, both corresponding to lower service revenues.

Slight year-on-year decrease in personnel expenses

In the financial year 2016, personnel expenses decreased slightly by EUR 9 million or 1.4 % to EUR 646 million. Adjusted for personnel-related restructuring expenses (2016: EUR 46 million; 2015: EUR 4 million), personnel expenses would have been 7.9 % lower than in the previous year as a result of the reduction in the number of FTEs following the workforce restructuring programme in 2015.

Decrease in other expenses

In the financial year 2016 other expenses amounted to EUR 2,838 million, a decrease of EUR 144 million or 4.8 % compared with the financial year 2015. Other expenses includes EUR 23 million higher operating lease expenses and other effects in connection with the sale of passive tower infrastructure to Telxius S.A. as well as restructuring expense in total amounted to EUR 43 million (2015: EUR 69 million), primarily due to the network and IT consolidation. Adjusted for restructuring expenses the decrease would have amounted to 4.0 %. Savings resulted from the synergy initiatives starting in 2015, but were partly offset by commercial and other investments especially related to customer migration activities in the financial year 2016.

Progress in integration reflected in positive OIBDA development

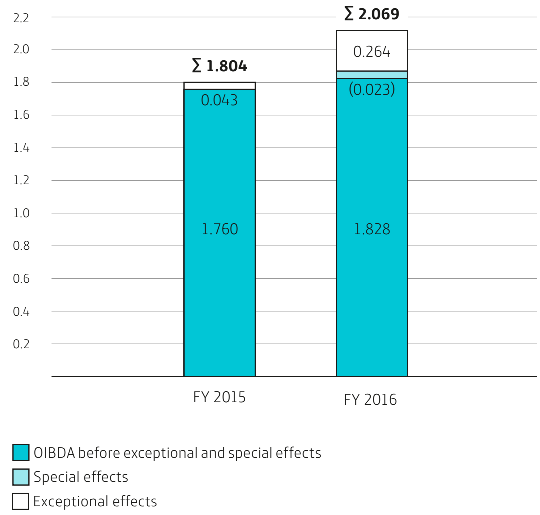
We generated OIBDA adjusted for exceptional and special effects of EUR 1,828 million in the financial year 2016, corresponding to a growth of EUR 68 million or 3.8 %. This reflects the lower cost base predominantly driven by the realisation of synergies such as the decommissioning of mobile sites in the course of the network integration. At 24.4 %, the resulting OIBDA margin before exceptional and special effects was up by 2.0 %-points compared with the prior-year figure.

Exceptional effects in the financial year 2016 include restructuring expenses of EUR 89 million and the net gain on the sale of passive tower infrastructure to Telxius S.A. in the amount of EUR 352 million. In the financial year 2015, they included a non-recurring net gain on the disposal of yourfone GmbH in the amount of EUR 15 million, restructuring expenses of EUR 73 million and net income of EUR 102 million from an agreement on the final purchase price for the acquisition of the E-Plus Group also considering the consultancy fees of the project.

Special effects in the financial year 2016 comprise effects from the Telxius transaction on OIBDA (EUR 23 million). This relates primarily to higher operating lease expenses.

OIBDA for the financial year 2016 amounted to EUR 2,069 million, an increase of EUR 265 million or 14.7 % as against the previous year. This is in particular due to the one-time net capital gain from the sale of passive tower infrastructure to Telxius S.A. of EUR 352 million (› SIGNIFICANT EVENTS). At 27.6 %, the resulting OIBDA margin was considerably higher than in the previous year.

G 15 — OIBDA (Euros in billions)



Depreciation and amortisation essentially unchanged

Depreciation and amortisation increased slightly by EUR 52 million or 2.5 % to EUR 2,118 million during the reporting period (2015: EUR 2,067 million). The increase resulted from investments in software. This was offset by lower depreciation of property, plant and equipment due to the sale of the passive infrastructure (› SIGNIFICANT EVENTS).

Growth in operating income due to exceptional effects

Operating income improved by EUR 213 million year on year to EUR -50 million (2015: EUR -263 million). This increase

T 03 — Consolidated Income Statements

	January 1 to December 31			
(Euros in millions)	**2016**	2015	Change	% Change
Revenues	**7,503**	**7,888**	**(385)**	**(4.9)**
Other income	502	265	237	89.3
Operating expenses	(5,936)	(6,349)	413	(6.5)
Supplies	(2,452)	(2,712)	260	(9.6)
Personnel expenses	(646)	(655)	9	(1.4)
Other expenses	(2,838)	(2,982)	144	(4.8)
Operating income before depreciation and amortization (OIBDA)	**2,069**	**1,804**	**265**	**14.7**
OIBDA margin	**27.6 %**	**22.9 %**		**4.7 %-p,**
Depreciation and amortization	(2,118)	(2,067)	(52)	2.5
Operating income (expense)	**(50)**	**(263)**	**213**	**(81.1)**
Net financial income (expense)	(36)	(48)	11	(23.9)
Profit (loss) before tax for the period	**(86)**	**(311)**	**225**	**(72.3)**
Income tax	(90)	(72)	(18)	24.8
Total profit (loss) for the period	**(176)**	**(383)**	**207**	**(54.0)**

is due primarily to the sale of passive tower infrastructure to Telxius S.A., which resulted in a net capital gain of EUR 352 million (› SIGNIFICANT EVENTS). This was offset by the net income of EUR 102 million from an agreement on the final purchase price for the acquisition of the E-Plus Group also considering the consultancy fees of the project and net proceeds on the sale of yourfone GmbH of EUR 15 million included in the previous year.

Net financial expense improves due to lower interest
Net financial expense for 2016 amounted to EUR -36 million (2015: EUR -48 million). It improved as a result of the lower level of interest due to the full repayment of the loan from Telfisa Global B.V. in 2016. This effect is partly compensated due to interest expense for the revolving credit facility concluded in March 2016.

The Telefónica Deutschland Group did not record any positive taxable income in 2016 and hence will not pay any current income tax once again. Accordingly, the tax expenses of EUR 90 million in the financial year primarily relate to changes in deferred taxes. In the previous period, an expense of EUR 72 million resulted from deferred taxes.

The aforementioned effects resulted in a loss for the period of EUR -176 million for 2016 compared with EUR -383 million in the previous year.

Financial Position

The net leverage ratio will be kept at or below 1.0x in the medium term./Net financial debt amounts to EUR 798 million./Net leverage ratio 0.4x./Free cash flow increases to EUR 1.408 million as a result of the sale of passive tower infrastructure to Telxius S.A.

Principles and goals of financial management

Risk control and a central management are the fundamental principles of financial management at the Telefónica Deutschland Group. The goal of financial management is to continually ensure sufficient financial liquidity and stability. Risk controls are used in order to anticipate potential risks and counteract them using corresponding measures. At present, there are no circumstances which would indicate that Telefónica Deutschland Group cannot meet its financial obligations.

One key performance indicator in this respect is the net leverage ratio. The Telefónica Deutschland Group intends to maintain a net leverage ratio at or below 1.0x (“target leverage”) in the medium term. The company has decided to refrain from paying dividends by distributing capital or capital reserves in cash or buying back shares if the net leverage ratio materially and consistently exceeds the target leverage of 1.0x.

Finance

Borrowed capital is procured using credit facilities and capital market instruments.

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 50 million had been utilised as of 31 December 2016. It serves general business purposes and has a term of five years. The loan term can be extended to no later than March 2023.

Financing agreement signed with European Investment Bank (EIB)
On 13 June 2016, the Telefónica Deutschland Group signed its first financial agreement with the EIB, which amounted to EUR 450 million. Telefónica Deutschland Group utilised the facility by an amount of EUR 250 million in the reporting period which is intended 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.

Promissory notes and registered bonds
On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds with different maturities to 2032 and a total volume of EUR 300 million.

Bond liabilities
In November 2013, O2 Telefónica Deutschland Finanzierungs GmbH placed a bond with a nominal amount of EUR 600 million and a term of five years. In February 2014, this was followed by another bond with a nominal amount of EUR 500 million and a term of seven years. The issuer transferred the net proceeds on the issue of the bond to its shareholder Telefónica Germany GmbH & Co. OHG as a loan. Both of the bonds are guaranteed by Telefónica Deutschland Holding AG. The details are as follows:

T 04 — Nominal Amount

(Euros in millions)	Term from	until	Coupon p.a.
600	22 Nov. 2013	22 Nov. 2018	1.875 %
500	10 Feb. 2014	10 Feb. 2021	2.375 %

Intragroup loan repaid in full
In 2012, the Telefónica Germany GmbH & Co. OHG signed a loan agreement with the finance company of the Telefónica, S.A. Group, Telfisa Global B.V., as the lender, with an initial amount of EUR 1.25 billion and annual repayments of 20 % of the nominal amount. The remaining liability of EUR 500 million was repaid in full as of 21 April 2016, prior to maturity.

Unused credit facilities provide financial flexibility
The Group's financial flexibility remains secure thanks to the availability of unused credit facilities totalling EUR 1.675 million. This comprises bilateral revolving credit facilities with various banks in the amount of EUR 710 million with a remaining term of more than one year, the unutilised syndicated loan facility in the amount of EUR 700 million, available overdraft facilities from Telfisa Global B.V. in the amount of EUR 65 million, and the unutilised part of the financial agreement with the EIB in the amount of EUR 200 million.

Telefónica Deutschland Group continues to benefit from Telefónica, S.A. Group cash pooling
The Telefónica Deutschland Group will continue to participate in the liquidity management system of the Telefónica, S.A. Group. Agreements have been made with Telfisa Global B.V. for deposits and liquidity management. The liquidity of the entire Telefónica, S.A. Group is centralised by means of these agreements. This allows us to benefit from the economies of scale of the entire Telefónica, S.A. Group. The cash pool means that the Group continues to have access to short-term overdraft facilities up to a maximum of EUR 65 million. Telefónica, S.A. has guaranteed the performance of Telfisa Global B.V.'s obligations arising from the cash pooling agreements.

Working capital strengthened by silent factoring
We have entered into factoring agreements with various credit institutions regarding the sale of receivables in order to strengthen our working capital. This mainly relates to factoring transactions for installment receivables with a total net cash effect of EUR 424 million in financial year 2016. The assigned receivables were derecognised. Further information on silent factoring can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2016 (› NOTE 5.4 TRADE AND OTHER RECEIVABLES).

Finance leases for mobile phones leased to end customers
The Telefónica Deutschland Group leases mobile phones to its end customers under lease agreements. In the past, devices relating to this business model were leased as part of a sale and leaseback agreement with the aim of ensuring a balanced cash flow. Because these leases are classified as finance leases, liabilities to the leasing company and receivables from the customer are recognised. The leases mostly have the same terms and payment arrangements. Since the beginning of the financial year 2015, no new refinancing sale and leaseback agreements have been concluded. The existing lease with the leasing company expired as of 31 December 2016. Further information can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2016 (› NOTE 5.10 INTEREST-BEARING DEBT).

Increased financial efficiency and payment flexibility due to extension of payment periods
In order to obtain greater financial efficiency and cash flexibility, the Telefónica Deutschland Group has entered into agreements with certain commercial suppliers to extend payment periods in 2015 and 2016 beyond the standard terms for the industry. Interest payments are expressly agreed for these extensions. This has entailed a change in the nature of debt in 2015 in the case of invoices affected by the deferral, from being trade liabilities to being financial debt. The interest agreed for the delay in the payment is recognised as financial expense. If the standard payment periods are not exceeded, the trade payables will continue to be recognised as such.

Finance analysis

Reduction in net financial debt despite dividend payment in part due to the sale of passive tower infrastructure to Telxius S.A.
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.

Net financial debt decreased by EUR 426 million to EUR 798 million as of 31 December 2016, resulting in a leverage ratio[6] of 0.4x.

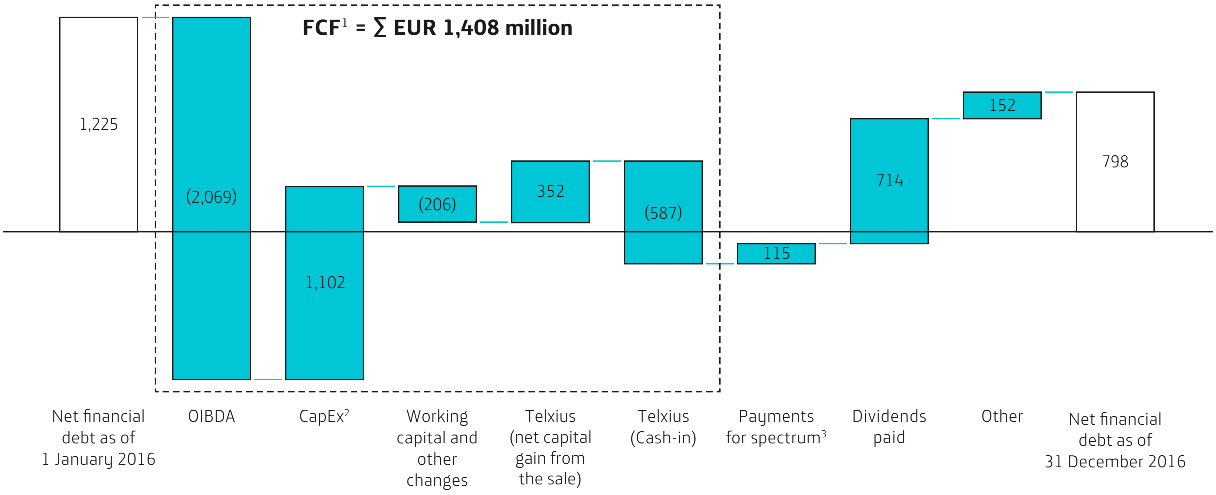
The reduction in net financial debt in the financial year 2016 was primarily affected by free cash flow before dividends and payments for spectrum of EUR 1,408 million. This was especially offset by dividend payment for the financial year 2015 (EUR 714 million), the decrease of handset receivables (EUR 156 million) and the payment in 2016 for mobile phone frequency auction amounting to EUR 111 million[7].

The › GRAPH 16: DEVELOPMENT OF NET FINANCIAL DEBT shows the development of net financial debt in the financial year 2016.

6 Leverage is defined as net financial debt divided by LTM (Last Twelve Months) OIBDA before exceptional and special effects (31 December 2016: EUR 1.828 million; 31 December 2015: EUR 1.760 million).

7 Excluding costs on borrowed capital.

G 16 — Development of net financial debt (Euros in millions)



1 Free cash flow before dividends and payments for spectrum.
2 Exkluding investments in spectrum (including capitalised costs on borrowed capital).
3 Including costs on borrowed capital.

T 05 — Development of consolidated financial debt

	As of December 31			
(Euros in millions)	**2016**	2015	Change	% Change
A Liquidity	613	533	80	15.0
B Current financial assets	251	324	(73)	(22.5)
C Current financial debt	31	564	(534)	(94.6)
D=C-A-B Current net financial debt	(833)	(292)	(541)	> 100.0
E Non-current financial assets	89	169	(80)	(47.2)
F Non-current financial debt	1,721	1,686	35	2.1
G=F–E Non-current net financial debt	1,631	1,517	115	7.6
H=D+G Net financial debt (1)	798	1,225	(426)	(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 245 million in 2016 and EUR 321 million in 2015; non-current: EUR 77 million in 2016 and EUR 157 million in 2015), positive fair value hedges for fixed interest financial liabilities (current: EUR 2 million in 2016 and EUR 2 million in 2015; non-current: EUR 12 million in 2016 and EUR 12 million in 2015) as well as loans to third parties (current: EUR 4 million in 2016 and EUR 1 million in 2015; non-current: EUR 0 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 1,422 million in 2016 and EUR 1,420 million in 2015), other loans (EUR 298 million in 2016 and EUR 501 million in 2015), finance lease payables (current: EUR 15 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 110 million (including capitalised costs of borrowed capital) are shown in trade payables to third parties in the Consolidated Statements of Financial Position and are therefore not included in the net financial debt calculation.

T 06 — Operating lease obligations, purchase obligations and other conctractual obligations

	Payment due by period			
(Euros in millions)	Less than 1 year	1 to 5 years	Over 5 years	Total
Operating lease obligations	535	1,265	992	2,793
Purchase obligations and other contractual obligations	1,129	47	692	1,868
Total	**1,664**	**1,312**	**1,684**	**4,661**

T 07 — Consolidated Statement of Cash Flows

(Euros in millions)	January 1 to December 31 2016	2015
Cash and cash equivalents at the beginning of the period	**533**	**1,702**
Cash flows from operating activities	1,859	1,838
Cash flows from investing activities	(455)	(1,984)
Cash flows from financing activities	(1,323)	(1,023)
Net increase (decrease) in cash and cash equivalents	**80**	**(1,169)**
Cash and cash equivalents at the end of the period	**613**	**533**

Off balance sheet obligations
Our contractual obligations decreased slighltly as of 31 December 2016 as shown in Table 6. The information in this table is based on estimates by the company's management with regard to the contractual maturity of our obligations. These may vary significantly from the actual maturity dates. The operating lease obligation increased by EUR 299 million to EUR 2,793 million especially due to the increase of future payments for antenna sites. The purchase obligations and other contractual obligations reduced by EUR 661 million to EUR 1,868 million especially due to lower hardware purchase orders and commitments.

Liquidity analysis

Consolidated Statement of cash flows
The following is an analysis of the cash flow development of the Telefónica Deutschland Group in the financial years 2016 and 2015.

Change in cash flows from operating activities up on previous year
Cash flow from operating activities amounted to EUR 1,859 million in the financial year 2016, a minor EUR 21 million or 1 % up on the previous year (2015: EUR 1,838 million).

Change in cash flows from investing activities positively driven by lower investments in frequency usage rights
Cash flow from investing activities amounted to EUR -455 million in the financial year 2016 (2015: EUR -1,984 million). Within this figure, cash inflows increased by EUR 504 million year on year, while cash outflows declined by EUR 1,024 million.

The increased cash inflows from investing activities were affected by the EUR 587 million cash inflow from the sale of passive tower infrastructure to Telxius S.A. (› SIGNIFICANT EVENTS). The decline in cash outflows was due primarily to the non-recurring effect of EUR 978 million due to investments in frequency usage rights in the previous year (2016: EUR 4 million). Investments in property, plant and equipment and intangible assets remained largely unchanged on the previous year.

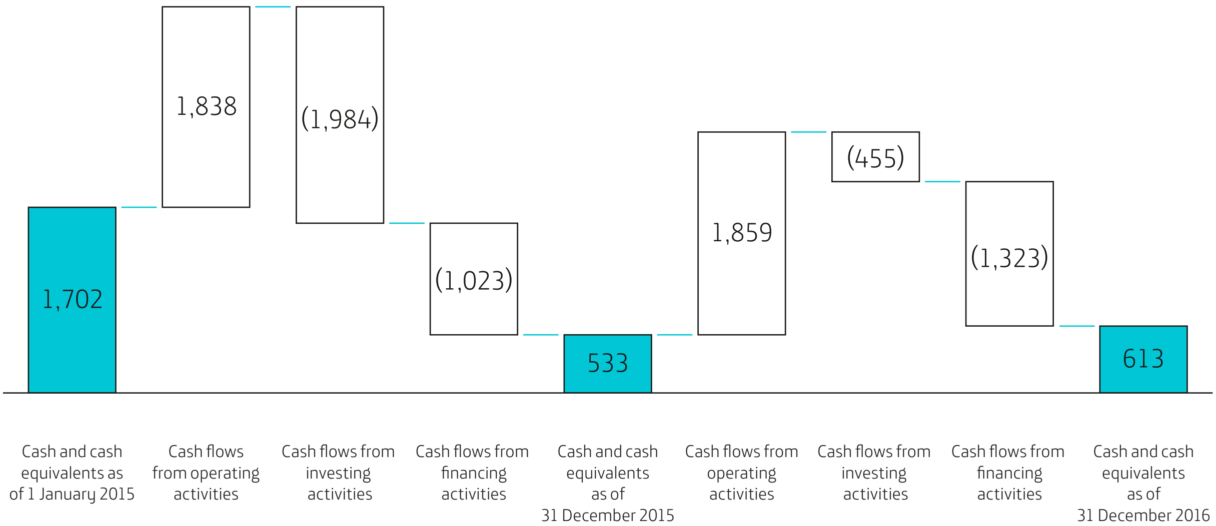
Change in cash flow from financing activities influenced in particular by loan repayment
Cash flow from financing activities amounted to EUR -1,323 million in the financial year 2016 (2015: EUR -1,023 million). The cash inflows from resulting from interest-bearing debt increased EUR 500 million as against the previous year. On the opposite cash outflows increased by EUR 801 million year on year.

The increase of cash inflows is mainly due to utilization of provided financing resources of EIB amounting to EUR 250 million. Furthermore, in the first half of 2016, EUR 600 million was drawn down from the syndicated credit facility concluded in March 2016 for this purpose; EUR 550 million of this figure was repaid as of 31 December 2016. The increased cash outflow was attributable primarily to the repayment of the outstanding loan from Telfisa Global B.V. in the amount of EUR 500 million. In addition, a cash outflow of EUR 111 million was recognised in the financial year 2016 for the next instalment of the investments in frequency usage rights conducted in 2015. Unlike the initial payment, the subsequent instalments are considered to represent financing and hence are allocated to financing activities.

Cash and cash equivalents higher year on year
The cash inflows and outflows described above led to a increase in cash and cash equivalents by EUR 80 million year on year. Cash and cash equivalents amounted to EUR 613 million as of 31 December 2016 (2015: EUR 533 million).

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 (› MANAGEMENT SYSTEM) before dividends and payments for spectrum as well as the acquisition of E-Plus

G 17 — Development of cash flows (Euros in millions)



T 08 — Calculation of cash flow and OIBDA minus CapEx

(Euros in millions)	1 January to 31 December 2016	2015	Change	% Change
OIBDA	**2,069**	**1,804**	**265**	**14.7**
- Other income and expenses resulting from finalization of purchase price[1]	–	(102)	102	(100.0)
- CapEx[2]	(1,102)	(1,032)	(70)	6.7
= Operating cash flow (OpCF)	**967**	**670**	**297**	**44.4**
+ Silent Factoring[3]	424	544	(120)	(22.1)
+/- Other working capital movements	(187)	(515)	328	(63.7)
Change in working capital	**237**	**29**	**208**	**> 100.0**
+/- Gains/(losses) from sale of assets	(352)	(15)	(337)	> 100.0
+/- Proceeds from sale of companies	–	57	(57)	(100.0)
+/- Proceeds from sale of fixed assets and other effects	591	1	590	> 100.0
+ Net interest payments	(23)	(33)	10	(31.1)
+ Proceeds/Payment on financial assets	(13)	(10)	(3)	29.7
= Free cash flow pre dividends and payments for spectrum[4] as well as pre-acquisition of E-Plus, net of cash acquired	**1,408**	**700**	**708**	**> 100.0**
+ Acquisition of E-Plus net of cash acquired[1]	–	132	(132)	(100.0)
= Free cash flow pre dividends and payments for spectrum[4]	**1,408**	**832**	**576**	**69.2**
- Payments for spectrum	(115)	(978)	863	(88.2)
- Dividends[5]	(714)	(714)	(0)	0.0
= Free cash flow post dividends and spectrum	**578**	**(860)**	**1,439**	**> (100)**

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 134 million. The differences between the preliminary purchase price and the final purchase price was recognized in an amount of EUR 30 million directly to goodwill within the twelve-month period. EUR 104 million less expenses to reach the agreement in the amount of EUR 3 million (of which EUR 2 million 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 424 million and of EUR 544 million 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 flows from operating activities and cash flows from investing activities and does not contain payments for investments in spectrum as well as related interest payments.
5 Dividend payments of EUR 714 million in May 2016 and EUR 714 million in May 2015 respectively.

increased by EUR 708 million, amounting to EUR 1,408 million as of 31 December 2016 (2015: EUR 700 million).

This development is attributable primarily to 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 297 million increase in operating cash flow (2016: EUR 967 million; 2015: EUR 670 million). The payment received for the purchase price receivable for the above sale to Telxius S.A. amounted to EUR 587 million (› SIGNIFICANT EVENTS).

The decrease of working capital of EUR 237 million in the financial year 2016 was higher than the EUR 29 million in the financial year 2015.This development is mainly due to the greater decline in the restructuring provision in the financial year 2015 than in the reporting period. Furthermore, liabilities for investments fell by EUR 55 million as of 31 December 2015, while they increased by EUR 72 million as of 31 December 2016.

Net Assets

The following analysis of the asset and capital structure compares the assets and liabilities as of 31 December 2016 with the figures as of 31 December 2015.

As of 31 December 2016, the Group reported total assets of EUR 15,301 million (31 December 2015: EUR 16,654 million). This represents a decrease of 8.1 %.

Decrease in intangible assets due in particular to amortisation

Intangible assets including goodwill amounted to EUR 8,146 million as of 31 December 2016 (31 December 2015: EUR 9,014 million). The decline of EUR 868 million or 9.6 % resulted from the amortisation of intangible assets with a finite useful life of EUR 1,210 million in the financial year 2016 (2015: EUR 1,090 million) and the decline in goodwill amounting to EUR 23 million due to the sale of Telxius Towers Germany GmbH (formerly Telefónica Germany Vermögensverwaltungsgesellschaft mbH) to Telxius S.A. (› SIGNIFICANT EVENTS). This was offset by the additions to intangible assets of EUR 366 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 4,217 million as of 31 December 2016 (31 December 2015: EUR 4,507 million). This represents a year-on-year decrease of EUR 291 million or 6.4 %. At EUR 277 million, this resulted in particular from the sale of passive tower infrastructure to Telxius S.A. (› SIGNIFICANT EVENTS). The decrease is also due to depreciation in the amount of EUR 908 million.

This was offset by additions in 2016 in the amount of EUR 742 million (2015: EUR 739 million), which related primarily to investments in faster network expansion, including the increased LTE expansion, the expansion of IP technologies and the expansion of mobile data services with even faster download speeds.

Additions to assets in property, plant and equipment relating to dismantling and removal obligations also increased by EUR 158 million, which was attributable primarily to the higher cost estimates based on new insights and to the interest rate trend.

Higher investments (CapEx[8])

Investments (CapEx) amounted to EUR 1,102 million in 2016 compared with EUR 1,032 million in the previous year. Telefónica Deutschland Group continued to invest into the roll-out of the LTE network, integration of the network as well as incurring higher software investments as a result of the system expansion for migration of E-Plus customers.

Year-on-year reduction in trade and other receivables

Trade and other receivables amounted to EUR 1,537 million as of 31 December 2016 and declined in comparison to the previous year (31 December 2015: EUR 1,677 million). The change of EUR -140 million or -8.3 % is mainly due to a decline in handset revenues and increased factoring volume.

Deferred tax assets down

Deferred tax assets amounted to EUR 427 million, a reduction by 15.6 % as against the previous year (31 December 2015: EUR 505 million).

Other financial assets up on previous year

Other financial assets amounted to EUR 85 million as of 31 December 2016, representing an increase of EUR 12 million or 16.7 % compared with the previous year (31 December 2015: EUR 73 million). This reflects primarily the increased security deposit for silent factoring.

Other non-financial assets decrease

Other non-financial assets amounted to EUR 191 million as of 31 December 2016 (31 December 2015: EUR 221 million) and comprise particulary advance payments for rent of antenna sites and leased lines.

Inventories of mobile devices decrease

Inventories amounted to EUR 85 million as of 31 December 2016 (31 December 2015: EUR 123 million). The decline of EUR 38 million or 30.7 % was due primarily to the reduction of devices on stock.

8 Excluding investments for licences in mobile phone frequency usage rights.

Year-on-year increase in cash and cash equivalents
Cash and cash equivalents totalled EUR 613 million as of 31 December 2016 (31 December 2015: EUR 533 million). This increase of EUR 80 million or 15 % is due to several effects (› FINANCIAL POSITION).

Interest-bearing debt down on previous year
Interest-bearing debt declined by EUR 496 million or 22 %, from EUR 2,254 million as of 31 December 2015 to EUR 1,758 million as of 31 December 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 both, payment periods and terms of interest and the EUR 180 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 48 million are included within the interest-bearing debt as of 31 December 2016. The facility of the financing agreement signed with EIB on 13 June 2016 was utilized in amount EUR 250 million as of 31 December 2016.

Year-on-year increase in provisions
Provisions increased by EUR 39 million or 5.4 %, from EUR 712 million as of 31 December 2015 to EUR 750 million at the reporting date. This increase related primarily to the change in non-current dismantling and removal of asset obligations totalling EUR 63 million. In addition to higher cost estimates based on new insights and an addition attributable to the interest rate trend of EUR 158 million, this change implied a disposal relating to the sale of passive tower infrastructure to Telxius S.A. of EUR 83 million (› SIGNIFICANT EVENTS). A further reason for the increase was due to the recognition of tax audit-related risks in connection with the VAT treatment of prepaid contracts. In contrast, the restructuring obligations declined by EUR 73 million, due mainly to scheduled consumption.

Decrease in trade and other payables
Trade and other payables amounted to EUR 2,303 million as of 31 December 2016, a decrease of EUR 122 million or 5.0 %, compared with 31 December 2015 (EUR 2,425 million). This was due in particular to the payment of the 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. In addition, the current portion of the outstanding payment obligation from the mobile frequency auction in the amount of EUR 111 million[9] was settled. This was offset by the EUR 72 million year-on-year rise in liabilities for investments made.

Other non-financial liabilities up on previous year
Other non-financial liabilities amounted to EUR 79 million as of 31 December 2016 (31 December 2015: EUR 48 million). These include VAT payables, wage taxes and social security contributions in particular.

9 Excluding costs on borrowed capital.

T 09 — Consolidated Statements of Financial Position

				As of December 31
(Euros in millions)	**2016**	2015	Change	% Change
Goodwill and other intangible assets	8,146	9,014	(868)	(9.6)
Property, plant and equipment	4,217	4,507	(291)	(6.4)
Trade and other receivables	1,537	1,677	(140)	(8.3)
Deferred tax assets	427	505	(79)	(15.6)
Other financial assets	85	73	12	16.7
Other non-financial assets	191	221	(30)	(13.8)
Inventories	85	123	(38)	(30.7)
Cash and cash equivalents	613	533	80	15.0
Total assets = Total equity and liabilities	**15,301**	**16,654**	**(1,353)**	**(8.1)**
Interest-bearing debt	1,758	2,254	(496)	(22.0)
Provisions	750	712	39	5.4
Trade and other payables	2,303	2,425	(122)	(5.0)
Other non-financial liabilities	79	48	32	66.7
Deferred income	1,002	895	107	12.0
Equity	**9,408**	**10,321**	**(912)**	**(8.8)**

Increase in deferred income

Deferred income increased by EUR 107 million or 12.0 % compared with 31 December 2015 and amounted to EUR 1,002 million as of 31 December 2016. The increase was mainly due to sales of vouchers at year end 2016. This was offset by services rendered in Mobile Bitstream Access Mobile Virtual Network Operator (MBA MVNO) agreement.

Equity declines

Equity declined by EUR 912 million or -8.8 % to EUR 9,408 million as of 31 December 2016. The change in equity is due primarily to the dividend payment of EUR 714 million on 12 May 2016, the loss for the period of EUR -176 million and effects captured in equity in relation to theremeasurement of post employment benefits in the amount of EUR -25 million.

Employees_

We would like to remain one of Germany's best employers to motivate our employees to grow with us and also to attract top talent in this increasingly competitive job market. The number of Telefónica Deutschland Group employees as of 31 December 2016 (9,476) is comparable to the prior year.

Our employees face the challenges of the rapid evolving Telecommunications industry which requires the constant development of new and relevant competencies for the digital era. We support the career development of our employees by offering a wide range of training programs and learning opportunities in areas like digital skills and leadership. We encourage our employees to invest in their career development and get aside sufficient time to allow them to succeed. We promote the conditions for our employees to achieve a positive work-life balance with measures such as flexible schedules and the opinion to work from home.

Management structure of the Telefónica Deutschland Group

The Management Board manages the commercial operations of the company and reports to the Supervisory Board.

In 2016, the upper level of management at the Telefónica Deutschland Group – the Corporate Board – was made up of the Management Board and the members of the Executive Committee.

The Corporate Board has a long-term perspective and addresses strategic orientation, new business ideas and end-to-end planning for the company as a whole.

It meets once a month in Munich or Düsseldorf.

The second level of management – the Senior Leadership Team – implements the strategic decisions of the Corporate Board.

Its core tasks are target attainment and all operational issues and decisions for the responsible business area.

As of 31 December 2016, the first level of management at the Telefónica Deutschland Group had a total of 14 members.

The Senior Leadership Team had 50 members.

Key priorities for personnel management

Business transformation

In 2016 a number of initiatives were implemented in order to keep driving Telefónica Deutschland Group's integration and transformation into the leading digital "onlife" telco. These initiatives include measures for the reorientation of our resources and our core business to reflect the corporate strategy.

Cultural change

Our cultural change initiatives inspire our employees to question processes, products and ways of thinking in order to address our customers' expectations to the greatest possible extent. We give our employees the necessary freedom to make decisions and motivate them to actively approach our customers. This cultural framework ultimately also forms the basis for our innovations.

Employee promise

Our employee promise to reward our employees for their performance goes beyond the purely material side. Additionally to the salary and fringe benefits, we offer a very good work-life balance and flexible working hours. This allows us to foster the loyalty of our employees and attract the best talent in Germany. We participate in relevant recruitment trade fairs and events in Germany, where we promote ourselves as an attractive employer.

Operational excellence

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

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

In order to harmonise our payroll processes and improve efficiency in this area, we have outsourced payroll accounting for E-Plus Mobilfunk GmbH to our long-standing partner of Telefónica Germany GmbH & Co. OHG, fideles HR GmbH.

Number of employees
In 2016 the Telefónica Deutschland Group had 9,272 employees (2015: 10,080 employees) based on an average calculation of the number of employees at the end of each quarter in 2016 and 2015, respectively.

The Group had a total of 9,476 employees at the end of 2016 (2015: 9,464 employees). The fluctuation rate was 17.9 % (2015: 21.8 %). The fluctuation during the financial year is primarily caused by the implementation of the restructuring plan. This is offset mainly by the insource of external consultants, particularly in Customer Service.

The business has a relatively young workforce. The average age of our employees in 2016 was around 39.5 years (2015: 39.5 years). A total of 1,882 employees, representing around 20 % of the workforce, worked on a part-time basis at year-end 2016 (2015: 1,912 employees, 20 %). These figures are based on figures at the balance sheet date of the years 2016 and 2015.

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

Female employees accounted for 40.8 % of our workforce in 2016 (2015: 39.9 %). At the end of the financial year 2016, nine women in leadership positions (2015: ten) were represented in the business-leading Senior Management, corresponding to a proportion of 15.0 % (2015: 15.2 %). We achieved first place out of 100 listed German corporations in the Women-on-Board Index 100 II 2016.

At the end of 2016 there were 74 nationalities represented in the Telefónica Deutschland Group. People with disabilities are also welcome in our corporation. Because we take our responsibility for inclusion very seriously, we have opened a barrier-free career portal, which went online at the end of 2012. In this way, we create direct access for and to qualified persons as part of our employer branding. In addition, we have been working with Stiftung Pfennigparade (Penny Parade Foundation) since 2009 in order to provide a work-related perspective for people with disabilities. At the end of 2016, 276 employees with disabilities were employed at our company (2015: 269).

We regularly measure employee satisfaction. We conduct an employee survey once a year to measure employee engagement and the general work climate. In light of the ongoing integration, we ask selected employees to provide us with additional feedback in quarterly "pulse checks" focusing on the progress of the transformation. We use both surveys as important indicator for how we lead and shape the organisation. We support our employees with a wide range of programmes to balance work and personal life, including the time before and during parental leave and their subsequent easing during their return to work. In addition we offer a comprehensive range of services for families in cooperation with external partners. In this way we support our employees in the search for the right childcare or for care opportunities for relatives and broker private tuition or household help.

All these initiatives aimed at increasing our employees' satisfaction and foster their loyalty even more.

Attractiveness as an employer
Our attractiveness on the employment market is reflected in the number of external candidates. In the past year we have made 1.657 external hires.

Training and further education are important goals
One of our most important goals in 2016 was to further develop our employees' skills. In 2016 the Telefónica Deutschland Group invested a total of EUR 7 million in the training and further education of its employees (2015: EUR 6 million). This represents an increase of around 17 % of the expenditure in this area compared with the previous year (2015: 46 %) also resulting from a higher proportion of online training courses and web seminars. In 2016 a total of 7,177 employees participated in one of our further education courses (2015: 8,800 employees). The number of course hours taken up amounted to 69,348 hours in the reporting year (2015: 186,500).

The Telefónica Deutschland Group's training system was decentralised in order to achieve a more efficient internal training organisation. Every business unit appointed one training coordinator. The decentralisation brings us one major advantage: a more targeted and efficient training offer, as the business units are closer to the target groups and have a much better understanding of their needs.

This decentralisation has one exception: leadership, change and cultural training will remain the responsibility of HR. Furthermore all training regarding compliance, data protection, industrial safety and safety guidelines referring to the exchange of information will be organised by the General Counsel.

Management training on corporate strategy and culture, leadership and personal development has been held at Universitas in Barcelona since 2008.

The objective is to achieve an understanding of the global strategy and the Telefónica environment, to train individual leadership skills and to promote international networking.

In addition, content from the Telefónica Universitas were brought to Germany in a "Universitas on the Road" programme with great success. The aim of this programme was to help managers in times of transformation to motivate their teams, share their vision and shape the transformation together.

In total, over 200 Telefónica Deutschland managers took part in the Universitas programmes in 2016, completing 6,844 hours overall in 2016.

Apprenticeships and dual study with more in-depth practical elements secure future employees

By training talented young individuals, we secure our future and, at the same time, fulfil the social responsibility that we bear as an employer. In the financial year 2016, we prepared 83 young people (apprentices and dual students) for their professional future at our company (2015: 120). A total of 69 (2015: 55) young people successfully completed their apprenticeship, and we were able to hire on 53 (2015: 44) of them, or 77 %.

We offer those starting their studies the opportunity to complement their studies with in-depth practical experience in various departments of our company. Our dual students complete the theoretical part of their studies at various universities in Stuttgart, Munich, Nuremberg, Mettmann and Hamburg. Subject areas include business administration, electrical engineering and information technology, computer science, business informatics and international management. In 2016, 35 (2015: 51) students took advantage of this opportunity.

Onlife Graduates: Telefónica's graduate programme

Our graduate programme Onlife Graduates is an innovative and attractive concept that we developed to acquire highly qualified graduates and rolled out in November 2016. It offers 13 university graduates the opportunity to gain experience both in the corporate world of Telefónica and on the start-up scene. The Onlife Graduates are assigned to specific departments during their 18-month programme, where they hold an entry-level position and assure operative responsibilities. At the same time, we support them in the development of their own business idea, which they will need to design and implement within a year. The programme aims to acquire and develop talented individuals who can actively help to shape and promote our transformation into the digital "onlife" telco. Moreover this unique offer makes us an attractive employer on the increasingly competitive employment market.

Corporate Responsibility_

CR measures are focused on the whole value chain./ As a fair partner of our customers and stakeholders, we want to set standards./Everyone should be able to benefit from the opportunities provided by the digital world./ Our products and services harness the potential of digitalisation to improve quality of life./We protect the climate by consistently reducing the environmental impact of our operations.

Corporate responsibility has long been one of the guiding principles of our company. With our new position as the largest mobile telecommunications provider in Germany, not only have our stakeholders' expectations increased; our own aspirations to act responsibly have risen too. For us, digital technologies are a crucial pacemaker of a sustainable development, as they allow us to develop responses to the big future issues. The Telefónica Deutschland Group wants to use the key raw materials of digitalisation – connectivity and data – responsibly and for the benefit of society. This requires us to keep an eye on the effects of all our business activities on people and the environment. The company presents annually the associated targets and measures transparently in its own CR Report. With it, we take into account established standards of sustainability reporting such as the Global Reporting Initiative (GRI). This does not only facilitate our participation in important sustainability ratings and rankings. It also shows that we manage CR issues efficiently in order to reduce costs and risks, increase market value and raise the resilience of the company.

Implementing the corporate responsibility strategy in a targeted and efficient manner

In a multistage process in 2015 the Telefónica Deutschland Group developed a comprehensive strategy that anchors corporate responsibility in all company levels and throughout the entire value chain. A key result was the definition of three CR focal-point areas with direct reference to the effects of our business activity: "responsible business", "strengthening life in the digital world" and "environmental and climate protection". We have combined these and company-relevant CR issues within the framework of a materiality analysis into a topic matrix that includes the perspectives of both the management and the stakeholders.

The dialogue with employees, customers, suppliers, shareholders and non-governmental organisations provides us with important impetus for the further development of our CR strategy. The Telefónica Deutschland Group wants to be a fair partner for all stakeholders, as it is only with their cooperation that the digital world can be made sustainable.

The Corporate Responsibility department has the task of developing and implementing the CR strategy in line with the corporate strategy and the global CR strategy of the Telefónica, S.A. Group. Under the responsibility of the Director Corporate Affairs, who reports directly to the CEO, the division manages all CR activities interdepartmentally, monitors the achievement of targets and initiates new projects. Therefore, the CR department remains in close contact with the other departments, particularly via the interdepartmental CR Committee. The Management and Management Board check and approve the CR targets.

The next step: our Responsible Business Plan

In 2016 we interwove our CR efforts even more closely with the core business of the Telefónica Deutschland Group. The Responsible Business Plan is the consistent further development of the CR strategy. On the basis of a gap analysis and internal workshops with our relevant departments, we formulated overarching targets for the years leading up to and including 2020. They have been allocated to our three focal-point areas and were formulated along the topic matrix. We are embedding them in high-level ambitions that will serve us as important milestones on our way.

In order to achieve these goals, the CR department and the relevant departments have jointly developed commitments and meaningful key performance indicators (KPI). As to how the measures for the various CR issues will be implemented, the company describes this in detail in the 2016 CR Report and in condensed form in the following sections.

Responsible business

For success in the digital world and the development of sustainable solutions, the Telefónica Deutschland Group builds on a fair partnership with the stakeholders.

G 18 — Telefónica's Responsible Business Plan 2020
Our future. Our aspiration.

Responsible business

We are a fair and trustworthy partner for our stakeholders.

In the years leading up to and including 2020 we achieve consistently good to very good results in relevant external assessments and our stakeholder surveys.

Supply chain
Employer
Compliance
Customers

Strengthening life in the digital world

We succeed in encouraging all people to embrace the digital opportunities available and develop their skills in everyday digital life according to their individual requirements and wishes.

In the years leading up to and including 2020, over 50 million people benefit annually from our products and programmes, enabling them to live digital and independent lives.

Quality of life
› 50 million
Digital inclusion
Data protection

Environmental and climate protection

We harness the opportunities provided by digitalisation to cut raw-material and energy consumption.

By 2020 we aim to have reduced our direct and indirect CO_2 emissions by 11 % compared with 2015.

Energy & CO_2 reduction
Resource conservation
CO_2
↓11 %

Integrated compliance system strengthens risk prevention

Maintaining and strengthening credibility is the foundation of our business activity. A clear target of the Telefónica Deutschland Group is to, with regard to all laws, international standards and internal guidelines, always act in accordance with the rules. The UN's Universal Declaration of Human Rights and the ILO core labour standards are an integral part of our business principles. Compliance with these standards is managed via an integrated compliance system (› MANAGEMENT DECLARATION). The moral and responsible actions of our employees are the cornerstone of the reputation of the company. With an extensive training programme, we ensure our employees know what constitutes correct behaviour.

Fair partnership for sustainability in the supply chain

The Telefónica Deutschland Group is committed to sustainable procurement and supplier management throughout the entire value chain. The basis for our actions is formed by the fair and long-term partnerships with our suppliers. Alongside the business principles, we use our own Supply Chain Sustainability Policy as well as a Web-based tool in our supplier management system for the evaluation of our suppliers, which also takes CR criteria into account. Within the framework of a compliance risk assessment, we are currently reviewing all existing guidelines and processes. From the results, we will together with Telefónica Global Services (TGS) derive measures for further risk mitigation.

T 10 — Supply chain

	Unit	2015	2016
Procurement volume	EUR millions	5,208	4,631
of which: volume attributable to suppliers located in Germany	EUR millions	3,855	3,235
Suppliers	Number	761	778
of which: suppliers located in Germany	Number	611	625
Share of domestic suppliers	%	80	80
Share of volume of domestic suppliers	%	74	70
Number of supplier assessments	Number	41	43

Optimum environment for satisfied employees
The Telefónica Deutschland Group is an attractive and progressive employer. Fair treatment of our employees and their high satisfaction with the working environment (› EMPLOYEES) are especially important to us. The aim is to provide employees with optimum working conditions with excellent career opportunities, offers of education and training and efficient health management. When filling new positions, we pay attention to diversity and equal opportunities. At the same time, we promote the compatibility of work and family through, for example, flexible working-hours models, opportunities to work from home and offers of childcare.

Creating added value for our customers
Customers' satisfaction and trust are the focal point of our actions. The Telefónica Deutschland Group wants to offer customers the best experience when it comes to products and services and provide them with attractive offers that are value for money. This is what the company is doing in adding a new dimension with the new O_2 Free tariff portfolio. From now on, people can conveniently move through the digital world at any time without worrying about their data usage. We are in dialogue with our customers regarding this tariff and all other offerings. In addition to the established formats, such as social-media channels, the O_2 customer forum and the O_2 shops, in 2016 we, for the first time, held an O_2 customer day in Munich.

Strengthening life in the digital world
All people should be able to benefit from the opportunities of the digital world. Therefore, we want to provide people with access, enthuse them and strengthen their skills.

Better quality of life through innovative solutions
We want to make life simpler with our products and services and protect the environment at the same time. Innovations and customer-focused solutions, such as O_2 Banking, which demonstrates our pioneering role in mobile banking, are crucial to this. To make the services available optimally, the Telefónica Deutschland Group is forging ahead with network expansion and the integration of the O_2[10] and E-Plus[11] networks.

We are investing in the Internet of Things and advanced data analytics, which carry great potential for the individual and society. At the same time, data protection and data security are a core element of our activities. When evaluating information for statistical analyses, which follows strict guidelines, we only use data that has been anonymised and aggregated.

With Smart Meter Connect, the Telefónica Deutschland Group has, as one of the first providers to do so, developed a dedicated communication solution for the digitalisation of the energy transition. Via a combination of mobile communications and broadband over power lines, real-time consumption data can be automatically, securely and quickly transmitted to energy suppliers and users. In several German cities, we are also currently exploring the potential of intelligent data analyses, which local authorities can use to better plan infrastructure measures, record emissions more precisely and make public transport in general more attractive.

Digital inclusion promotes equal opportunities
The Telefónica Deutschland Group is committed to enabling everyone to share in the advantages of digitalisation and providing them with inspiration and assistance. The O_2 Gurus make it easier especially for senior citizens, families, young people and people with disabilities to use digital offerings. They help customers online, over the phone and in many O_2 shops. In free workshops, the trained experts also provide non-customers with advice on the proper use of digital technologies. With our guide to mobile phones for children and parents and through funding projects such as "Medien in die Schule" (Getting Media into Schools), we underscore our commitment to youth protection and media literacy.

Since 2010, the Telefónica Foundation and the German Children and Youth Foundation have been working with O_2 to develop young people's digital skills. The Think Big programme has so far supported around 93,000 young people in implementing their own charitable ideas in the digital world.

The Telefónica Deutschland Group is also firmly committed to making it easier for elderly people to access digital and mobile media. Around 4,600 people have been reached by our project Tablet PCs for Senior Citizens since we launched it in 2012 in cooperation with "Stiftung Digitale Chancen" at retirement homes. There, the residents can use the devices and benefit from network access free of charge for eight weeks.

The Telefónica Deutschland Group also strenghthens inclusion via participation in the German-industry initiative "Wir zusammen" (Us Together). Within this framework, the company has installed Wi-Fi in refugee accommodations and initiated various integration projects via Think Big.

10 Network of Telefónica Deutschland Group pre acquisition of E-Plus Group.
11 Network of E-Plus Group pre acquisition by Telefónica Deutschland Group.

T 11 — Donations to charitable projects and participants of digital-integration programmes

	Unit	2015	2016
Donations to charitable projects	in EUR	172,112	198,265
Participants in Think Big (young people)	Number	19,518	17,930
Participants in Tablet PCs for Senior Citizens	Number	1,400	979

Control over personal data is retained by customers

It is important to us that people retain control over their data and can themselves shape their digital lives. For this reason, the Telefónica Deutschland Group protects customers' data in all products and processes. In its data security policy, the company has defined strict guidelines for the protection of personal data. Our employees are obliged to comply with data and telecommunications secrecy and are given regular training on this.

On our websites and portals, we offer our customers maximum transparency regarding the use of their personal information. In addition, the Telefónica Deutschland Group has established its own data anonymisation process (DAP) on a platform.

Environmental and climate protection

Our goal is to lessen the environmental impact of our business activities. We see climate protection, energy efficiency and resource conservation as the areas with the greatest potential for action throughout the entire value chain. Since 2004 now, all material office locations have been certified according to ISO 14001 and 9001. In the 2016 financial year, our energy management system was certified according to ISO 50001 for all our office locations, shops and network locations.

Reducing energy consumption and CO_2 emissions considerably

Since 2015 the Telefónica Deutschland Group has been pursuing a strategy of climate protection and energy efficiency for the merged company. By 2020, we want to have reduced our direct and indirect CO_2 emissions by 11 % compared with 2015. We purchase goods and services responsibly and give green energy priority. Today, 74 % of our total electricity consumption already comes from renewable energy sources. By 2020 we want to have reduced energy consumption per data volume by 40 % compared with 2015. In the base year 2015 we recorded energy consumption per data volume of 0.41 GWh/PB. In addition, the Telefónica Deutschland Group is committed until 2020 to annually buying from green sources 100 % of the energy that the company itself procures and controls – without purchasing compensation certificates.

We make consistent use of our energy-saving potential, especially via our efficient network technology. With the help of modern network equipment, improved software, more efficient rectifiers, optimised air conditioning and free cooling systems, we are extending this commitment even further. In the area of mobility, we are lowering our CO_2 emissions by reducing business travel given we, where possible, use digital tools, such as videoconferences, to communicate. We are also striving for a reduction in the average emissions of our vehicle fleet.

With our green services, our customers can also act more energy-efficiently and environmentally friendly. These include, for instance, intelligent electricity meters (smart meters) and the Eco Index, which helps customers to better estimate the environmental effects of mobile phones.

Recycling improves resource conservation

The Telefónica Deutschland Group pays attention to using resources sparingly and wants to improve in this area continuously. At present, we are focusing on the responsible disposal of hardware. At the same time, our mobile-phone recycling programme involves the consumers in environmental protection. In 2016 we managed to collect 62,361 used mobile phones (36 % more than in the previous year) via this programme. Of these, 51,145 used mobile phones were recycled (via melting) and 11,216 were remarketed. We received an additional 55,703 used devices for recycling outside of the mobile-phone recycling programme. The total number of used devices collected was therefore 118,064.

Expert disposal is carried out by the charitable AfB GmbH (Employment for People with Disabilities). A share of the returns for the mobile phones received is given to Germany's Nature and Biodiversity Conservation Union (NABU) for the restoration of the Lower Havel valley. In future, we want to annually implement a further effective measure for the conservation of resources in the years leading up to 2020.

T 12 — Energy[12]

	Unit	2015	2016
Total energy consumption	GWh	859	843
Total electricity consumption	GWh	817	803
of which: network and data centres	GWh	776	775
of which: offices, shops, call centres	GWh	41	28
Total fuel consumption[13]	GWh	42	40
Energy from renewable sources	GWh	602	591
Share of total electricity consumption from renewable sources	%	74	74
Energy intensity[14]	GWh/PB	0,41	0,30

T 13 — GHG emissions

	Unit[15]	2015	2016
Total CO_2 emissions (Scope 1, 2 and 3)[16]	tCO_2eq	479,196	443,272
Direct emissions (Scope 1) with refrigerant gas emissions	tCO_2eq	9,541	7,549
Indirect emissions (Scope 2)	tCO_2eq	464,313	430,740
Other indirect emissions (Scope 3)[17]	tCO_2eq	5,342	4,983

12 Network electricity consumption is calculated by multiplying the number of mobile and fixed line sites by the average electricity consumption per site, which has been determined on the basis of historical consumption data.

13 The fuel consumption (in the form of diesel, natural gas and district heating) only covers the units supplied by direct contract between supplier and Telefónica (72 % of the data centres and administration buildings, 4 % of the call centres and 13 % of the shops (referring to the area in square metres) separate from those units of which the supply is managed via the lessor of the unit.

14 Energy intensity is calculated by dividing total energy consumption by the data volume in petabytes.

15 $CO_2eq = CO_2, CH_4 \& N_2O$.

16 CO_2 emissions (incl. Scope 1 and Scope 2 in the following representation) are calculated according to ISO 14.064, the Greenhouse Gas Protocol and ITU-T L.1420. For the conversion of the electricity consumption into CO_2 emissions, a uniform Germany-wide conversion factor is applied independent of the fact that a share of 74 % (74 % the previous year) was procured from renewable energy sources. This amounts to 535 g CO_2 per kWh in 2016. In previous years, the electricity conversion factor of the International Energy Agency (IEA) was used (475.41 g CO_2 per kWh); since 2016 the factors of the German Federal Environment Agency (569 g CO_2 per kWh in 2015) have been applied retrospectively in order to improve topicality and regionality. There are, however, no fundamental changes in trends.

17 Other indirect emissions (Scope 3) from business travel.

Subsequent Events_

There were no significant events after the end of the financial year 2016.

Report on Risks and Opportunities_

Risks and opportunities are continuously monitored and identified at an early stage./We involve risk management in all decision-making process./Risks are classified using a 5x5 matrix and examined carefully in line with this approach./Opportunity management is an important element of the overall strategy planning process./We want to take advantage of opportunities in a targeted manner./There is no risk to the continued existence of the company.

The Telefónica Deutschland Group anticipates new business opportunities in order to increase the long-term value of the company and to pursue revenue growth. To take advantage of these opportunities and increase efficiency, however, the company also has to take certain risks. Our risk management is designed to recognise these risks at an early stage and actively mitigate them.

Risk Management and Financial Instruments

General financial market risks
The Telefónica Deutschland Group is exposed to various financial market risks in the course of its business activities.

If these financial risks occur, they could have a negative impact on the net assets, financial position and results of operations of the Telefónica Deutschland Group. The Telefónica Deutschland Group has developed guidelines for risk management processes and for the use of financial instruments including the clear separation of responsibilities with respect to financial activities, invoicing, financial reporting and associated controlling. Derivative financial instruments are used solely to manage interest and currency risks. The Telefónica Deutschland Group has developed guidelines derived from established standards for the evaluation of risks and monitoring with regard to the use of financial derivatives.

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

Currency risk
The underlying currency of the financial reports of the Telefónica Deutschland Group is the Euro. All financial statements of all subsidiaries of the Telefónica Deutschland Group are also prepared in Euro, meaning that the Telefónica Deutschland Group is not subject to any translation risk. The regional focus of the Telefónica Deutschland Group's activities means that the transaction risk arising from the group's business relationships with its suppliers or business partners in countries with a different national currency than the Euro is not material. Because the Telefónica Deutschland Group finances itself exclusively through internally generated cash in Euro as well as Euro-denominated equity and debt, there is also no exchange rate risk.

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

Interest-rate risk
Interest-rate risk is the risk that the fair value or future cash flows of a financial instrument could fluctuate as a result of changes in market interest rates. The Group manages its interest-rate risk by seeking to ensure it has a balanced portfolio of fixed-interest and variable-interest financing instruments. Where necessary, interest rate swaps are used in achieving this aim.

Interest-rate risks at the Telefónica Deutschland Group arise primarily from variable-interest loan agreements under which it is the borrower and from interest rate swaps, as well as its variable-interest cash pooling accounts with Telfisa Global B.V. In order to reduce existing interest-rate risks, interest rate swaps were concluded in November 2013 and February 2014 in connection with the issue of bonds for a partial amount of the bonds' nominal values. Under these interest rate swap contracts, the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. These interest rate swaps compensate, to the level of their nominal amounts, the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities from the bond issues (fair value hedge). Hedge accounting for these hedges complies with IAS 39. The relationship between the hedge instrument and the underlying transaction as well as the goal and strategy of the hedge were documented at the inception of each hedge. A specific allocation of the hedging instrument to the corresponding liability took place and an estimate of the degree of effectiveness of the hedge was made. The existing hedge is continuously monitored for effectiveness.

Credit risk
Credit risk describes the risk of financial losses due to the inability of contractual partners to repay or service contractually agreed debts. The Telefónica Deutschland Group's maximum credit risk corresponds to the carrying amount of its financial assets (excluding any guarantees or securities).

The Telefónica Deutschland Group considers the management of the commercial credit risk to be critical in order to achieve its goals for the sustainable growth of its business and customer base in line with its risk management guidelines. Suitable processes have been established for the management and the monitoring of credit risk.

These include the ongoing monitoring of the expected risks and the level of default. Particular attention is paid to customers who could have a significant effect on the Consolidated Financial Statements of the Telefónica Deutschland Group and for whom, depending on the business area and the type of business relationship, appropriate credit management instruments are used such as credit insurance or security to limit the credit risk. To control credit risk, the Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and recognises adjustments on doubtful receivables with a credit risk.

In accordance with Telefónica corporate policy, the Telefónica Deutschland Group has concluded cash pooling and deposit agreements with Telfisa Global B.V., a subsidiary of the Telefónica, S.A. Group, with regard to its cash surpluses and deposits its cash surpluses there. Telefónica, S.A. is rated by international rating agencies with an investment grade rating.

Liquidity risk
Liquidity risk describes the risk that the Telefónica Deutschland Group may be unable to sufficiently comply with its financial obligations. To safeguard liquidity, cash inflows and outflows are permanently monitored and controlled centrally on the basis of detailed financial planning. The Telefónica Deutschland Group works on its liquidity management closely with the Telefónica, S.A. Group and, in accordance with the corporate policy, has concluded cash pooling and deposit agreements with Telfisa Global B.V., Netherlands. In addition to operating liquidity, the opportunities arising on the financial markets are continuously examined with a view to ensuring the financial flexibility of the Telefónica Deutschland Group.

Capital management
The Telefónica Deutschland Group strives to guarantee the sustainability of its business and to maximise its enterprise value by permanently monitoring its capital costs, equity ratio and OIBDA.

Risk Management and Risk Reporting

Fundamental risk management principles

In the course of our business activities, we are confronted with various business, operational, financial and other (global) risks. We perform our services on the basis of the organisational, strategic and financial decisions made and precautions taken by us.

Every business activity involves risks that can prejudice the process of goal-setting and goal fulfilment. These risks arise from the uncertainty of future events – often due to insufficient information – and can result in objectives being missed. If risks are not recognised and dealt with, they can endanger the successful development of the company. In order to respond appropriately to this fact, the company's management has introduced a risk management process. This is intended to guarantee timely and complete transparency with regard to new risks or changes to existing risks.

Risk management is a component of the decision-making processes within the Telefónica Deutschland Group. The procedure ensures that risk evaluations are taken into account in decision-making and measures to minimise and deal with risks are taken at an early stage. This is based on the evaluation, communication and management of risks by all of the company's managers. A lower limit for the recognition of risks is generally not set. The risk management department compiles the company's risk registry, which also covers the subsidiaries. As part of the creation of the risk registry, it is ensured that risks of a similar type or of cumulative effect are aggregated and thus provided for overall consideration. In addition, this bottom-up approach, i.e. the identification of risks by the operating units, is complemented by a top-down approach in order to ensure a cross-business risk perspective. The purpose of the top-down approach is to ensure that risks that can only be identified at the highest management level or on the basis of a group-wide consideration, are discussed with the operationally responsible units. This is intended to enable full classification and integrated management as well as the evaluation of relevance for future reporting. Risk management is in continuous contact with all areas of the company and our risk coordinators in order to continuously pursue and evaluate risks and their management and development. Responsible employees are trained in order to ensure a uniform, structured process of risk identification and evaluation. In addition, fundamental training is available to all employees in order to raise their general awareness of risk management.

Risks are evaluated with regard to their impact on our business goals from an operational and financial viewpoint. The risk registry is based on a database that contains all identified risks, their status, the measures already taken and defined action plans.

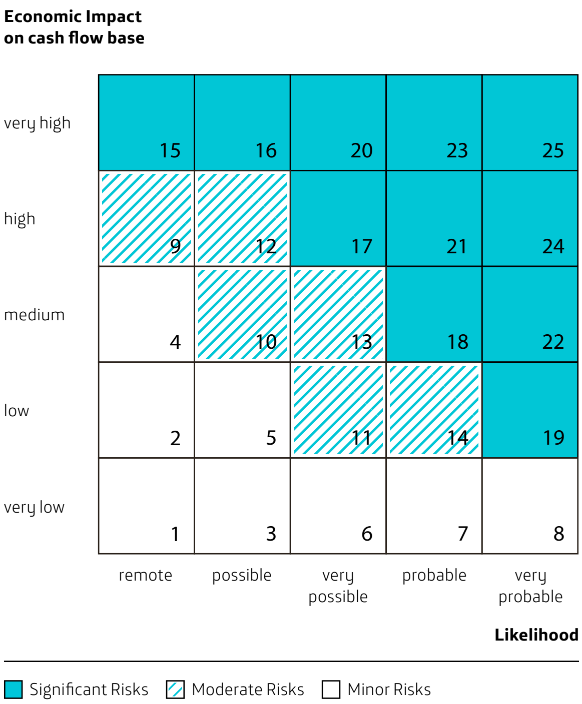
In a formal forward-looking process, the risk registry of Telefónica Deutschland Group is subject of regular reporting to the Management Board. The Supervisory Board (Audit Committee) is regularly informed about risks and their development.

Opportunities are not recorded in the risk management system.

Risk evaluation
The following section illustrates the risks that can significantly impact our financial situation, our competitiveness or our ability to realise our objectives. They are presented in line with the net principle, i.e. risks are presented and evaluated net of the risk mitigation measures performed.

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

G 19 — Risk profile



Based on the combination of the potential level of damages and the estimated probability of occurrence, the individual risk points are divided into three categories (significant, moderate and minor risks). All risks with a very high potential level of damages are seen as significant for the company; this does not take into account the estimated probability of occurrence. With a growing probability of occurrence, risks with a high or medium potential level of damages also fall into this category. Risks with only a very low potential impact are assessed as minor risk, regardless of the estimated probability of occurrence.

Minor risks are not included in the reporting to the Management Board and therefore are not included in the risk summary in the following section. Such risks are identified, documented and administered by the relevant management levels as part of the risk management process.

For internal use and reporting within the group, risks are divided into business risks, operational risks, financial risks and other (global) risks; this division also forms the basis of this section of the report. The most important risk topics are discussed in the relevant category.

In addition, our company can be influenced by other or additional risks of which we are presently unaware or that we do not consider significant based on the current state of knowledge. Moreover, the possibility cannot be precluded that risks currently evaluated as lower will change within the forecast period in such a way as to have a potentially greater effect than the risks currently evaluated as more material.

Risks

Business risks

Competitive markets and changing customer demands
We operate in markets characterised by a high level of competition and continuous technological developments. Our company faces increasing competition from alternative telecommunications service providers – among them cable operators, MVNOs and entertainment electronics companies – and also competes with alternative telecommunications services like OTT (over-the-top). This entails a significant risk to the achievement of our growth targets and our planned revenues. In order to prevail against these companies and developments, we must continue to successfully market and make available our services and products in future. To this end, we systematically observe and anticipate the business activities of our competitors, technological changes, new customer requirements and the general economic, political and social conditions.

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

Licences and frequencies
Our licences and frequency usage rights are limited in time and depend on a preceding assignment, which represents a significant risk to the operation and development of the network. If we do not extend or cannot newly obtain the licences and frequency usage rights necessary for our business or if the financial conditions for the use of these licenses and rights change significantly, this will lead to higher investment costs than planned. The potential delay to the network expansion resulting from this could also have a negative impact on expected revenues.

In 2015, the Telefónica Germany GmbH & Co. OHG successfully participated in the frequency auction conducted by the BnetzA and with it secured frequencies necessary for the business until the end of the year 2033. We were also granted permission for the mutual use of the frequencies of the Telefónica Germany GmbH & Co. OHG and E-Plus Mobilfunk GmbH, as well as of the frequencies of their wholly owned subsidiary Erste MVV Mobilfunk Vermögensverwaltungs GmbH, meaning that we now have sufficient frequencies at our disposal in the short and medium term to provide the services offered and to achieve our strategic goals. We do not see any justification for the current BNetzA investigation into frequency allocation in the 2 GHz range. The risk of deficient frequency resources currently exists only in the long term.

However, in connection with the significant reduction in the risk situation in relation to frequency resources, it should be added that according to our knowledge the companies Airdata AG, Stuttgart, and Liquid Broadband AG, Frankfurt am Main, have appealed against the decision of the presidential chamber of the Federal Network Agency that set out the conditions for the auction. In the event of a positive ruling, this could lead to the frequency auction having to be repeated under changed conditions. This would lead to the revival of the above risks.

Furthermore, there is a moderate risk of a negative impact on the performance and expansion of our mobile telecommunications network in the event of a change in the specifications for the maximum permitted transmission power due to new regulations regarding the electromagnetic fields.

Termination fees in mobile and fixed communications
Termination fees in mobile and fixed communications have declined in Europe in recent years, while Germany has also seen considerable reductions in the past years. Various reviews of these fees and court proceedings regarding regulatory measures are still in progress. The European Commission intends to further reduce mobile and fixed termination rates and has recommended a new method for the calculation of these rates by the relevant national regulatory authorities in the form of Pure LRIC (LRIC = long-run incremental costs). If the BNetzA continues to implement this method of calculation, there is a moderate risk of further reductions in termination rates and hence a lower level of revenues in this area.

Other regulatory influences on fees
Price-regulated services include international roaming and SMS and data services within roaming.

With the Telecoms Single Market Regulation (TSM-R), which came into force in November 2015, the European Commission has resolved the gradual removal of roaming charges for end customers on top of their domestic tariff (“roam like at home”) by 15 June 2017 (› REGULATORY INFLUENCES ON THE TELEFÓNICA DEUTSCHLAND GROUP).

Nevertheless, the regulatory authorities could take additional measures at any time in order to curtail roaming tariffs and fixed or mobile telecommunications termination fees even more. They could similarly oblige us to grant third parties access to our networks at reduced prices. There is a moderate risk that further reductions of these tariffs and fees could negatively affect our business activity, our financial situation and our earnings.

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

Changes in the regulatory requirements for collecting and validating customer data
An amendment to section 111 TKG means that the requirements for collecting and validating customer data, particularly for prepaid contracts, will increase from mid-2017. For the industry, this entails a risk that it may no longer be possible to use established sales channels to the same degree of efficiency or at all, which could result in additional costs for acquiring new customers. Although the scope can only be predicted once the requirements of the BNetzA are known, we now consider the resulting risk to be moderate.

Regulatory requirements in connection with the acquisition of the E-Plus Group
In approving the acquisition of the E-Plus Group, the European Commission obligated the Telefónica Deutschland Group to meet various requirements. This included an obligation to provide frequencies, infrastructure and network capacities to a potential new mobile network operator in

exchange for payment. There were no new market participants in the 2015 frequency auction and the Group has not been otherwise called upon to meet this requirement to date. To meet another requirement of the European Commission, we entered into extensive agreements with the Drillisch Group on the provision of network capacities and services. An extensive project was launched to ensure strict compliance with the contracts concluded and hence prevent the possibility of significant fines. Despite these measures, the corresponding risk is now considered to be significant.

Insurance

Considering the existing opportunities and evaluating financial efficiency, the Telefónica Deutschland Group counters some risks by concluding insurance contracts. In particular, risks in connection with the operation of the technical infrastructure and potential breaches of copyright or patent law are thereby significantly reduced, generally to the selected excess.

Despite an existing risk management process, there is a moderate risk that unforeseen events will entail financial losses in the event that our accruals or our insurance cover prove to be insufficient. As part of the management of our insurance cover, a regular review takes place in order to achieve the best possible cover for all conceivable risks.

Operational risks

Service quality

The success of our business depends on our ability to attract new customers and retain existing customers. A key factor for success in this respect is anticipating technical requirements and customer demands and implementing them in good time. False interpretations or incorrect decisions could entail the significant risk of negatively influencing the acceptance of our products by customers and could lead to us not reaching our growth and earnings targets. We counter these risks by intensively monitoring and evaluating customer satisfaction as well as the extensive monitoring of our network elements.

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

Supplier defaults

As a mobile and fixed network operator and a provider of telecommunications services and products, we are dependent on a few main suppliers in the same way as other companies in the industry – a situation that entails a risk now rated as moderate. These suppliers make important products and services available that primarily relate to the IT and network infrastructure. If these suppliers do not make their products and services available when due, this could endanger the operation and expansion of the network, which in turn could negatively affect our company and its earnings. The same applies if service providers to whom we award projects for reasons of efficiency do not perform the services by the required deadline or to the required quality. As part of our supplier management, we continuously evaluate risks and the quality of the services provided in order to allow us to identify and counter weaknesses at an early stage.

Dependence on services of the major shareholder Telefónica and of KPN

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

Legal risks

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

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

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

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

In June 2015, Airdata AG, Stuttgart, and 1&1 Telecom GmbH, Montabaur, filed suits with the General Court of the European Union against the European Commission's decision to approve the merger of Telefónica Deutschland Holding AG and E-Plus on 2 July 2014. In each case, the complainants are seeking the full revocation of the approval decision. In its statements issued on 9 October 2015, the European Commission defended its decision and applied for the suits to be dismissed in full. In response to its application, the Telefónica Deutschland Group was granted leave to intervene in both cases on 16 December 2015. It exercised its right to comment and is supporting the European Commission in its defence with a view to achieving the dismissal of the suits in full. The suits do not have a direct effect on the merger or the company's operating business. In particular, they do not constitute a condition precedent or subsequent with regard to the decision on approval. Similarly, any subsequent court decision would not have a direct effect on the merger. Even in the theoretical case of the decision on approval being revoked by the court, the merger would then be re-examined by the European Commission. However, the potential financial consequences for the group as a whole means that the risk theoretically resulting from these suits would have to be classified as significant.

Financial risks

Taxes

Like every company, we are regularly subject to tax audits. These include an intrinsic risk that higher subsequent tax payments for prior tax periods may be imposed if the tax authorities have a divergent opinion about the interpretations and calculation principles that form the basis of our tax declaration. Furthermore, changes in tax laws or in the interpretation of tax laws by courts or tax authorities may also have an adverse effect on our business activities as well as our financial position and results of operations. Due to the potential financial impact of a different interpretation this represents a significant risk.

Other (global) risks

There were no material other (global) risks at the end of the financial year.

Opportunity Management

The consistent use of entrepreneurial opportunities with respect to future revenue and OIBDA potential, as well as their early and continuous identification, analysis and management, is a significant task of the management of the Telefónica Deutschland Group.

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

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

Opportunities are neither recognised in the risk register nor quantified.

Opportunities

High penetration of O_2 Free

In October 2016, we launched our new customer proposition O_2 Free. As explained in the › GOALS AND STRATEGIES chapter, this offer follows a "more-for-more" approach. This means more and better services for the customer in exchange for a higher price. If the customer penetration of our new proposition exceeds our expectations, our revenuesand operating results could exceed our current forecast.

Greater demand for mobile data and LTE

The development of the German telecommunications market will continue to be driven by mobile data business and the increased use of mobile data devices like smartphones and tablets. Generally, a substantial increase in demand for mobile data is conceivable via various effects. Firstly, demand for data will be strengthened in 2017 through the further roll-out of LTE networks and increased penetration of LTE devices and plans. The higher transmission rates of LTE in comparison to UMTS are also encouraging customers to make increasing use of data-intensive services such as music streaming and video streaming on mobile devices. As a consequence, LTE customers have higher data consumption than UMTS customers, meaning that LTE customers require a higher data volume in their tariff, which has a positive impact on their mobile service revenues. In addition, demand may also be influenced by potential new services, additional devices connected to the internet and the growing popularity of existing data-intensive services.

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

Expansion of our LTE network

As already mentioned in section › GOALS AND STRATEGIES, in 2017 we will progress further with the expansion of our LTE network. The quality of the network will be impacted by the deployment of the LTE 1,800 MHz layer in urban areas, thus increasing the overall capacity. Should our expansion of the LTE network proceed more quickly due to more positive general conditions or should our customers respond to the better LTE network quality more positively than described in our outlook, our share of mobile data business could grow more strongly than predicted and thus our revenues and operating results could exceed our current forecast.

Cooperation with Telekom Deutschland GmbH in the fixed network

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

Digital innovation

In order to fully exploit our position on the German market for mobile telecommunications services and to monetise additional opportunities for growth, we have introduced innovative digital products and value added services in various areas such as communication services and financial services. There are also further projects that we plan to introduce, for example those related to our new unit Telefónica NEXT. Specifically in relation to the Internet of Things, some analysts expect that demand will grow at double-digit compound annual growth rates in the coming years.

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

Digitalisation of service processes

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

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

Membership of the Telefónica, S.A. Groupp

As a part of one of the largest telecommunications corporations in the world, the Telefónica Deutschland Group benefits from economies of scale in the areas of purchasing, cooperations and the development of digital products. Should these economies of scale develop better than currently expected, this could positively affect our revenues and our earnings position and lead to us exceeding our forecast.

Opportunities for greater synergies

As described above, considerable synergies are expected as a result of the acquisition of E-Plus. If economies of scale have a greater effect than anticipated (e.g. in the form of favourable negotiations with suppliers or landlords), this would have a positive impact on the forecast of cost synergies. Greater revenue synergies could be generated if, for example, the market success of Drillisch exceeds expectations.

Summary of the Risks and Opportunities

Based on our assessment, the intensive competition on the German telecommunications market, the regulatory environment and the need to ensure high-quality service pose our greatest challenges. No new reportable risks were identified in the risk management process.

Risks related to integration of the E-Plus Group into the Telefónica Deutschland Group have become less prominent over the course of the year. The risk of reduced profitability or unachieved synergies from business combinations, take-overs and disposals is now deemed low. The risk of violations against antitrust laws is also deemed low, due to appropriate processes that were put in place. As explained above, we have refrained from presenting risks that we consider to be insignificant.

We have not identified any risks that could threaten our going concern, individually and in the aggregate.

Therefore, the situation regarding substantial risks and opportunities for the Telefónica Deutschland Group has not changed significantly compared to the previous year, except for the items described above.

In the coming financial year, we are confident that we will again be able to identify relevant risks at an early stage and take appropriate measures to counter them by continuing to implement the risk management approach applied to date.

We are confident that the profitability of our company serves as a solid basis for our future business development and ensures the resources needed in order to pursue the opportunities presented to the company. Considering our technologically high-value products, our position in the market, our digital innovation power, the fact that we belong to one of the largest telecommunications companies in the world, our committed employees and our structured processes to recognise risks and identify opportunities at an early stage, we are confident that we will be able to successfully meet the challenges arising from the risks and opportunities mentioned above in 2017.

Accounting-Related Internal Control and Risk Management System_

The Telefónica Deutschland Group's accounting-related internal control system (ICS) meets the requirements of the AktG and HGB as well as the US Sarbanes-Oxley.

The following statements contain information in accordance with section 289 (5) HGB and section 315 (2) no. 5 HGB.

The primary goal of our accounting-related internal control and risk management system is to ensure proper financial reporting in the sense of ensuring that the Consolidated Financial Statements comply with all relevant provisions.

The risk management system described in chapter › REPORT ON RISKS AND OPPORTUNITIES also includes an accounting-related perspective with the aim of ensuring the reliability of financial reporting. In addition to the legal requirements of, for example, the German Stock Corporation Act (AktG) and the German Commercial Code (HGB), the ICS introduced by us also complies with the provisions of the US Sarbanes-Oxley Act (SOX). The obligation for the Telefónica Deutschland Group to fulfil these SOX requirements results from the registration of its majority shareholder, Telefónica, S.A., with the US SEC (Securities and Exchange Commission). In addition, the Telefónica Deutschland Group's ICS complies with the global ICS control setup of Telefónica, S.A. The necessary additions to the ICS of the E-Plus Group, which has belonged to the Telefónica Deutschland Group since 1 October 2014, were implemented in the financial year 2015.

Establishing and effectively maintaining appropriate internal controls for financial reporting is the responsibility of the Management Board of Telefónica Deutschland and is performed taking company-specific requirements into account.

The conceptual framework for preparing the Consolidated Financial Statements primarily consists of the uniform group-wide accounting guidelines and the chart of accounts, both of which must be applied consistently by all companies of the Telefónica Deutschland Group. New laws, accounting standards and other official pronouncements are analysed on an ongoing basis with regard to their relevance and effects on the proper preparation of the Consolidated Financial Statements. The resulting changes are taken into account by the Accounting Policies & External Reporting department of Telefónica Germany GmbH & Co. OHG in our accounting guidelines and the chart of accounts.

The data basis for the preparation of the Consolidated Financial Statements consists of the financial statement information reported by Telefónica Deutschland, its subsidiaries and joint ventures, which in turn is based on the accounting entries recorded within the companies. The financial reporting of the individual companies is performed either by the Finance & Accounting department of Telefónica Germany GmbH & Co. OHG or in close cooperation with it. For certain topics requiring specialist knowledge, such as the valuation of pension obligations, we draw upon the support of external service providers. The Consolidated Financial Statements are prepared within our consolidation system on the basis of the reported financial statement information. The steps to be taken when preparing the Consolidated Financial Statements are subject to both manual and system-based controls at all levels.

Employees involved in the financial reporting process are already examined in terms of their professional suitability before they are hired, and are provided with regular training. The financial statement information must go through certain approval processes at every level. Critical task areas in the financial reporting process are divided appropriately in order to ensure the effective separation of duties, and the dual control principle generally applies. Further control mechanisms include target/performance comparisons and analyses of the composition of content and changes in individual items, both in the financial statement information reported by individual group companies and in the Consolidated Financial Statements. The accounting-related IT systems are used to control IT security, change management and IT operations in particular. For example, access authorisations are defined and established in order to ensure that accounting-related data is protected from unauthorised access, use and change.

The appropriateness and effectiveness of the ICS are assessed annually by the Management Board of Telefónica Deutschland. Our Internal Audit department continuously reviews compliance with guidelines, the reliability and functionality of our ICS and the appropriateness and effectiveness of our risk management system and reports on this to the Management Board of Telefónica Deutschland.

The Supervisory Board of Telefónica Deutschland is involved in the ICS via the Audit Committee in accordance with section 171 (1) AktG in conjunction with section 107 (3)

AktG. In particular, the Audit Committee is responsible for monitoring the accounting process, the effectiveness of the ICS, the risk management and internal audit systems, as well as the audit of the financial statements. It also reviews the documents for the Annual Financial Statements of Telefónica Deutschland and the Consolidated Financial Statements and discusses the financial statements with the Management Board and the external auditor.

As part of its risk-oriented audit approach, the external auditor expresses an opinion on the effectiveness of the parts of the ICS that are relevant for financial accounting and reports to the Supervisory Board in the course of the discussion of the financial statements.

The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS). If required, e.g. for the purposes of the HGB Annual Financial Statements or for tax purposes, a reconciliation based on the relevant provisions is performed at account level. Accordingly, the correct preparation of the IFRS financial statement information also serves as an important basis for the Annual Financial Statements of Telefónica Deutschland Holding AG. For Telefónica Deutschland Holding AG and other group companies reporting in accordance with HGB, the conceptual framework described above is supplemented by a HGB chart of accounts.

As the parent company of the German Telefónica Group, Telefónica Deutschland is included in the aforementioned Group-wide accounting-related internal control system. As a matter of principle, the information presented above also applies to the HGB Annual Financial Statements of Telefónica Deutschland Holding AG and the other group companies reporting in accordance with HGB.

Report on Expected Developments_

Economic growth in Germany set to continue./The telecommunications industry as a trailblazer for digital change./Underlying mobile service revenues expected to be slightly negative to flat year-on-year in 2017./Upgrading total operating cash flow synergies to approximately EUR 900 million in 2019./OIBDA excluding exceptional effects is anticipated to be flat to grow by mid-single digit percentage year-on-year./Expectations for Capex of around EUR 1 billion in 2017.

Economic Outlook

The leading economic research institutes expect economic growth in Germany to continue in 2017. They are forecasting an 1.4 % increase in gross domestic product. According to the economic institutes, private and public consumer spending will remain the pillars of the German economy in 2017. As in 2016, the favourable conditions on the labour market, sustained positive income expectations and the low-interest environment will provide a considerable incentive for private households to make purchases. In the public sector, the main drivers are additional spending on refugee accommodation, support and integration.

Any escalation at international trouble spots still poses a risk to the consumer economy, and thus also to overall economic development in Germany. It remains to be seen how the planned withdrawal of the United Kingdom from the European Union (Brexit) and Donald Trump's victory in the US presidential election will affect the European, and above all the German, economy.

Growth in economic performance of 1.4 % is forecast for the Euro area in 2017.

Source: GfK Konsumklima, Focus Economics, Bundesbank, Cologne Institute for Economic Research

T 14—BIP Growth 2015–2017 for Germany and the Euro area

In %	2015	2016	**2017**
Germany	1.7	1.8	1.4
Euro area	1.5	1.6	1.4

Market Expectations

Growing digitalisation and the resulting interconnection of man and machine is a key trend that will shape the future of society and the economy./Digital technologies like the Internet of Things (IoT), big data and cloud computing are increasingly penetrating every area of society and the economy./This digital transformation process is fundamentally changing every aspect of our lives and will continue to do so in future./This trend is being driven by the increasing penetration of mobile internet and an "always-on" mentality.

In addition to connecting people, the intelligent connection of things via the internet (IoT) offers numerous application and growth opportunities, such as Industry 4.0, connected cars, smart health, smart energy and smart cities. Another trend is data analytics, which is facilitating new insights as well as new business models.

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 as well as video streaming providers, is increasing data usage.

This all means further growth in the transmitted data volume. 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 in the "traditional telecommunications sector" 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 2017.
Source: Analysys Mason, Bitkom, BMWi

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 O_2 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 O_2 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 revenues. As of 1 December 2016 the BNetzA cut mobile termination rates from 1.66 to 1.1 Euro cents, 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 revenues of approximately 3–4 % year-on-year. Excluding these regulatory effects, we expect the underlying mobile service revenues 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 approximately EUR 800 million to approximately 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 approximately 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 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 exceptionals[18]), predominantly driven by synergies. This includes an expected impact from the European roaming regulation and the termination rate effects 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 leverage[19] 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 (2016–2018). We will consider expected future synergies when making dividend proposals.

18 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.

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

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.

T 15—Financial Outlook 2017

(Euros in millions)	Base line 2016	Outlook 2017 (year on year)
Mobile service revenues (MSR) underlying[20]	5,437	Slightly negative to flat
Operating income before depreciation and amortization (OIBDA) before exceptional effects[21]	1,793	Flat to mid single-digit % growth
CapEx	1,102	Around EUR 1 billion
Dividend[22]	0.25 EUR per share	Annual dividend growth for three years

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

21 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: Exceptional effects such as restructuring costs are excluded from our 2017 OIBDA guidance. We have calculated a 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.

22 For 2016: Proposal to the Annual General Meeting 2017.

Other Declarations_

Report on Relations with Affiliated Companies

In the period from 1 January to 31 December 2016, Telefónica Deutschland Holding AG was a directly dependent company of Telefónica Germany Holdings Limited, Slough, United Kingdom, within the meaning of section 312 AktG. In addition, Telefónica Deutschland Holding AG was an indirectly dependent company of O2 (Europe) Limited, Slough, United Kingdom and of Telefónica, S.A., Madrid, Spain, within the meaning of section 312 AktG. There is neither a domination agreement nor a profit and loss transfer agreement between Telefónica Deutschland Group and the aforementioned companies.

Accordingly, the Management Board of Telefónica Deutschland Holding AG has prepared a report on relations with affiliated companies in accordance with section 312 (1) AktG. This report includes the following final declaration:

"Our company has, with regard to the legal transactions and measures listed in the dependency report, and based on the circumstances which were known to us at the time at which the legal transactions were carried out or the measures were taken or refrained from, received adequate compensation for each legal transaction and has not been disadvantaged as a result of measures being taken or refrained from."

Essentials of the Remuneration System

Remuneration of Management Board members

Based on the resolution of the Annual General Meeting on 5 October 2012 in accordance with section 314 (3) sentence 1 and section 286 (5) HGB, Telefónica Deutschland Holding AG does not publish the additional information for listed stock corporations in accordance with section 314 (1) no. 6a sentences 5 to 8 HGB and section 285 no. 9a sentence 5 to 8 HGB. In this section, the essentials of the remuneration system for the Management Board will be illustrated with the aforementioned limitation.

In accordance with section 314 (1) no. 6a HGB, the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG for the financial year ended 31 December 2016 amounted to EUR 4,105 thousand (thereof EUR 22 thousand accounted for the reimbursement of cost incurred by obtaining tax advice for a former Management Board member).

The service agreements of the members of the Management Board of Telefónica Deutschland Holding AG valid in the financial year 2016 were signed on 2 July 2014 and became effective on 1 October 2014. The service agreement of one Management Board member was modified with an amendment dated 22 January 2015. New employment contracts were entered into with the Management Board members Markus Haas and Rachel Empey with effect from 1 January 2017 until the end of 31 December 2018 (Rachel Empey) and 31 December 2019 (Markus Haas). The Management Board member Thorsten Dirks resigned as CEO and Management Board member with effect as of 31 December 2016. He will leave the company by mutual agreement on 31 March 2017. On 11 December 2016, the Supervisory Board appointed Markus Haas as CEO of Telefónica Deutschland Holding AG with effect from 1 January 2017.

The total remuneration of the Management Board members (including a former Management Board member) comprises a fixed salary, variable cash remuneration and long-term remuneration components, a company car, life insurance, D&O and accident insurance, pension contributions, travel allowances, rental allowances, the reimbursement of the cost of British social insurance, the reimbursement of moving costs, the reimbursement of brokerage fees, flights home, tax compensation, costs of tax advice, committee fees, and compensation for exchange rate losses and differences in the cost of living. Not all Management Board members receive all of these benefits. For further information, please refer to the Notes to the Consolidated Financial Statements for the year ended 31 December 2016 (› NOTE NO. 14 TRANSACTIONS WITH MANAGEMENT BOARD AND SUPERVISORY BOARD).

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

The fixed component comprises the annual fixed salary, which is paid in twelve equal monthly instalments, and the aforementioned benefits. The Management Board members receive either an allowance for a private pension fund of 20 % of the annual fixed salary or a retirement commitment.

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

1) The first variable portion of the remuneration is an annual cash bonus (Bonus I). Bonus I is calculated as the target bonus multiplied by business performance multiplied by individual performance. The target bonus is set as a percentage of the relevant annual fixed salary.

   Two components are critical for business performance. These are based on the success of Telefónica Deutschland Holding AG (Telefónica Deutschland component) in the amount of 70 % and Telefónica, S.A. (Telefónica, S.A. component) in the amount of 30 %.

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

   In order to ascertain the individual performance of each of the Management Board members, personal objectives are set by the Supervisory Board annually at the start of each year. Target attainment is reviewed at the start of the following year and the Supervisory Board assigns each Management Board member to one of five performer classes. These are allocated to ranges of target attainment percentages and the Supervisory Board assigns a certain percentage to each Management Board member. The knock-out threshold is 30 %. Individual performance is capped at 150 %.

2) The second variable remuneration component is participation in the Performance and Investment Plan (PIP). The first plan (“Performance and Investment Plan 2011”) was adopted by the Annual General Meeting of Telefónica, S.A. in 2011. Members of the Management Board of Telefónica Deutschland Holding AG have participated in the PIP since 2011. On 30 May 2014, the Annual General Meeting of Telefónica, S.A. adopted the following plan (“Performance and Investment Plan 2014”). There are two versions of the “Performance and Investment Plan 2014”, namely the version for members of the ExComm of Telefónica, S.A. (which applies to one member of the Management Board) and the version for senior management (which applies to one member of the Management Board); the difference between the two versions is that members of the ExComm of Telefónica, S.A. – as described in greater detail below – may be allocated 125 % of the performance shares awarded. Unless stated otherwise, the information presented below relates to the “Performance and Investment Plan 2011” and both versions of the “Performance and Investment Plan 2014”.

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

   As an alternative to the Core Award, the PIP provides for an Enhanced Award whereby the number of performance shares is increased by 25 % in comparison with the Core Award. The condition for achieving the Enhanced Award is that a Management Board member must acquire a certain number of shares in Telefónica, S.A. (currently 25 % of the Core Award) at their own cost. If the conditions for the Enhanced Award are met, the number of shares to be actually allocated is calculated on the basis of the Enhanced Award rather than the Core Award.

   The Executive Committee of Telefónica, S.A. decided that PIP participants would no longer receive shares in financial year 2016. Therefore, the Board members of Telefónica Deutschland Holding AG will not receive any share-based payments from the PIP in financial year 2016. For further information, please refer to the Notes to the Consolidated Financial Statements for the year ended 31 December 2016 (› NOTE NO. 15 SHARE-BASED PAYMENTS).

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

   At the time these Consolidated Financial Statements were issued, the Supervisory Board of Telefónica Deutschland Holding AG had not yet decided on the Bonus II amount for the current bonus cycle, which started in financial year 2016.

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

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

   The shares are allocated in three equal tranches over a period of three years, provided the plan beneficiary is in employment at Telefónica Deutschland Holding AG at the relevant allocation date (for each of the tranches as applicable). Shares were distributed in October 2015 and February 2016.

Remuneration of Supervisory Board members

The members of the Supervisory Board receive fixed remuneration of EUR 20 thousand annually in accordance with the articles of association, payable at the end of the financial year. The Chair of the Supervisory Board receives EUR 80 thousand and the Vice-Chair of the Supervisory Board receives EUR 40 thousand. The Chair of the Audit Committee receives an additional EUR 50 thousand if the Chair of the Supervisory Board or the Vice-Chair does not hold the chair in this committee. Supervisory Board members who hold office in the Supervisory Board or the position of Chair of the Supervisory Board or Chair of a Committee only for a certain part of the financial year receive proportionate remuneration on a pro-rata basis.

Alongside the remuneration, the company reimburses the Supervisory Board members for the expenses arising in the fulfilment of their duties as Supervisory Board members as well as any value-added tax on their remuneration and their expenses.

Four members of the Supervisory Board who work-besides that in one of the Group companies of Telefónica S.A. Group have waived their remuneration for their current period of office to the extent that their remuneration rights exceed EUR 2 thousand per year.

No services, and in particular consultancy or brokerage services, were provided outside of the stated activities of the Supervisory Board and the committees.

Further information can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2016 (› NOTE NO. 14 TRANSACTIONS WITH MANAGEMENT BOARD AND SUPERVISORY BOARD).

Disclosures

pursuant to section 315 (4) and section 289 (4) of the HGB

Composition of subscribed capital

The registered share capital of Telefónica Deutschland amounts to EUR 2,974,554,993, which is consistent with the prior year. The share capital is divided into 2,974,554,993 no-par value registered shares, each with a proportionate interest in the share capital of EUR 1.00 ("shares"). The registered share capital is fully paid. As of 31 December 2016 and at the time this Management Report was prepared, Telefónica Deutschland did not hold any of its own shares. In accordance with section 6 para. 2 of the articles of association the shareholders have no right to certificates of shares. As a matter of principle, each no-par value share grants one vote at the Annual General Meeting. The shares are in general freely transferable.

Voting restrictions and restrictions on the transferability of shares

There are no general limitations on voting rights. We are not aware of any contractual agreements with Telefónica Deutschland or other agreements about limitations on voting rights or the transferability of shares. In addition to the statutory provisions on insider trading and the prohibition on trading in accordance with the Market Abuse Regulation, the company informs the relevant parties about "silent periods" of 30 days prior to the publication of financial data with corresponding recommendations to refrain from trading in this period. Other than this, there are no internal governance provisions providing for restrictions on the purchase and sale of shares by Management Board members or employees.

Participation in the share capital of more than 10 % of the voting rights

As of 31 December 2016 Telefónica Germany Holdings Limited, Slough, United Kingdom, holds approximately 63.22 % of the shares of Telefónica Deutschland and the same amount of voting rights. Both O2 (Europe) Limited, Slough, United Kingdom, and Telefónica, S.A., Madrid, Spain, indirectly hold more than 63.22 % of the shares in Telefónica Deutschland via Telefónica Germany Holdings Limited.
As of 31 December 2016 KPN holds approximately 15.46 % of the shares and voting rights of Telefónica Deutschland. Other than this, we were not informed of any participation in the share capital of Telefónica Deutschland of more than 10 % of the voting rights and we are not aware of any such participations.

Shares with special rights

There are no shares with special rights, and in particular no shares with rights that grant control.

Control of voting rights when employees hold stakes in the share capital

Just like all other shareholders, employees who hold shares in Telefónica Deutschland exercise their control rights directly in accordance with the statutory provisions and the articles of association.

Appointment and dismissal of Management Board members

Pursuant to section 7 of the articles of association and section 84 AktG, the Supervisory Board determines the number of members of the Management Board and is responsible for their appointment and dismissal as well as for the appointment of the Chair of the Management Board (Chief Executive Officer, CEO). Deputy members of the Management Board may be appointed. As of 31 December 2016, the Management Board of Telefónica Deutschland consisted of three members. Since 1 January 2017 the Management Board comprises of 2 members see Management Declaration).

Management Board members are appointed by the Supervisory Board for a term of no more than five years. They can be re-appointed and their term can be extended provided one period of office does not exceed a period of five years. The Supervisory Board may dismiss a Management Board member in the event of good cause, such as a gross breach of duties or if the Annual General Meeting adopts a no-confidence resolution in relation to the respective Management Board member. Other reasons for dismissal – such as mutual termination – remain unaffected.

Telefónica Deutschland is subject to the provisions of the German Co-Determination Act (Mitbestimmungsgesetz – MitbestG).

Pursuant to section 31 MitbestG, a majority of two-thirds of the votes of Supervisory Board members is required for the appointment and dismissal of Management Board members. If this majority is not reached in the first round of voting by the Supervisory Board, the appointment or dismissal may occur on the recommendation of the Mediation Committee, which is to be formed in accordance with section 27 (3) MitbestG, in a further round of voting with a simple majority of the votes of the Supervisory Board members. If the mandatory majority is still not achieved, a third round of voting must take place which again requires a simple majority; for this round of voting, however, the Chair of the Supervisory Board has two votes.

If a required Management Board member is missing, the Munich Local Court must appoint the member on application by a party concerned pursuant to section 85 (1) AktG in urgent cases.

Changes to the articles of association

In accordance with section 179 (1) sentence 1 AktG, any change to the articles of association of Telefónica Deutschland requires a resolution of the Annual General Meeting. In accordance with section 27 of the articles of association together with section 179 (2) sentence 2 AktG, resolutions of the Annual General Meeting of Telefónica Deutschland regarding changes to the articles of association are passed with a simple majority of the votes cast and a simple majority of the share capital represented at the passing of the resolution. If the law requires a higher majority of votes or capital, this majority must be applied. In connection with changes that only affect the wording of the articles of association, the Supervisory Board is entitled to make changes in accordance with section 179 (1) sentence 2 AktG in conjunction with section 17 (3) of the articles of association.

Authorisation of the Management Board to issue shares

The powers of the Management Board are governed by sections 76 ff. AktG together with section 8 ff. of the articles of association. In particular, the Management Board runs the company and represents it in and out of court.

The authorisation of the Management Board to issue shares is governed by section 4 of the articles of association in conjunction with the statutory provisions. As of 31 December 2016, the following authorisations of the Management Board for the issuing of shares exist:

Authorised capital
As of 31 December 2016, the Management Board is authorised, with the approval of the Supervisory Board, to increase the share capital of the company in the period until 18 May 2021, on one or more occasions, by a total of EUR 1,487,277,496 by issuing up to 1,487,277,496 new no-par value shares in exchange for cash and/or non-cash contributions (Authorised Capital 2016/I). The authorisation stipulates that shareholder subscription rights can, in certain cases, be completely or partially excluded (section 4 (3) of the articles of association). This was resolved by the Shareholders' Meeting on 19 May 2016, which at the same time cancelled the existing Authorised Capital 2012/I.

Conditional capital
For the purpose of the issue of registered no-par value shares to the holders or creditors of bonds, the share capital of the company is conditionally increased by up to EUR 558,472,700 by issuing 558,472,700 new registered no-par value shares (Conditional Capital 2014/I).

Authorisation of the Management Board to buy back shares
The authorisation of the Management Board to buy back own shares is governed by section 57 (1) sentence 2 and sections 71 et seq. AktG.

The Shareholders' Meeting on 19 May 2016 cancelled the existing authorisation to buy back own shares dated 5 October 2012 and resolved a new authorisation in accordance with section 71 (1) 8 AktG to buy back own shares of up to a total of 10 % of the share capital on the resolution date or, if lower, on the date on which the authorisation is exercised.

Change of control/compensation agreements
Telefónica Deutschland's significant agreements containing a change-of-control clause relate to financing.

In the event of a change of control, the rating of Telefónica Deutschland or of the outstanding non-current liabilities within the Group will be examined with regard to capital market liabilities. In the event of a deterioration in the rating as contractually defined, the contracts grant O2 Telefónica Deutschland Finanzierungs GmbH as the issuer the option to terminate the financing early at a redemption amount of 101 % of the nominal amount plus accrued interest. Otherwise, the interest is increased by 1.25 % p.a. until the end of the term.

A small number of other contracts grant the contracting partners the right of termination in the event of a change of control in accordance with normal practice; this would result in an obligation to fulfil all outstanding obligations.

The service contracts of the Management Board members of Telefónica Deutschland grant the right to terminate these contracts in the event of a takeover offer by a third party with three months' notice to the end of the month; however, this termination must occur within six months of a change of control. In this event, the relevant Management Board member may claim a one-off compensatory amount equal to one year's fixed salary plus the most recently received annual bonus,whereby the compensation may not exceed the remuneration that would have been payable up to end of the contract.

Business Development of Telefónica Deutschland Holding AG_

Telefónica Deutschland Holding AG performs services for its subsidiaries./In particular, these include management services by the Management Board./Revenues rise 14 % year on year./Net loss for the year amounts to EUR 2 million.

The Annual Financial Statements of Telefónica Deutschland AG have been prepared in accordance with the rules set out in the German Commercial Code (Handelsgesetzbuch).

Telefónica Deutschland acts as a holding company and is responsible for the management and strategic orientation of the Telefónica Deutschland Group and its operating business activities as a service provider. As such, its opportunities and risks, post-reporting date events and the outlook for the coming financial year are the same as for the Telefónica Deutschland Group. Telefónica Deutschland did not have any employees as of 31 December 2016.

Results of Operations

Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its operating business activities as a service provider and holding company. Telefónica Deutschland's revenues are generated from the remuneration of the services it performs for its subsidiaries. This includes management services performed for the Telefónica Deutschland Group by the Management Board in the areas of corporate strategy and communication, controlling, new business and innovation.

The oncharging of these management costs resulted in revenues of EUR 12 million in the financial year 2016. This is almost in line with the company's expectation formed in the prior year with regards to revenues.

Despite reduced personnel expenses and lower other expenses compared to the previous year, there was a net loss for the year of EUR 2 million. The net result was therefore down significantly on the profit of EUR 130 million in the previous year. This was mainly due to positive exceptional effects of EUR 134 million which were recognized in operating income in the financial year 2015. The prior year expectation to end the financial year 2016 break-even was nearly reached.

Revenues up slightly on previous year
In the financial year, revenues of EUR 12 million (2015: EUR 10 million) were generated. They consisted primarily of oncharged costs for the remuneration of the Management Board members and other administrative expenses assumed by Telefónica Germany GmbH & Co. OHG in accordance with the agreements on the reimbursement of management services. Revenues also included billed management services in the amount of EUR 240 thousand for services performed by Telefónica Deutschland Holding AG for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH.

Other operating income down significantly on previous year
Other operating income declined by EUR 134 million to EUR 0 million in the financial year 2016. The previous year included mainly income from the final agreement with KPN on the cash component of the purchase price for the acquisition of E-Plus Mobilfunk GmbH & Co. KG amounting to EUR 134 million.

Personnel expenses down on previous year
Personnel expenses amounted to EUR 4 million (2015: EUR 5 million) in the financial year, 22 % below the previous year. This item contains the remuneration of the Management Board including social security contributions.

Other expenses are at the previous year's level
Other expenses are on par with the previous year at EUR 10 million. They consist primarily of legal and consulting costs for external service providers.

Net loss for the year following elimination of positive non-recurring effects in the previous yearr
In 2016, the company generated a net loss for the year of EUR 2 million compared to net profit of EUR 130 million in 2015. The net result for the financial year 2015 was due primarily to positive non-recurring effects.

T 16 — Income Statements

(Euros in millions)	January 1 to December 31 2016	2015	Change	% Change
Revenues	**12**	**10**	**1**	**14**
Other operating income	0	134	(134)	(100)
Operating expenses	(13)	(15)	2	(11)
Personnel expenses	(4)	(5)	1	(22)
Other expenses	(10)	(10)	1	–
Operating income (expense)	**(2)**	**129**	**(131)**	**> (100)**
Net financial income (expense)	0	0	0	–
Profit (loss) before tax for the period	**(2)**	**130**	**(131)**	**> (100)**
Income tax	0	–	0	–
Total profit (loss) for the period	**(2)**	**130**	**(131)**	**> (100)**

Net Assets and Financial Position

Principles and goals of financial management

The Telefónica Deutschland is responsible as a service provider for the management of the Telefónica Deutschland Group and its operative business activities. It essentially finances itself out of equity and generates an operative cash flow via charges for these management services for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. In addition, the Telefónica Deutschland is integrated into the group-wide finance management of the Telefónica Deutschland Group and therefore at any time able to meet its payment obligations.

Therefore further explanations from the section financial position of the Telefónica Deutschland Group also apply to the Telefónica Deutschland.

Loan to Telefónica Germany GmbH & Co. OHG

In the financial year 2016 Telefónica Deutschland has granted Telefónica Germany GmbH & Co. OHG a loan in the amount of EUR 110 million to finance its general business activities. The loan has a term to 2017 and a renewal option.

Bonds

In November 2013 and February 2014 the O2 Telefónica Deutschland Finanzierungs GmbH issued tow bonds with original nominal values of EUR 600 million and EUR 500 million and an original maturity was five and seven years.

The net issuing proceeds of the bonds have been transferred to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan and will be used for general corporate purposes.

As part of the group's overall financial management the punctual payment of interest, principal and other payments according to the bond terms are guaranteed by the Telefónica Deutschland.

Investments

After the acquisition of E-Plus the focus is on the successful management of the group and the realisation of synergies. Currently there are no plans for further major investments by Telefónica Deutschland Holding AG.

Financial assets at prior-year level

Financial assets in the amount of EUR 10,747 million (2015: EUR 11,427 million) related to the shares in Telefónica Germany GmbH & Co. OHG, Munich. On the basis of a shareholder resolution dated 2 May 2016, a withdrawal from Telefónica Deutschland totalling EUR 680 million was conducted in accordance with section 4 para. 3 of the shareholder agreement in the year under review; this resulted in a corresponding reduction in the carrying amount of the investment.

The carrying amount of the shares in Telefónica Germany Management GmbH, Munich, remained unchanged against the previous year at EUR 10 million.

Lower cash pool receivables lead to reduction in receivables from affiliated companies

The decline in receivables from affiliated companies was due primarily to the lower level of cash pool receivables from Telfisa Global B.V., Amsterdam, which fell from EUR 137 million in 2015 to EUR 7 million in 2016. The granting of a loan of EUR 110 million to Telefónica Germany GmbH & Co. OHG, Munich, had a contrary effect in 2016.

Other assets down compared with 2015

Other assets fell to EUR 0 million (2015: EUR 15 million). In the previous period, there was a significant tax receivable from allowable capital gains tax prepayments resulting from a merger of EUR 15 million, which was settled in 2016.

Provisions on a par with previous year
Provisions for pensions remained essentially unchanged.

The slight increase in other provisions from EUR 5 million in 2015 to EUR 6 million at the end of the year under review was attributable primarily to the higher level of provisions for outstanding invoices, especially for consulting services received.

Liabilities on a par with previous year
Trade payables, liabilities to affiliated companies and other liabilities are on a par with the previous year at EUR 1 million.

Reduction in equity
In the financial year 2016, equity fell by EUR 716 million or 6.0 % to EUR 10,870 million (2015: EUR 11,586 million). The changes in equity were due mainly to the dividend payment on 20 May 2016 in the amount of EUR 714 million, as well as the loss for the period of EUR -2 million.

Employees

As in 2015, Telefónica Deutschland Holding AG did not have any employees in the financial year 2016.

Subsequent Events

There were no significant events after the end of the financial year 2016.

Risks and Opportunities

Telefónica Deutschland's business development is fundamentally exposed to the same risks and opportunities as that of the Telefónica Germany Group. As a matter of principle, Telefónica Deutschland participates in the risks of its subsidiaries and equity interests in line with the stake held. (› REPORT ON RISKS AND OPPORTUNITIES).

As the parent company of the Telefónica Germany Group, Telefónica Deutschland is included in the group-wide risk management system (› RISK MANAGEMENT AND RISK REPORTING). The description of the internal control system for Telefónica Deutschland required in accordance with section 289 (5) HGB is included in › ACCOUNTING-RELATED INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM.

Outlook 2017

Telefónica Deutschland Holding AG acts as a management and holding company. Accordingly, its permanent future development is largely dependent on the development of the operating companies of the Telefónica Deutschland Group, and particularly Telefónica Deutschland GmbH & Co. OHG. Information on economic and market performance and the expected development of key performance indicators at the level of the Telefónica Deutschland Group can be found in the Report on Expected Developments.

Due to contracts in place in conjunction with the compensation for management services, we expect Telefónica Deutschland AG's revenues for the financial year 2017 to be slightly reduced but remain broadly at similar levels as in the financial year 2016. For the financial year 2017 Telefónica Deutschland Holding AG expects a net result similar to the net result in financial year 2016.

T 17 — Balance Sheets

				As of December 31
(Euros in millions)	**2016**	2015	Change	% Change
Fxed Assets				
Investments in affiliated companies	10,757	11,437	(680)	(6)
Current assets				
Receivables and other assets	121	141	(20)	(14)
Receivables from affiliates	0	15	(15)	(98)
Total assets	**10,879**	**11,593**	**(714)**	**(6)**
Equity	**10,870**	**11,586**	**(716)**	**(6)**
Provisions	**7**	**7**	**1**	**8**
Liabilities	**1**	**1**	**0**	**0**
Total equity and liabilities	**10,879**	**11,593**	**(714)**	**(6)**

Management Declaration_

The company has published this declaration, which also contains the declaration of compliance pursuant to section 161 AktG, section 76 (4) and section 111 (5) AktG, on its website (**WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN/CORPORATE-GOVERNANCE/MANAGEMENT-DECLARATION.HTML**) and in the Corporate Governance/Declaration of Compliance section of the Annual Report. This management declaration in accordance with section 289a HGB and forms section 315 (5) HGB part of this combined management report.

Munich, 2 February 2017

Telefónica Deutschland Holding AG

The Management Board

Markus Haas

Rachel Empey

Consol-idated Financial State-ments_

for the financial year ended 31 December 2016

B

pp. 71–155

Consolidated Financial Statements_

Notes

Consolidated Statements of Financial Position_

Assets (Euros in millions)	Notes	As of 31 December **2016**	2015
A) Non-current assets		**13,055**	**14,406**
Goodwill	[5.1]	1,932	1,955
Other intangible assets	[5.2]	6,215	7,059
Property, plant and equipment	[5.3]	4,217	4,507
Trade and other receivables	[5.4]	77	157
Other financial assets	[5.5]	60	63
Other non-financial assets	[5.6]	128	160
Deferred tax assets	[6.6]	427	505
B) Current assets		**2,246**	**2,248**
Inventories	[5.7]	85	123
Trade and other receivables	[5.4]	1,460	1,520
Other financial assets	[5.5]	25	10
Other non-financial assets	[5.6]	63	61
Cash and cash equivalents	[5.8]	613	533
Total assets (A+B)		**15,301**	**16,654**

Equity and Liabilities (Euros in millions)	Notes	As of 31 December **2016**	2015
A) Equity		**9,408**	**10,321**
Subscribed capital	[5.9]	2,975	2,975
Additional paid-in capital	[5.9]	4,800	4,800
Retained earnings		1,634	2,546
Total equity attributable to owners of the parent		9,408	10,321
B) Non-current liabilities		**2,637**	**2,779**
Interest-bearing debt	[5.10]	1,721	1,686
Trade and other payables	[5.11]	17	154
Provisions	[5.12]	561	516
Deferred income	[5.11]	338	424
C) Current liabilities		**3,256**	**3,554**
Interest-bearing debt	[5.10]	37	568
Trade and other payables	[5.11]	2,286	2,272
Provisions	[5.12]	190	196
Other non-financial liabilities	[5.6]	79	48
Deferred income	[5.11]	664	471
Total equity and liabilities (A+B+C)		**15,301**	**16,654**

Consolidated Income Statements_

(Euros in millions)	Notes	1 January to 31 December 2016	2015
Revenues	[6.1]	7,503	7,888
Other income	[6.2]	502	265
Supplies		(2,452)	(2,712)
Personnel expenses	[6.3]	(646)	(655)
Other expenses	[6.4]	(2,838)	(2,982)
Operating income before depreciation and amortisation (OIBDA)		**2,069**	**1,804**
Depreciation and amortisation	[5.2], [5.3]	(2,118)	(2,067)
Operating income		**(50)**	**(263)**
Finance income		11	10
Exchange gains		1	2
Finance costs		(48)	(56)
Exchange losses		(1)	(4)
Financial result	[6.5]	**(36)**	**(48)**
Loss before tax		**(86)**	**(311)**
Income tax	[6.6]	(90)	(72)
Loss for the period		**(176)**	**(383)**
Loss for the period attributable to owners of the parent		**(176)**	**(383)**
Loss for the period		**(176)**	**(383)**
Earnings per share	[9]		
Basic earnings per share in EUR		**(0.06)**	**(0.13)**
Diluted earnings per share in EUR		**(0.06)**	**(0.13)**

Consolidated Statements of Comprehensive Income_

		1 January to 31 December	
(Euros in millions)	Notes	2016	2015
Loss for the period		**(176)**	**(383)**
Other comprehensive income/(loss)			
Items that will not be reclassified to profit/(loss)		**(25)**	**7**
Remeasurement of benefits after termination of employment	[5.12]	(36)	11
Income tax impact	[6.6]	11	(3)
Other comprehensive income/(loss)		**(25)**	**7**
Total comprehensive loss		**(201)**	**(375)**
Total comprehensive loss for the period attributable to owners of the parent		(201)	(375)
Total comprehensive loss		**(201)**	**(375)**

Consolidated Statements of Changes in Equity_

(Euros in millions)	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Equity attributable to owners of the parent	Equity
Financial position as of 1 January 2015		**2,975**	**4,800**	**3,637**	**11,412**	**11,412**
Loss for the period		–	–	(383)	(383)	(383)
Other comprehensive income		–	–	7	7	7
Total comprehensive loss		**–**	**–**	**(375)**	**(375)**	**(375)**
Dividends	[5.9]	–	–	(714)	(714)	(714)
Other movements		–	–	(2)	(2)	(2)
Financial position as of 31 December 2015		**2,975**	**4,800**	**2,546**	**10,321**	**10,321**
Financial position as of 1 January 2016		**2,975**	**4,800**	**2,546**	**10,321**	**10,321**
Loss for the period		–	–	(176)	(176)	(176)
Other comprehensive loss		–	–	(25)	(25)	(25)
Total comprehensive loss		**–**	**–**	**(201)**	**(201)**	**(201)**
Dividends	[5.9]	–	–	(714)	(714)	(714)
Other movements		–	–	2	2	2
Financial position as of 31 December 2016		**2,975**	**4,800**	**1,634**	**9,408**	**9,408**

Consolidated Statements of Cash Flows_

(Euros in millions)	Notes	1 January to 31 December 2016	2015
Cash flows from operating activities			
Loss for the period		**(176)**	**(383)**
Adjustments to profit/(loss)			
Financial result	[6.5]	36	48
Gains on disposal of assets	[2]	(352)	(14)
Income tax	[6.6]	90	72
Depreciation and amortisation	[5.2], 5.3]	2,118	2,067
Retrospective purchase price adjustment[2]		–	(102)
Changes in working capital			
Other current and non-current assets	[5.4], [5.5], [5.6],[5.7]	196	36
Other non-current liabilities and provisions	[5.11], [5.12]	(188)	(82)
Other current liabilities and provisions	[5.11], [5.12]	157	127
Other			
Taxes paid		(0)	0
Interest received		16	15
Interest paid[1]		(39)	(47)
Payment received for E-Plus[2]	[7]	–	102
Cash flows provided by operating activities		**1,859**	**1,838**
Cash flows from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets	[8]	591	0
Payments on investments relating to mobile phone frequency auctions[1]		(4)	(978)
Payments on investments in property, plant and equipment and intangible assets	[5.2], [5.3]	(1,030)	(1,083)
Proceeds from disposals of companies	[8]	–	57
Acquisition of E-Plus, net of cash acquired[2]	[7]	–	30
Net payments on financial assets		(13)	(10)
Cash flows used in investing activities		**(455)**	**(1,984)**
Cash flows from financing activities			
Payments made for capital increase costs		–	(6)
Payments made for frequency auctions		(111)	–
Proceeds from interest-bearing debt	[5.10]	850	350
Repayment of interest-bearing debt	[5.10]	(1,348)	(653)
Dividends paid	[5.9]	(714)	(714)
Net cash used in financing activities		**(1,323)**	**(1,023)**
Net increase/(decrease) in cash and cash equivalents		**80**	**(1,169)**
Cash and cash equivalents at the beginning of the period	[5.8]	**533**	**1,702**
Cash and cash equivalents at the end of the period	[5.8]	**613**	**533**

1 As of 30 September 2016, the total amount of interest paid amounted to EUR 43 million and is presented in the Consolidated Statement of Cash Flows in interest paid of EUR 39 million and payments on investments in mobile phone frequencies of EUR 4 million.

2 An agreement on the final purchase price was reached with KPN in financial year 2015. The preliminary purchase price was reduced by EUR 134 million in financial year 2015. The payment received with an amount of EUR 104 million, deducted by expenses to reach the agreement with an amount of EUR 2 million is presented in cash flows from operating activities. The remaining amount of EUR 30 million is presented in cash flows from investing activities.

Notes to the Consolidated Financial Statements_ for the year ended 31 December 2016

1. Reporting Entity

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared as of and for the year ending 31 December 2016 and are comprised of Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland") and its subsidiaries as well as joint operations (together referred to as the "Telefónica Deutschland Group" or the "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**). 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 31 December 2016, Telefónica Deutschland Holding AG had share capital of EUR 2,974,554,993, which is consistent with prior year and is 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 no-par-value share has one vote at the Annual General Meeting.

As of 31 December 2016, 21.32 % of the shares were in free float. 63.22 % were held by Telefónica Germany Holdings Limited, Slough, United Kingdom (Telefónica Germany Holdings Limited), an indirect wholly owned subsidiary of Telefónica, S.A., Madrid, Spain (Telefónica, S.A.). The remaining 15.46 % were held by Koninklijke KPN N.V., The Hague, Netherlands (KPN).

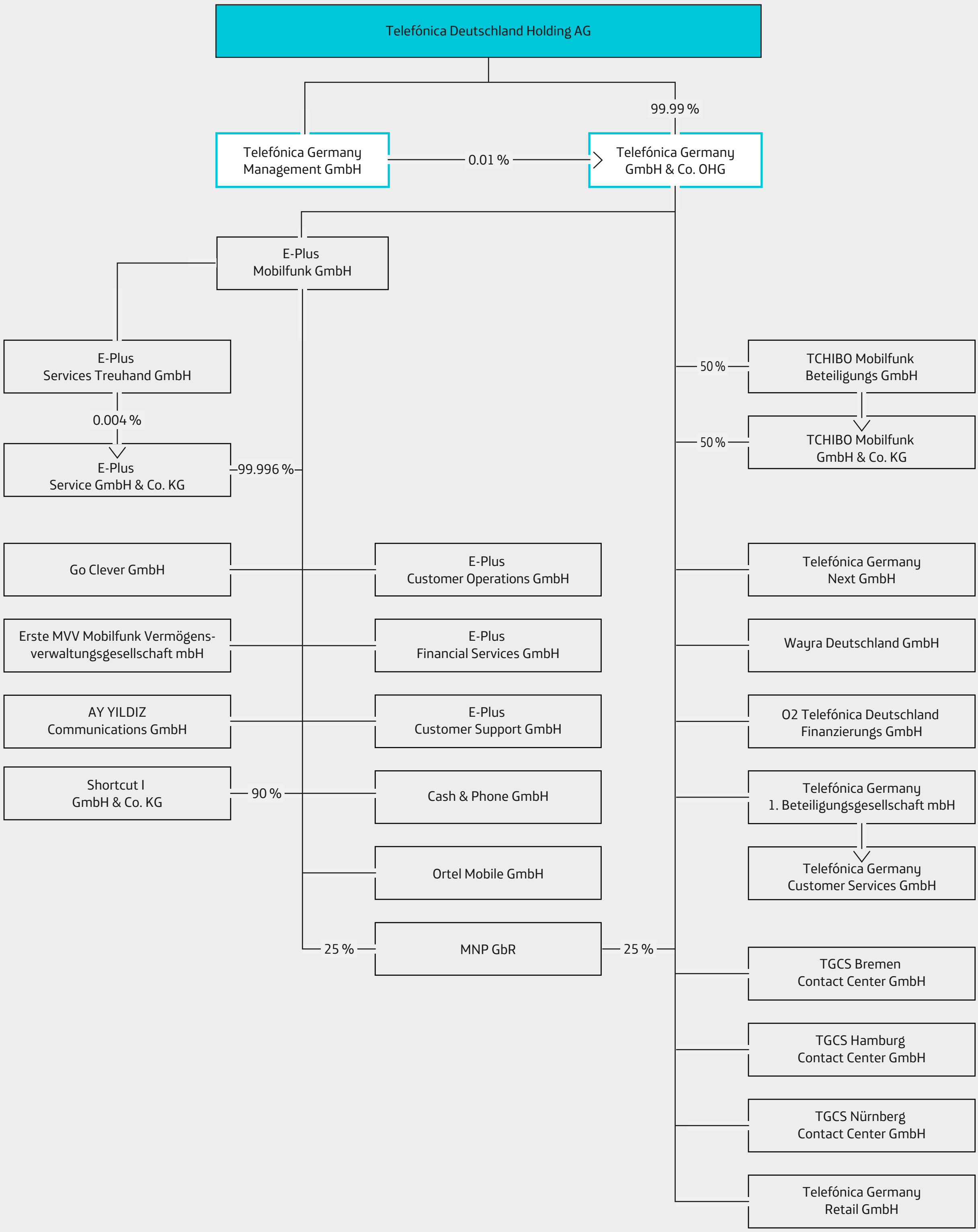
As of 31 December 2016, Telefónica Deutschland Holding AG had Authorised Capital 2016/I of EUR 1,487,277,496.

As of 31 December 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 Consolidated Financial Statements (Telefónica, S.A. Group) of the ultimate holding company, Telefónica, S.A., Madrid, Spain. The parent company of Telefónica Deutschland Holding AG is Telefónica Germany Holdings Limited, a wholly owned subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited), and an indirect subsidiary of Telefónica, S.A.

The Telefónica Deutschland Group, which includes E-Plus Mobilfunk GmbH, Düsseldorf (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 on 1 October 2014. 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 31 December 2016, the companies included in the Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart:



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

In the first quarter of the financial year, Fonic GmbH was merged with Telefónica Germany GmbH & Co. OHG.

In the third quarter of the financial year, WiMee-Plus GmbH and WiMee-Connect GmbH were merged with Telefónica Germany GmbH & Co. OHG and Gettings GmbH was merged with E-Plus Mobilfunk GmbH, while Telefónica Germany Next GmbH was newly formed. In the fourth quarter of the financial year, E-Plus 2. Beteiligungsgesellschaft mbH was merged with Telefónica Germany GmbH & Co. OHG. E-Plus Retail GmbH changed its legal name to Telefónica Germany Retail GmbH by registration into the German Commercial Register on 8 December 2016.

2. Significant Events and Transactions in the Reporting Period

Annual General Meeting and dividends
The Annual General Meeting for the financial year 2015 took place on 19 May 2016. In addition to presenting the Annual Financial Statements and Consolidated Financial Statements of Telefónica Deutschland 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 on a new Authorised Capital 2016/I of EUR 1,487,277,496, cancelling the former Authorised Capital 2012/I, and resolved on a new authorisation to buy back own shares of 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, cancelling the previous authorisation to buy back own shares dated 5 October 2012.

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

Changes in the Supervisory Board of Telefónica Deutschland
Antonio Manuel Ledesma Santiago left the Supervisory Board of Telefónica Deutschland with effect from 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 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.

Christoph Braun has been a member of the Supervisory Board of Telefónica Deutschland as successor to Imke Blumenthal since 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

Changes in the Management Board of Telefónica Deutschland
Thorsten Dirks left – as mutually agreed – the management board and as CEO by the end of 31 December 2016.

The supervisory board had approved on 21 November 2016 as per Thorsten Dirks' request an early termination of his contract, and has announced it accordingly.

The supervisory board appointed Markus Haas as CEO of Telefónica Deutschland Holding AG with resolution on 11 December 2016 effective as of 1 January 2017.

Rachel Empey, in addition to her previous responsibility for Finance and Corporate Strategy, is since 1 January 2017 also responsible for the areas of Transformation &Integration, Business Intelligence, Innovation and Telefónica NEXT.

Sale of passive tower infrastructure to Telxius S.A.
Based on a decision by the governing 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 these network towers without restrictions through operating lease agreements.

Framework social 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.

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 50 million had been utilised as of 31 December 2016. It serves general business purposes and has a term of five years. The loan term can be extended to no later than March 2023.

Financing agreement signed with European Investment Bank (EIB)
On 13 June 2016, the Telefónica Deutschland Group signed its first financing agreement with the EIB in the amount of EUR 450 million, of which EUR 250 million had been utilised as of 31 December 2016. The facility is intended 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 Consolidated Financial Statements of Telefónica Deutschland Holding AG are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

The accounting policies are consistent with the prior year issued Consolidated Financial Statements for the year ended 31 December 2015, with the exception of the changes to IFRS and the measurement changes described in Note 4 Accounting Policies (sections r) and t)). Furthermore, the Group applied the additional requirements of German commercial law pursuant to section 315a (1) of the German Commercial Code (HGB).

The Consolidated Financial Statements of Telefónica Deutschland Holding AG were forwarded to the Supervisory Board on 2 February 2017.

Functional currency and presentation currency
These Consolidated Financial Statements are presented in euros, which is the functional currency of the Telefónica Deutschland Group and all the Telefónica Deutschland Group companies.

Unless stated otherwise, the figures in these Consolidated Financial Statements are presented in millions of euros (EUR million). The figures in these Consolidated Financial Statements are rounded according to established commercial principles. Therefore, recalculations may slightly differ from the totals shown in the respective tables.

Other

The Consolidated Statements of Financial Position are divided into current and non-current assets and liabilities in accordance with IAS 1. The Consolidated Income Statements are prepared using the nature of expense method.

Comparative information

The Consolidated Statements of Financial Position presented in these Consolidated Financial Statements includes the amounts as of 31 December 2016 compared to 31 December 2015.

4. Accounting Policies

The principal accounting policies used in preparing the accompanying Consolidated Financial Statements are as follows:

a) Business combinations

Business combinations are accounted for in accordance with the purchase method. Telefónica Deutschland as the acquirer and the acquiree may have had an existing relationship prior to a business combination. If the business combination settles such a pre-existing relationship, Telefónica Deutschland, as the acquirer, recognises a resulting gain or loss. The costs of an acquisition are measured according to the fair values of the assets transferred and the liabilities incurred or assumed on the acquisition date. Any agreed contingent consideration by Telefónica Deutschland as the acquirer, is recognised at fair value as of the acquisition date. Subsequent changes in the fair value of contingent consideration that constitutes an asset or a liability are recognised either in profit or loss or as a change in other comprehensive income. Contingent consideration classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Transaction costs are recognised in profit or loss at the date they are incurred. Telefónica Deutschland initially recognises identifiable assets acquired in a business combination and the liabilities assumed, including contingent liabilities, at fair value at the acquisition date.

b) Goodwill

For business combinations after 1 January 2010, the effective date of revised IFRS 3 – Business Combinations, goodwill represents the excess of acquisition costs over the fair values of identifiable assets acquired and liabilities assumed at the acquisition date. Cost of acquisition is the sum of the fair value of consideration delivered and the value attributed to existing non-controlling interests. For each business combination, the Telefónica Deutschland Group determines the value of non-controlling interests at either their fair value or their proportional part of the net identifiable assets acquired. After initial measurement, goodwill is recognised less any accumulated impairment losses. If Telefónica Deutschland Group held an equity interest in the acquiree prior to the business combination (business combinations achieved in stages), the carrying value of such previously held equity interest is remeasured at its acquisition-date fair value and the resulting gain or loss, if any, is recognised in profit or loss.

For business combinations that occurred after 1 January 2004, the date of the transition to IFRS, and before 1 January 2010, the effective date of revised IFRS 3 – Business Combinations, goodwill represents the excess of the acquisition costs including transaction costs over the acquirer's interest, at acquisition date, in the fair values of the identifiable assets, liabilities and contingent liabilities of the acquired business. After initial measurement, goodwill is carried less any accumulated impairment losses.

In all cases, goodwill is recognised as an asset denominated in the currency of the company acquired.

Goodwill is not amortised, but tested for impairment annually or more frequently if there are certain events or changes in circumstances indicating the possibility that the carrying amount is higher than the recoverable amount (see Note 5.1 Goodwill).

c) Other intangible assets

Other intangible assets are carried at acquisition or production cost, less any accumulated amortisation and any accumulated impairment losses. Subsequent expenditure is capitalised only for existing other intangible assets if it increases the future economic benefit embodied in the asset to which it relates. All other expenditures on internally generated goodwill and brands are recognised in the Consolidated Income Statements as incurred.

Borrowing costs within the meaning of IAS 23 that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as a component of the cost of the respective asset.

The useful lives of other intangible assets either finite or indefinite are determined individually. The Telefónica Deutschland Group has not recognised other intangible assets with indefinite useful lives. Other intangible assets with finite useful lives are amortised systematically over the economic useful life and are assessed for impairment if events or circumstances indicate that their carrying amount may not be recoverable. Other intangible assets that are not yet available for use are also tested for impairment annually. Residual values of assets, useful lives and amortisation methods are reviewed annually at year-end and, when appropriate, adjusted prospectively.

Licences
Licenses include primarily the acquisition costs of the licences granted by public authorities to provide telecommunications services as well as values allocated to licences held by certain companies at the time they were included in the Telefónica Deutschland Group.

These licences are amortised on a straight-line basis starting from the moment commercial operation begins (14 to 20 years).

Customer base
This item represents primarily the allocation of acquisition costs attributable to customers acquired in business combinations, as well as the acquisition value of this type of asset in a third-party transaction for good and valuable consideration. Amortisation is performed on a straight-line basis over the estimated period of each customer relationship (mostly nine to ten years).

Software
Software is carried at acquisition or production cost and amortised on a straight-line basis over its useful life, generally estimated to be between two and five years.

Brand names
This includes brand names acquired and thus capitalised in connection with business transactions. The brand names are amortised on a straight-line basis over their expected economic useful lives (three to 20 years).

d) Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any accumulated impairment losses. Land is not depreciated.

Cost includes external and internal costs comprising warehouse material used, direct labour used in installation work and the allocable portion of indirect costs required for the related investment. The latter two items are recorded as revenues in Other Income – Own Work Capitalised.

Cost includes in addition, when appropriate, the estimate of the costs at initial recognition for dismantling and removing the item and restoring the site on which it is located and the obligation which the entity incurs either when the item is acquired or as a consequence of having used it. Any corresponding valuation changes in subsequent years are allocated to the respective asset.

The costs of expansion, modernisation, or improvement leading to increased productivity, capacity and efficiency or to an extension of the useful lives of assets are capitalised when the recognition criteria are met.

Upkeep and maintenance costs are expensed as incurred.

If an asset within property, plant and equipment consists of multiple components with different useful lives, each part of the asset having a significant acquisition value is assessed and depreciated separately over the term of the useful life of the individual component (component approach).

The Telefónica Deutschland Group assesses the need to write down the carrying amount of each item of property, plant and equipment to its recoverable amount, whenever there are indications that the carrying amount of the asset exceeds the higher of the fair value less costs of disposal and its value in use. The impairment charge is reversed if the factors giving rise to the impairment no longer exist (see section e).

The Telefónica Deutschland Group depreciates its property, plant and equipment once they are in full working condition using the straight-line method based on the following estimated useful lives of the assets. The useful lives are calculated in accordance with technical studies which are reviewed periodically and, where appropriate, updated based on technological advances and the rate of dismantling:

	Estimated useful life in years
Buildings	5–20
Plant and machinery (incl. telephone installations, networks and subscriber equipment)	5–20
Furniture, tools and other items	2–10

The estimated residual values of assets and depreciation methods are also regularly reviewed and, where appropriate, adjusted prospectively at each financial year-end.

e) Impairment of property, plant and equipment, goodwill and other intangible assets

Goodwill and intangible assets which have not yet been placed in service are tested for impairment annually at the reporting date or if there are any indications. Property, plant and equipment and intangible assets with a finite useful life are tested for impairment only if any indications of impairment exist at the reporting date. Assets are tested for impairment either individually or on the level of the cash-generating unit to which the asset belongs; goodwill is always tested on the level of a cash-generating unit to which it was allocated or groups of cash-generating units. An impairment is required if the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount. The recoverable amount is determined as the higher of the fair value less costs to sell and the value in use.

The impairment test for goodwill is performed at the lowest level within the entity at which the goodwill is monitored for internal management purposes, but must be at least performed at segment level. If the recoverable amount of a cash-generating unit to which goodwill is allocated is less than the carrying amount of the unit, an impairment loss shall be recognised corresponding to the difference. If the impairment loss exceeds the carrying amount of the goodwill, the remainder shall be allocated pro rata on the basis of the respective carrying amounts of the other assets.

If the carrying amount of an asset exceeds its recoverable amount, the carrying amount written down to its recoverable amount and the resulting loss is recognised in the Consolidated Income Statement. Future depreciation or amortisation charges are adjusted for the asset's new carrying amount over its remaining useful life.

If new events or changes in circumstances indicate that an impairment loss recognised for an asset no longer exists or may have decreased, a new estimate of the recoverable amount of the asset will be determined. A previously recognised impairment loss shall be reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. The reversal is limited to the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. The amount of the reversal is recognised in profit or loss, and the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount on a systematic basis over its remaining useful life. An impairment loss recognised for goodwill shall not be reversed in subsequent reporting periods.

As of 31 December 2016, the Telefónica Deutschland Group comprises one single cash-generating unit, the reportable segment Telecommunications.

As a matter of principle, the Telefónica Deutschland Group determines the recoverable amount of a cash-generating unit based on its fair value less costs to sell.

The fair value is determined based on the market capitalisation of Telefónica Deutschland Holding AG as of the reporting date. Costs to sell contain costs such as legal and consulting fees that can be directly allocated to the sale of the cash-generating unit.

f) Investments in joint operations

The Telefónica Deutschland Group's interests in companies over which it has joint control with third parties are recognised in accordance with the guidelines based on the relation to its interest in the joint operation. Thus, the Telefónica Deutschland Group's respective share of the assets and the liabilities of the joint operations are included in the Consolidated Financial Statements. The share of expenses incurred by Telefónica Deutschland Group in connection with the joint operations and its share of the revenues are recognised in the Consolidated Income Statements.

g) Foreign currency transactions

Transactions denominated in a foreign currency are translated to euros at the exchange rate prevailing on the transaction day. At the end of the reporting period, monetary assets and liabilities denominated in a foreign currency are translated at the exchange rate applicable at the reporting date.

The following exchange rates have been used for the respective Consolidated Financial Statements:

	Spot rates		Average rates	
(EUR/foreign currency)	**As of 31 December 2016**	As of 31 December 2015	**2016**	2015
USD	1.054	1.089	1.106	1.109
GBP	0.855	0.734	0.817	0.726
BRL	3.435	4.251	3.833	3.643
CHF	1.074	1.084	1.090	1.068

All realised and unrealised foreign exchange gains and losses are included in the Consolidated Income Statements.

h) Inventories

Inventories are stated at the lower of cost and net realisable value and are written down, if necessary. Cost is determined on the basis of weighted average cost and comprises direct materials and, where applicable, direct labour cost that has been incurred in bringing the inventory to its present location and condition. Estimates of the net realisable value are based on the most reliable evidence available and are based on the amount the inventories are expected to sell. These estimates take into consideration the fluctuations of sales prices or costs as well as the purpose for which the inventory is held.

If the circumstances that previously caused inventories to be written down to an amount below cost no longer exist, the amount of the write-down is reversed, so that the new carrying amount is the lower of cost and revised net realisable value.

The Group's inventory mainly consists of merchandise intended for sale to end customers. At the time of the sale or transfer of the risk to the customer, inventory is expensed through cost of sales.

i) Cash and Cash Equivalents

Cash and cash equivalents are defined as short-term, highly liquid financial investments, which can be converted into cash at any time and are not materially impacted by the risk of a change in values.

j) Financial instruments

A financial instrument, according to IAS 39, is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments are recognised as soon as the Telefónica Deutschland Group becomes a party to the contractual provisions of the financial position on the trade day, i.e. the date that the Telefónica Deutschland Group commits to purchase or sell the financial asset. Upon initial recognition, financial instruments are measured at fair value. Transaction costs directly attributable to the acquisition or issuance are considered in determining the carrying amount if the financial instruments are not measured at fair value through profit or loss.

For the purpose of subsequent measurement, financial instruments are allocated to the following categories:
- financial assets or financial liabilities at fair value through profit or loss
- held-to-maturity investments
- loans and receivables
- available-for-sale financial assets
- financial liabilities measured at amortised cost

The Telefónica Deutschland Group did not allocate any financial instruments to the category held-to-maturity during the reporting period.

Financial assets

Financial assets mainly include trade and other receivables, other financial assets as well as cash and cash equivalents.

Financial assets measured at fair value and recognized in profit or loss

Financial assets measured at fair value and recognized in profit or loss consist of financial assets that are designated as measured at fair value and recognized in profit or loss upon initial recognition. This includes derivatives in the form of interest rate swaps that qualify for hedge accounting and have positive market values at the reporting date. Changes to the fair values recorded after the initial recognition are also recognised in profit or loss at the remeasurement date.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market (such as trade and other receivables). After the initial recognition, loans and receivables are subsequently carried at amortised cost using the effective interest method less any impairment losses. Gains and losses are recognised in the Consolidated Income Statement when the loans and receivables are written off or impaired. Interest effects from the application of the effective interest method are also recognised in profit or loss.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or that cannot be classified in any of the other categories. These include equity instruments (investments in start-ups).

After initial measurement, available-for-sale financial assets are measured at fair value, with unrealised gains and losses being recognised in other comprehensive income/loss. If objective evidence of an impairment exists, it is recognised in the Consolidated Income Statement. Upon the disposal of the financial assets, the accumulated gains and losses recognised in other comprehensive income/loss resulting from measurement at fair value are recognised in profit or loss.

If there is no active market for equity instruments and their fair value cannot be reliably determined, they are measured at acquisition cost.

Impairment of financial assets

At each reporting date, the carrying amounts of financial assets other than those measured at fair value through profit or loss are assessed to determine whether there is objective evidence of an impairment. Objective evidence may, for example, exist if a debtor faces serious financial difficulties or is unwilling to pay.

Loans and receivables

The amount of impairment loss on loans and receivables is measured as the difference between the carrying amount of the asset and the present value of the expected future cash flows (excluding expected future credit losses that have not been incurred), discounted at the original effective interest rate of the financial asset. The amount of the impairment is recognised in the Consolidated Income Statement. If, in a subsequent reporting period, the amount of impairment loss decreases and the decrease can be attributed objectively to an event occurring after the impairment was recognised, the impairment loss recorded in prior periods is corrected and recognised in the Consolidated Income Statement. The impairment losses of loans and receivables (e.g. trade receivables) are recorded using allowance accounts. When receivables are assessed as uncollectible, the impaired asset is derecognised.

Available-for-sale financial assets

If an available-for-sale financial asset is impaired, the difference between its cost (less any principal payments and amortisation) and its current fair value (less any impairment loss previously recognised in the Consolidated Income Statement) is reclassified from other comprehensive income/loss to the Consolidated Income Statement. Reversals with respect to equity investments classified as available-for-sale are recognised in the other comprehensive income/loss. Reversals of impairment losses on debt instruments are recorded in the Consolidated Income Statement if the increase in fair value of the instrument can be objectively attributed to an event occurring after the impairment losses were recognised in the Consolidated Income Statement.

For financial assets classified as available-for-sale, objective evidence of an impairment exists if there is a significant (> 20 %) or other than temporary decline (over a period of six months) in the fair value of the instrument.

Financial liabilities

Financial liabilities include primarily trade and other liabilities and interest-bearing debt (including bonds).

Extended payment terms with vendors lead to a change in the nature of the liability and as such, require a reclassification into interest-bearing debt, if the adjusted payment terms exceed usual accepted industry conditions. If the new payment terms are within normal industry term, a reclassification is not required and the payments are presented within trade payables.

Financial liabilities at fair value through profit or loss

A financial liability is measured at fair value through profit or loss if it is held for trading or is designated as fair value through profit or loss on initial recognition. They are presented as current or non-current liabilities or debt depending on their maturity.

Financial instruments included in this category are recorded at fair value on initial recognition and on every subsequent reporting date. Any realised and unrealised gains or losses are recognised in the Consolidated Income Statement.

The company classifies *derivative financial instruments* as held for trading unless they are designated as a hedging instrument (hedge accounting) (see Note 5.10 Interest-bearing liabilities). The fair value used to measure listed derivatives is equal to their positive or negative market value. If a market value is not available, fair value is calculated using standard financial valuation models, such as discounted cash flow or option price models. Derivatives are presented as assets if their fair value is positive and as liabilities if their fair value is negative. Changes in the fair value of derivative financial instruments are recognised periodically in the Consolidated Income Statements. In the current financial year, the Telefónica Deutschland Group has two interest rate swaps (derivative financial instrument) to hedge interest-rate risks.

Hedging transactions: if the effectiveness of a hedging relationship can be demonstrated and documented accordingly, the Telefónica Deutschland Group enters into a hedge consisting of the hedged item and the corresponding hedging instrument.

If the company hedges a fair value (fair value hedges), the portion of profit or loss attributable to the hedged risk is allocated to the carrying amount of the hedged item. The carrying amount of the hedged item is increased or decreased by the profit or loss that is attributable to the hedged risk. For hedged items that are recorded at amortised cost, the increase or decrease of the carrying amount is completely released at maturity of the hedged item. When hedging pending transactions, the company increases or decreases the initial carrying amount of the assets or liabilities that result from the fulfilment of the pending transactions by the accumulated changes in the fair value of financial assets or liabilities that were previously separately recognised.

From the date the hedging instrument expires, or is sold, terminated, or exercised, the accounting of the hedging relationship also ends. The same applies if there is no longer a hedging transaction within the meaning of IAS 39 or the Telefónica Deutschland Group ends the designation.

Liabilities at amortised cost

After initial recognition, financial liabilities are subsequently remeasured at amortised cost using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the interest rate that exactly discounts the estimated future cash payments through the expected life of the financial liability, or where appropriate, a shorter period to the net carrying amount on initial recognition. The interest expense is recognised on an effective interest basis.

Liabilities to members of partnerships with puttable shares are initially recognised at the present value of the buyout obligation. They are subsequently measured at amortised cost.

Derecognition of financial assets and liabilities

Financial assets are derecognised when the rights to receive cash flows from the assets expire or the financial assets are transferred and the Telefónica Deutschland Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of consideration received including the cumulative gains or losses that had been recognised directly in equity, is recognised in the Consolidated Statements of Comprehensive Income. If the Telefónica Deutschland Group does not retain or transfer substantially all risks and rewards, and retains control, it continues to recognise the transferred asset to the extent of its continuing involvement.

Financial liabilities are derecognised when the underlying obligation is settled, cancelled, or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss.

k) Provisions

Pension obligations

The Telefónica Deutschland Group's obligations under defined benefit pension plans are determined using the projected unit credit method and are recognised as personnel expenses unless otherwise stated below.

The Telefónica Deutschland Group determines the net interest expense (net interest income) by multiplying the net defined benefit liability (asset) at the beginning of the period by the interest rate used to discount the defined benefit obligation at the beginning of the period.

The discount rate is determined using market yields at the end of the reporting period on fixed-interest high-quality corporate bonds.

The net defined benefit liability (asset) is determined at every reporting date on the basis of an actuary report based on assumptions that are explained as follows. If the plan assets less the defined benefit obligation results in a surplus, then the level of the reported net defined benefit asset is limited to the present value of economic benefits associated with the plan asset surplus in the form of refunds from the plan or on the basis of reduced future contributions. In addition, in the event of a surplus of the plan, the new valuation components include the change in the net defined benefit asset from the application of the asset ceiling, to the extent not taken into account in the net interest component.

Assets incurred by the Telefónica Deutschland Group to meet its pension obligations, which do not qualify as plan assets in accordance with IAS 19, are reported under other financial assets.

As part of the determination of the present value of economic benefits associated with the plan asset surplus, any existing minimum funding requirements are taken into account.

The remeasurement component includes on the one hand the actuarial gains and losses from the valuation of the defined benefit obligation and on the other hand the difference between the actual return on plan assets and the amounts contained in the net interest on net defined benefit liability (assets).

The company recognises all remeasurement effects in other comprehensive income, whereas the remaining components of the net pension expense (service cost and net interest) are recognised in the Consolidated Income Statement.

In the case of defined contribution plans, the relevant company pays contributions to special purpose pension institutions that are presented in personnel expenses.

Other provisions including termination benefits
Provisions are recognised when the Telefónica Deutschland Group has a present (legal or constructive) obligation, as a result of a past event that can be estimated reliably and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are discounted and the corresponding increase in the provision due to the passage of time is recognised as interest expense. For the purpose of discounting, the group applies non-risk market interest rates before tax which are matched to the duration. This does not apply to other long-term employee benefits (partial retirement obligations), for which the discount rate is determined on the same basis as for pension obligations. Potential risks are fully taken into account in determining the settlement amount. When the Telefónica Deutschland Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented, if applicable net of any reimbursement, in the Consolidated Income Statement.

Other provisions also include partial retirement obligations, to which the block model applies. Under this model, an outstanding settlement amount is incurred on the part of the employer during the employment phase that equates to the as yet uncompensated portion of work. After the end of the employment phase and during the reporting periods of the second block of the model (time-off phase), in which the employee receives part-time consideration without performing work, the liability is amortised accordingly.

Top-up amounts are accumulated in the amount of the present value of all future payments over a certain time period. The period over which the top-ups are earned extends to the end of the employment phase for all payments. The provision for partial retirement is allocated to other long-term employee benefits.

Provisions for death benefit obligations are recognised on the basis of actuarial reports based on the same parameters as those for pension obligations.

Provisions for restructuring including termination benefits are recognised if there is a detailed, formal plan that provides for the individual measures and has been adopted by the appropriate managing bodies. In addition, implementation is expected to begin as soon as possible and a valid expectation has been raised in those affected that the restructuring will be carried out.

The provisions for restructuring include only those expenses necessary and directly attributable to the respective measures. No provisions are recognised for future operating losses.

Provisions for the costs of decommissioning or dismantling and retirement are recognised if the Telefónica Deutschland Group has a legal or constructive obligation to dismantle the relevant items after their utilisation. The estimated costs are recognised as an asset and a provision. Changes in the timing or estimation of the costs are reflected in the asset and in the provision, respectively.

For further details, see r) Significant change of estimates, assumptions and judgements.

l) Revenues and expenses

Revenues and expenses are recognised in the Consolidated Income Statements in line with the accrual basis of accounting (i.e. when the goods are delivered or services are rendered) regardless of when actual payment or collection is made. Revenues are recognised if the amount can be measured reliably and the economic inflow of benefits from the transaction is classified as probable. Discounts, such as rebates, represent a reduction of revenues.

The revenues of the Telefónica Deutschland Group include all income attributable to the company's typical business activity.

The Telefónica Deutschland Group's revenues are primarily derived from the following telecommunications services: voice traffic, connection fees, regular (usually monthly) network usage fees, interconnection services, network and equipment leasing, handset sales, value-added services (e.g. text and data messaging) and maintenance. Products and services may be sold separately or in promotional packages (bundled services).

Voice traffic, connection fees and network usage fees
Revenues from calls carried on the Telefónica Deutschland Group networks (voice traffic) include an initial connection fee plus a variable call rate, which is based on the length and distance of the call and type of service. Both fixed line and mobile voice traffic revenues are recognised at the time the service is rendered. For prepaid calls, the unused credit generates deferred revenues that are recognised in deferred income in the Consolidated Statements of Financial Position. Revenues from unused credits are recognized when the company is no longer obligated to provide a service or utilisation is no longer likely, whichever occurs first. Revenues from voice traffic sales and other services generated at a fixed rate over a specified period of time (flat rate) are recognised on a straight-line basis over the term that is covered by the customer's payment.

Initial connection fees are recognised in deferred income and are subsequently realised in profit or loss over the average estimated term of the customer relationship, which may vary depending on the type of service. All related costs, with the exception of expenses for the network expansion and general administration costs and overheads, are recognised in profit or loss for the period in which they were incurred.

Interconnection services
Interconnection revenues from fixed line to mobile calls and vice versa, as well as other customer services are recognised in the period in which the calls are made.

Handset sales
Revenues from handset and equipment sales are recognised once the sale is considered complete, i.e. generally at the time of delivery to the end customer. Revenues from instalment sales are recognised at the amount of the discounted future receipts. The amount is discounted based on an interest rate derived from market interest rates.

Network and equipment leasing
Leases are classified according to the principles described under p) Leases.

Leases from operating lease agreements with customers and income from the leasing of equipment and other services are recognised in profit or loss as the income is earned or the service is provided and therefore on a straight-line basis over the contract term.

Leases with customers classified as finance leases are recognised in revenues at the fair value of the leased asset at the inception of the lease. If the present value of the minimum lease payment allocable to the Group is less than the fair value, the revenues are measured on this basis. Minimum lease payments are discounted based on an interest rate derived from market interest rates.

Multiple element arrangements
The Group offers bundled packages which combine multiple elements from the fixed line, mobile and internet businesses. They are evaluated to identify the separate units of accounting and allocated the corresponding revenues to each element. Total revenues are allocated to the identified elements based on their respective fair value (i.e. the fair value of each element in relation to the total fair value of the package).

As connection fees or initial activation fees, or upfront non-refundable fees, are not separately identifiable elements in these types of packages, any revenues received from the customer for these items are allocated to the remaining elements. However, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

The Group sells multiple element arrangements primarily through the sale or lease of handsets combined with a new mobile service contract. The purchase price is allocated based on the sales price of the items, if they were sold separately, and is recognized in the Consolidated Income Statements. Therefore, revenues for the handset are recognized upon delivery to the customer, while revenues for the mobile services are recognized ratably over the contract term. If a subsidized handset is provided to the customer in connection with a bundled offer, the recognition of revenues related to the handset is limited. Additional payments which are jdependent on further mobile services are not included herein.

All expenses related to bundled promotional packages are recognised in the Consolidated Income Statement as incurred.

Customer acquisition and retention costs
The Telefónica Deutschland Group pays commission to retailers and intermediaries for customer acquisition and retention. These payments are recognised into expense when the related services are rendered.

m) Income tax

Income tax includes both current and deferred taxes. Current and deferred tax is recognised in the Consolidated Income Statements except to the extent that they relate to business combinations or items directly recognised in equity or in other comprehensive income.

Current tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from, or paid to, the taxation authorities. To calculate the amount, tax rates and tax laws applicable or enacted on the reporting date are used.

The Telefónica Deutschland Group determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability is settled. Tax rates and tax laws that are enacted (or substantively enacted) at the reporting date are used.

Deferred tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that a sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that a future taxable income will allow the deferred tax asset to be recovered.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint operations are not recognised if the parent company is in a position to control the timing of the reversal and if the reversal is unlikely to take place in the foreseeable future. Cases in which no deferred tax liabilities were recognised for subsidiaries are of minor significance in terms of amount.

To the extent that deferred taxes relate to items recognised directly in equity or in other comprehensive income, these are also recognised in equity or in other comprehensive income. Deferred tax assets and liabilities arising from the initial recognition of the purchase price allocation of business combinations impact the amount of goodwill. However, subsequent changes in tax assets acquired in a business combination are recognised as an adjustment to profit or loss.

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

n) Discontinued operations and disposal groups

Components of a company that meet the criteria of IFRS 5 are classified as discontinued operations and are presented separately in the Consolidated Income Statements and the Consolidated Statements of Cash Flows if they meet the definition of a major line of business under IFRS 5. All changes made in the current reporting period to amounts that are directly related to the sale of discontinued operations in one of the prior reporting periods are likewise presented within this separate category. If a component of the company is no longer classified as held for sale, the profit or loss of this component, which had previously been presented within discontinued operations, is reclassified as continuing operations in all presented reporting periods. If supply of goods and services between continued and discontinued operations also continue after disposal, these supplies are recorded prior to consolidation in the Consolidated Income Statement.

Disposal groups, if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, are classified accordingly if the criteria of IFRS 5 are met. The disposal groups are measured at the lower of carrying amount and fair value less costs to sell and are classified as held for sale. Individual assets of the disposal group are no longer depreciated or amortised. If an impairment loss is recognised for the disposal group, then on any subsequent increases in the fair value less costs to sell, the previously recognised impairment loss has to be reversed. The reversal of the impairment is limited to the cumulative impairment loss that was recognised for the respective disposal group previously. The assets and liabilities of the disposal group are presented separately in the Consolidated Statement of Financial Position.

o) Share-based payments

Telefónica, S.A. grants share options to employees of the Telefónica Deutschland Group. The determination of the fair value is based on the performance of the shares of Telefónica, S.A. Some of the share option plans are cash-settled whereas others are equity-settled.

In the case of cash-settled share-based payment transactions, the total cost of the share options is measured at fair value, taking into account the terms and conditions of the specific plan. The total cost is recognised as an expense in the Consolidated Income Statement from the grant date until the vesting date with recognition of a corresponding liability. The fair value is first determined on the grant date by applying statistical techniques. In contrast to equity-settled share-based payments, the Group must remeasure the fair value at each reporting date and settlement date and recognise all changes in profit or loss until the debt is settled.

For equity-settled share option plans, fair value at the grant date is determined by applying statistical techniques or using a benchmark securities model. The costs are recognised as expenses and the corresponding increase in equity over the vesting period.

p) Leases

The accounting a lease is based on the substance of the agreement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the Telefónica Deutschland Group to use the asset.

Leases where the lessor does not transfer substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense or as income on a straight-line basis over the term of the lease in the Consolidated Income Statements.

Leases are classified as finance leases when the terms of the lease transfer substantially all risks and rewards incidental to ownership of the leased item to the Telefónica Deutschland Group or from the Telefónica Deutschland Group to the end customer. Leases are recorded at the inception of the lease, in accordance with their nature and the associated liability or receivable, at the lower of the present value of the minimum lease payments or the fair value of the leased object. Lease payments are allocated to the principal and interest of the lease liability in order to apply a consistent effective interest rate over the outstanding balance over the term of the lease. Finance costs and income are recognised over the term of the lease in the financial result in the Consolidated Income Statements.

If a lease includes a renewal option, the Group considers if these renewals are likely at the time of entering into the agreement. If the original estimate, as it relates to potential renewals, changes over the life of the lease, the Group will adjust the estimated future lease payments for operating leases accordingly.

In sale and leaseback transactions resulting in a finance lease, the asset sold is not derecognised, and the funds received are considered financing for the asset during the term of the lease. If the corresponding assets are leased on under a finance lease, the asset is immediately derecognised through profit and loss (see also l) Revenues and expenses).

However, when the sale and leaseback transaction results in an operating lease, and it is clear that both the transaction and subsequent lease income are established at fair value, the asset is derecognised and any gain or loss generated on the transaction is recognised.

q) Use of estimates, assumptions and judgements

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the Consolidated Financial Statements within the next financial year are discussed below. The estimated and associated assumptions are based on historical experience as well as other factors considered to be relevant.

A significant change in the facts and circumstances on which these estimates and related judgements are based could have a material impact on the Telefónica Deutschland Group's net assets, financial position and earnings.

Unforeseeable development outside management's control may cause actual amounts to differ from the original estimates. In this case the underlying assumptions, and if necessary the carrying amounts of the pertinent assets and liabilities, will be adjusted accordingly.

Changes in estimates are recognised in the period in which they occur, and also in subsequent periods if the changes affect both the reporting period and the subsequent periods.

Pensions – defined benefit plans
The determination of the present value of defined benefit obligations involves the application of actuarial assumptions.

To determine the interest rate for the defined benefit pension plans, first the so-called bond universe is established on the basis of the AA corporate bonds available on the reporting date. On the basis of these bonds a yield curve is calculated. Then a uniform average interest rate is calculated with a cash flow that corresponds to the duration of the Telefónica Deutschland Group. This latter interest rate is the actuarial discount rate used.

The determination of the expected increase in pensions is aligned with the long-term inflation expectations in the euro area.

The assumption on the fluctuation of the respective employees is based on historical experience. The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables. The mortality tables underlying the actuarial calculation of the defined benefit obligations (DBO) as of the reporting date are the Heubeck Mortality Tables 2005 G (Heubeck Richttafeln 2005 G).

Property, plant and equipment, intangible assets and goodwill
Accounting for investments in property, plant and equipment and intangible assets involves the use of estimates to determine the useful life for depreciation and amortisation purposes and to assess the fair value of assets acquired in a business combination at the acquisition date.

Determining the useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgement involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognised in the Consolidated Income Statement for the period. The decision to recognise an impairment loss involves estimates of the timing of the expected use and the amount of the impairment, as well as an analysis of the reasons for the potential loss. Furthermore, additional factors, such as technical obsolescence, the suspension of certain services and other circumstantial services are taken into account.

The Telefónica Deutschland Group evaluates the recoverable amount of its cash-generating unit regularly to identify potential goodwill impairment. Determining the recoverable amount of the cash-generating unit to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgement. The fair value is determined based on the market capitalisation of Telefónica Deutschland Holding AG as of the reporting date.

Deferred income taxes
The Telefónica Deutschland Group assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Telefónica Deutschland Group's ability to generate taxable income over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of the taxable income, which are based on internal projections and continuously updated to reflect the latest trends. In the past, time horizons of five to seven years have been used to measure loss carry forwards and temporary differences. The time horizons used have not changed since the previous year.

The recognition of tax assets and liabilities depends on a series of factors, including estimates with respect to timing and the realisation of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments of the Telefónica Deutschland Group could differ from the estimates made by the Telefónica Deutschland Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balance.

Provisions

Both the recognition and the valuation of provisions involve judgements to a high extent. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the reporting date, including the opinions of independent experts such as legal counsel or consultants.

Given uncertainties inherent in the estimates used to determine the amount of provisions, the actual outflows of resources may differ from the amounts recognised originally on the basis of the estimates.

Termination benefits

If employees are offered voluntary severance, the benefits are measured on the basis of the number of employees expected to accept the offer. Benefits attributable to a period of more than twelve months after the reporting date are recognised at present value.

The amount for termination benefits is determined on the basis of various assumptions, which also require judgements and estimates and can therefore entail uncertainties. These primarily include the assumed salary, length of employment and gardening leave period until the date of departure.

Liabilities at amortised cost

The amortised cost on which the subsequent measurement of liabilities to members of partnerships with puttable shares is based depends on the expected payment obligations.

If the estimate of the payment obligation changes, the amortised cost is adjusted.

Revenue recognition

Revenues from equipment leasing

The determination of minimum lease payments should in some cases account for future fair values determined by the Group on the basis of past and current transactions.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognised.

Connection fees

Initial connection fees are deferred and recognised as revenues over the average estimated term of the customer relationship.

The estimate of the average customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of future recognition of revenues.

Bundled offers

Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. The total package revenues are allocated among the identified elements based on their respective fair values.

Determining fair values for each identified elements requires estimates that vary from case to case.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognised.

Joint operations
The classification of interests in businesses as joint operations or as joint ventures requires partly a certain degree of judgement. The classification is made in accordance with the contractual and actual circumstances.

r) Significant changes of estimates, assumptions and judgements

Amended network planning
As the network consolidation progresses, original assumptions must be adjusted. These adjustments will lead to longer as well as shorter useful lives of certain network elements.

The useful lives of the non-current assets attributable to this part of the network were adjusted to reflect the new assumptions after the decision to amend the planned network.

Due to the offsetting effects, this did not have a significant impact on the financial year under review or on future financial years.

Asset retirement obligation
As a result of the annual review of the costs associated with the asset retirement obligation and changing interest rates, the provision increased by EUR 158 million as of 31 December 2016. The adjustment also includes effects from the update of the dismantling schedule due to the amended network planning.

The adjustment of the provision resulted in a corresponding adjustment to the associated assets and thus will also result in additional depreciation expense going forward.

Trade payables
Trade payables are reclassified to other financial liabilities when extended payment terms are agreed to, which bear interest and which exceed standard industry terms. This reclassification reflects the changed nature of these liabilities.

s) Consolidation methods

The consolidation methods applied are as follows:

— Full consolidation method for companies where the Telefónica Deutschland Group has control. Control is assumed if the Telefónica Deutschland Group has power over an investee and is exposed to variable returns or has rights to these returns. In addition, the ability must exist to use its power over the investee to affect the returns.

— Proportionate consolidation of the attributable assets, liabilities, expenses and income for companies jointly controlled with third parties (joint operations), so that the corresponding share of total assets, liabilities, expenses, income and cash flows of these companies is integrated in the corresponding items in the Consolidated Financial Statements.

All material receivables and liabilities and transactions between the consolidated companies were eliminated in consolidation. The returns generated on transactions involving capitalisable goods or services by subsidiaries with other Telefónica Deutschland Group companies were also eliminated in consolidation.

The financial statements of the consolidated companies are prepared using the same accounting policies and have the same financial year-end as the parent company's individual financial statements. In the case of Group companies whose accounting and valuation methods differ from those of the Telefónica Deutschland Group, adjustments are made in consolidation in order to present the Consolidated Financial Statements on a consistent basis.

The Consolidated Income Statement and Consolidated Statement of Cash Flows include the revenues and expenses as well as the cash flows of companies that are no longer in the Telefónica Deutschland Group up to the date on which the related interest was sold or the company was liquidated.

Revenues and expenses as well as the cash flows of new Group companies are included from the date on which the interest was acquired or the company was established until the end of the year.

t) Accounting policies adopted as of 31 December 2016

Accounting policies applied in the financial year from 1 January 2016 to 31 December 2016 and deviating from the accounting policies of the previous year are described below. These relate to new standards as well as changes to the standards and interpretations as published by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC) and endorsed for application by the European Union (EU).

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
With the amendments to IAS 16 – Property, Plant and Equipment and IAS 38 – Intangible Assets issued on 12 May 2014, the IASB provides additional guidance for determining an acceptable method of depreciation and amortisation. In particular, the permissibility of revenue-based methods is denied for property, plant and equipment and limited to exceptional cases for intangible assets. The EU approved the amendments for adoption by way of a regulation dated 2 December 2015.

Amendments to IFRS 11: Accounting for Acquisitions of Interests in Joint Operations
On 6 May 2014, the International Accounting Standards Board (IASB) issued amendments to IFRS 11 – Joint Arrangements in relation to the acquisition of interests in joint operations. An acquirer of interests in a joint operation that meets the definition of a business according to IFRS 3 must apply the accounting guidelines of IFRS 3 unless they contradict IFRS 11. The EU adopted the amendments in EU law by way of regulation dated 24 November 2015.

Amendments to IAS 27: Equity Method in Separate Financial Statements
On 12 August 2014, the IASB issued amendments to IAS 27 that reinstate the permissibility of applying the equity method in separate financial statements. The EU endorsement took place on 18 December 2015.

Annual Improvements 2012 – 2014 Cycle
Under its annual improvements project, the IASB published “Annual Improvements to the IFRSs 2012 – 2014” in September 2014, which were adopted into European law on 15 December 2015. These include minor changes and clarifications to IFRS 5, IFRS 7, IAS 19 and IAS 34.

Amendments to IFRS 10, 12 and IAS 28: Applying the Consolidation Exception
Also on 18 December 2014, the IASB issued amendments to IFRS 10, IFRS 12 and IAS 28. The aim of these amendments is to clarify the application of the consolidation exception according to IFRS 10 if the parent company meets the definition of an investment entity. The EU endorsed the amendments to IFRS 10, IFRS 12, and IAS 28 and adopted them into EU law with the regulation dated 22 September 2016.

Amendments to IAS 1: Presentation of Financial Statements
On 18 December 2014, the IASB issued amendments to IAS 1 – Presentation of Financial Statements. The amendments primarily concern the clarification that disclosures must be made if the content is not immaterial and explanations regarding the aggregation and disaggregation of items in the Statement of Financial Position and the Statement of Comprehensive Income. In addition, the prescribed structure of the notes is discarded in favour of presentation relevant to the entity. The approval of the EU was granted on 18 December 2014.

The aforementioned amendments had no effect or no significant effect on the net assets, financial position or result of operations of the Group.

u) New standards and IFRIC interpretations issued, but not yet effective as of 31 December 2016

At the time of publication of the Consolidated Financial Statements, the following standards and interpretations were published, but their application was not yet mandatory.

Standards, interpretations and amendments		Mandatory application for financial years beginning on or after
Amendments to IAS 12	Recognition of Deferred Tax Assets for Unrealised Losses	1 January 2017[1]
Amendments to IAS 7	Disclosure Initiative	1 January 2017[1]
Annual Improvements 2014–2016 Cycle	Amendments to IFRS 12	1 January 2017[1]
Annual Improvements 2014–2016 Cycle	Amendments to IFRS 1 and IAS 28	1 January 2018[1]
Amendments to IAS 40	Transfers of Investment Property	1 January 2018[1]
IFRIC Interpretation 22	Foreign Currency Transactions and Advance Consideration	1 January 2018[1]
Amendments to IFRS 2	Classification and Measurement of Share-based Payment Transactions	1 January 2018[1]
IFRS 15	Revenue from Contracts with Customers	1 January 2018
Clarifications to IFRS 15	Revenue from Contracts with Customers	1 January 2018[1]
IFRS 9	Financial Instruments	1 January 2018
IFRS 16	Leases	1 January 2019[1]
Amendments to IFRS 10 and IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	[2]

1 Endorsement by EU still outstanding, information for first-time adoption according to IASB.
2 First-time adoption postponed indefinitely according to IASB resolution of 17 December 2015.

Amendments to IAS 12 Income Taxes
On 19 January 2016, the IASB issued amendments to IAS 12 Income Taxes , which concerns the recognition of deferred taxes for unrealised losses. The amendments, Recognition of Deferred Tax Assets for Unrealised Losses, clarify how to account for deferred tax assets related to debt instruments measured at fair value. The amendments have to be applied retrospectively for financial years beginning on or after 1 January 2017.

Amendments to IAS 7: Disclosure Initiative
The IASB added an initiative to improve disclosure (disclosure initiative) to its work programme in 2013, which is made up of a number of smaller projects. The aim is to optimise and simplify the presentation and disclosure requirements in existing standards. As part of the project, the IASB issued amendments to IAS 7 Statement of Cash Flows on 29 January 2016. In the future, disclosures must be made regarding the development of borrowing costs during the reporting period, whereby payment transactions were reported or must be reported in the Statement of Cash Flows under cash flow from financing activities. The amendments have to be applied prospectively for financial years beginning on or after 1 January 2017.

Annual Improvements 2014–2016 Cycle
The IASB published the “Annual Improvements to the IFRSs 2014–2016” on 8 December 2016 as part of its annual improvements project. These include minor changes and clarifications to IFRS 1, IFRS 12, and IAS 28. The amendments to IFRS 1 and IAS 28 are effective for periods beginning on or after 1 January 2018, the amendments to IFRS 12 for periods beginning on or after 1 January 2017.

Amendments to IAS 40: Transfers of Investment Property
On 8 December 2016, the IASB issued amendments to IAS 40, which specify that transfers to or from investment property shall only be made when there is evidence of a change in use. The amendments are effective for periods beginning on or after 1 January 2018.

IFRIC 22: Foreign Currency Transactions and Advance Consideration
Also on 8 December 2016, the IASB issued the interpretation IFRIC 22 Foreign Currency Transactions and Advance Consideration. This clarifies which exchange rate shall be used for the accounting of transactions that include advance consideration in a foreign currency. IFRIC 22 is effective for periods beginning on or after 1 January 2018.

Amendments to IFRS 2: Share-based Payment
On 20 June 2016, the IASB issued amendments to IFRS 2 Share-based Payment, which contain clarifications regarding the following three issues: measurement of cash-settled share-based payment transactions, classification of share-based payment transactions with tax withheld and modification of share-based payment transactions from cash-settled to equity-settled. The amendments must be applied retrospectively for financial years beginning on or after 1 January 2018, although early application is permitted. Telefónica Germany is examining the amendments on potential impacts on the Consolidated Financial Statement.

IFRS 15: Revenue from Contracts with Customers
On 28 May 2014, the IASB issued IFRS 15 – Revenue from Contracts with Customers with the aim of enshrining regulations from various standards and interpretations in a single standard for all industries. IFRS 15 will therefore supersede IAS 18 “Revenue” and IAS 11 “Construction Contracts” in particular. According to the amendments to IFRS 15 that were issued by the IASB on 11 September 2015 the implementation of the standard is mandatory for financial years beginning on or after 1 January 2018 whereas an early application is permitted. The EU endorsed IFRS 15 – Revenue from Contracts with Customers and adopted it into EU law with the regulation dated 22 September 2016. Furthermore, the IASB issued clarifications to IFRS 15 on 12 April 2016 with regard to the following issues: (identifying performance obligations and their distinctness in the contract, principal versus agent considerations and licensing.

As a core principle IFRS 15 rules that revenue should be recognised for the amount which is the expected equivalent value of the performance obligation.

For the enforcement of this principle, the standard provides a five-stage model to determine the amount and time of revenue:
— Identification of contract
— Identification of the independent performance obligation
— Determination of transaction price
— Allocation of transaction price
— Revenue recognition with fulfilment of performance obligation.

Furthermore, the standard contains some additional provisions regarding detailed questions and no longer includes certain currently applied accounting rules. For example for the allocation of the transaction price it is no longer of importance whether the supply of goods or the provision of services take place in the future. Moreover, under certain conditions, IFRS 15 governs that customer acquisition costs directly attributable to a contract, such as commissions, are capitalised and allocated over the estimated customer retention period. Due to the customary fixed-term contracts, the first-time application starting from 1 January 2018 requires an analysis of the contracts concluded in previous financial years. The transition guidance offers entities the option of:
— applying IFRS 15 in full to prior periods with certain practical expedients
— recognising the effect of applying IFRS 15 in the form of cumulative adjustments to the opening balance of equity in the reporting period.

As part of a project, the Telefónica Deutschland Group is currently analysing the standard with respect to corresponding effects. Furthermore, the group ensures that all prerequisites for a timely implementation of the standard are put in place.

The Telefónica Deutschland Group intends to implement IFRS 15 for the first time in its Consolidated Financial Statements for financial years beginning on or after 1 January 2018 and to choose the retrospective method. As a result, all IFRS 15 requirements will be applied to every comparative period presented.

According to the current level of knowledge, the Telefónica Deutschland Group particularly expects effects on the net assets, financial position and results of operations from the following circumstances:

— The Group offers products within multiple-element arrangements (see I) Revenues and expenses). In some of these contracts, the realisable amount of an identified component depends on future deliverables. Under the accounting policies currently applied, the share of revenues that depends on the provision of future deliverables is apportioned to these future deliverables. Under IFRS 15, however, revenues are to be allocated to the identified component in full. In such cases, the adoption of IFRS 15 will lead to a value-based shift of revenues between the individual components and consequently to a different presentation of revenues as regards time and content. Revenues allocated to a subsidised mobile hardware component will thus be fully realised when the hardware is delivered to the customer. This will result in the increase and earlier recognition of revenues from mobile hardware components at the expense of revenues from the provision of mobile services. The difference between the resulting receivable and the legal receivable from the customer will be capitalised as an asset in the Statement of Financial Position. Models affected by this have been sold in the past, so significant effects are expected for the comparative periods in particular.
— Expenses are recognised in profit or loss when the underlying service is performed (see I) Revenues and expenses). This also applies to customer acquisition costs, which are by their nature incurred in connection with contract conclusion. In contrast, IFRS 15 requires the capitalisation of customer acquisition costs that can be directly attributed to contracts with customers. Amortisation will depend on how the components to which the costs relate are transferred to the customer under the relevant contract or over the estimated customer retention period. On initial recognition, this will increase total assets. In the future, customer acquisition costs will be recognised in profit or loss at a later date under this system. However, assuming costs in instalments, a smoothing effect in the Income Statement is to be expected.
— According to IFRS 15, there are more detailed and in some cases more complex requirements with regard to the recognition of contractual amendments compared to the existing regulations. For example, certain contractual amendments are recognised prospectively as a separate contract. This results in a reallocation of the transaction prices between the individual performance obligations identified, which leads to a value-based shift of revenues between the individual components.

Due to the high number and complexity of the transactions and the high volume, it is not possible to reliably estimate the quantitative effects before the conclusion of the project.

IFRS 9 and amendments to IFRS 7: Financial Instruments
On 24 July 2014, the IASB issued IFRS 9 – Financial Instruments on comprehensive accounting for financial instruments. Particularly notable in comparison to the predecessor standard IAS 39 are the new classification requirements for financial assets, revised in the latest version of IFRS 9. Also new are the requirements for recognising impairment, which are now based on an expected loss model. Accounting for hedging relationships is also adjusted under IFRS 9 in order to more closely reflect operational risk management. Mandatory application is planned for financial years beginning on or after 1 January 2018. The EU endorsed IFRS 9 – Financial Instruments and adopted it into EU law with the regulation dated 22 November 2016. The Telefónica Deutschland Group is currently analysing the standard for its potential impact as part of a project.

IFRS 16 Leases

On 13 January 2016, the IASB issued IFRS 16 – Leases, replacing IAS 17 and other existing interpretations. Under IFRS 16, the lessee must account for all contracts identified as leases such that the associated right of use is recognised as an asset. The current distinction between finance leases and operating leases according to IAS 17 will cease to apply in the future. Accordingly, the present value of the lease liability must be recognised as a liability. The lease liability is discounted at the rate implicit in the lease and the right-of-use asset is reduced by depreciation or impairment. As a rule, the resulting interest effects lead to higher expenses at the inception of the lease. Exceptions are permissible if there are leased assets with low value or short-term contracts. For lessors, IFRS 16 poses similar requirements to the previous standard IAS 17.

In addition or building on the described systematic change, IFRS 16 includes further amendments or new requirements such as the definition of leases, accounting sale and leaseback transactions, recognition in the Statement of Financial Position and the scope of disclosures required in the notes.

Implementation of the standard is mandatory for financial years beginning on or after 1 January 2019, although early application is permitted.

The Telefónica Deutschland Group is currently analysing the standard for its potential impact. On the basis of an initial, qualitative high-level assessment, the Group anticipates the following effects:

— On the introduction of IFRS 16, payment obligations from contracts classified as operating leases must be recognised as right-of-use assets or liabilities. Accordingly, lease liabilities, non-current assets and net financial liabilities are expected to increase significantly. In the future, payments of all lease liabilities will be shown in cash flow from financing activities and thus reduce cash flow from operating activities.
— Future write-downs and interest expenses on right-of-use assets and liabilities will replace lease expenses in the Income Statement. Accordingly, a movement is expected from operating income before depreciation and amortisation (OIBDA) to depreciation and amortisation and the financial result.

The Telefónica Deutschland Group is currently setting up a project to analyse and evaluate these and other potential effects in detail. As part of this project, all the requirements for implementing IFRS 16 on time shall be fulfilled.

Amendments to IFRS 10 an IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The objective of the amendments to IFRS 10 and IAS 28 published by the IASB in September 2014 is to address a clarification for the reporting enterprise that sales or contribution of assets between an investor and its associate or joint venture will be recognised in profit or loss as long as the assets being sold or transferred assets constitute a business. In accordance with the IASB resolution of 17 December 2015 the initial application schedule was postponed indefinitely.

Telefónica Deutschland Group expects to adopt all required amendments. Except as disclosed otherwise, the Group does not expect the new and revised standards to have a material impact on the Consolidated Financial Statements.

5. Selected Explanatory Notes to the Consolidated Statements of Financial Position

5.1. Goodwill

The carrying amount of goodwill as of 31 December 2016 was EUR 1,932 million.

(Euros in millions)	2016	2015
Carrying amount of goodwill at 1 January	**1,955**	**1,955**
Disposal of Telxius Towers Germany GmbH	(23)	–
Carrying amount of goodwill at 31 December	**1,932**	**1,955**

The decrease of EUR 23 million is attributable to the sale of Telxius Towers Germany GmbH to Telxius S.A. For further information see Note 8, Disposal Groups.

The impairment test, which was carried out at the level of the cash-generating unit Telecommunications, did not result in an impairment in fiscal year 2016, because the recoverable amount of EUR 12,028 million, which is based on the fair value less costs to sell, exceeds the carrying amount. Furthermore, the Group did not recognize an impairment charge in financial year 2015.

The impairment test is described in Note 4 Accounting Policies.

5.2. Other intangible assets

The Other intangible assets are comprised of the following:

(Euros in millions)	Service concession arrangements and licenses	Customer base	Software	Thereof own work capitalised	Brand names	Other	Construction in progress/ prepayments on intangible assets	Other intangible assets
Cost								
As of 1 January 2015	10,888	3,076	1,126	120	104	98	6	15,297
Additions	–	–	293	29	–	–	1,198	1,491
Disposals	–	(1)	(309)	(2)	(24)	(30)	–	(364)
Reclassifications	–	–	65	–	24	(24)	(3)	62
As of 31 December 2015	10,888	3,075	1,176	147	104	45	1,201	16,487
As of 1 January 2016	10,888	3,075	1,176	147	104	45	1,201	16,487
Additions	0	–	348	30	–	0	17	366
Disposals	(175)	–	(391)	(29)	–	–	–	(566)
Reclassifications	10	–	2	–	–	–	(12)	(0)
As of 31 December 2016	10,722	3,075	1,136	148	104	45	1,206	16,288
Accumulated amortisation								
As of 1 January 2015	(7,770)	(178)	(649)	(87)	(5)	(95)	–	(8,697)
Additions	(442)	(328)	(292)	(6)	(21)	(7)	–	(1,090)
Disposals	–	1	309	2	24	30	–	364
Reclassifications	–	(29)	(5)	–	(21)	50	–	(5)
As of 31 December 2015	(8,211)	(534)	(638)	(91)	(23)	(22)	–	(9,428)
As of 1 January 2016	(8,211)	(534)	(638)	(91)	(23)	(22)	–	(9,428)
Additions	(437)	(328)	(423)	(38)	(18)	(4)	–	(1,210)
Disposals	175	–	391	29	–	–	–	566
Reclassifications	–	–	–	–	–	–	–	–
As of 31 December 2016	(8,473)	(862)	(670)	(100)	(41)	(26)	–	(10,072)
Net book value								
As of 31 December 2015	2,676	2,541	538	56	81	22	1,201	7,059
As of 31 December 2016	2,249	2,213	466	48	62	19	1,206	6,215

Licences

As of 31 December 2016, licences consist primarily of the licences listed below:

In May 1997, Telefónica Germany GmbH & Co. OHG acquired a GSM licence (Global System for Mobile Communications) (2G). In connection with the E-Plus Group acquisition on 1 October 2014, another GSM licence was acquired by the Telefónica Deutschland Group. The GSM licences expired and were written off as of 31 December 2016 (2015: carrying amount of EUR 76 million).

In August 2000, Telefónica Germany GmbH & Co. OHG acquired a UMTS licence (3G) that will expire on 31 December 2020. In May 2010, Telefónica Germany GmbH & Co. OHG acquired frequency usage rights in the UMTS band that will expire in December 2025 and December 2020. As part of the E-Plus Group acquisition on 1 October 2014, another UMTS licence, which will expire on 31 December 2020, as well as additional frequency usage rights in the UMTS band that will expire in December 2025, were acquired. The carrying amount of these licenses as of 31 December 2016 was EUR 853 million (2015: EUR 1,060 million). The remaining amortisation periods are four to nine years respectively.

In May 2010, Telefónica Germany GmbH & Co. OHG also acquired frequency usage rights used for LTE (4G), among others, that will expire in 2025. With the acquisition of E-Plus on 1 October 2014, additional frequency usage rights were acquired by the Telefónica Deutschland Group that can be used for LTE and also expire in 2025. The carrying amount of the usage rights as of 31 December 2016 was EUR 1,396 million (2015: EUR 1,540 million). The remaining amortisation period is nine to 17 years.

As of 31 December 2016, licences also include EUR 6 million (2015: EUR 1 million) that have been fully amortized but are still in use.

Customer base
The customer base of EUR 2,213 million (2015: EUR 2,541 million) resulted primarily from the acquisition of the E-Plus Group by Telefónica Deutschland. The customer base acquired in the E-Plus acquisition on 1 October 2014 is amortised over a remaining period of seven to eight years.

Software
Software mainly includes licences for office and IT applications. The carrying amount as of 31 December 2016 was EUR 466 million (2015: EUR 538 million). The software is amortised on a straight-line basis over its useful life, which is generally estimated to be between one and five years. In financial years 2016 and 2015, there were no significant individual additions to software. Software disposals primarily relate to application software that reached the end of its useful life.

As of 31 December 2016, software also includes EUR 72 million (2015: EUR 4 million) of assets that have been fully amortized but are still in use.

Brand names
The brand names acquired in the E-Plus Group acquisition on 1 October 2014 have a carrying amount of EUR 62 million as of 31 December 2016 (2015: EUR 81 million). The brand names are amortised over a remaining period of one year to 18 years.

Construction in progress/prepayments on intangible assets
In financial year 2015, the Telefónica Deutschland Group acquired additional frequencies for a total of EUR 1,198 million that were reported in construction in progress/prepayments on intangible assets. At the mobile phone frequency auction, the Telefónica Deutschland Group acquired two paired blocks in the 700 MHz range, two paired blocks in the 900 MHz range and two paired blocks in the 1.8 GHz range. The acquired frequencies at 900 MHz and 1.8 GHz can be used starting 1 January 2017. The use of the acquired frequencies at 700 MHz is expected to begin as soon as they will have been vacated by the broadcasting companies. During the reporting period, EUR 12 million of these mobile frequencies acquired in 2015 were reclassified from construction in progress/prepayments on intangible assets to service concession arrangements, licences and software due to their active use.

During the current year, borrowing costs were capitalised as a component of the acquired frequencies. Capitalised borrowing costs amounted to EUR 6 million as of 31 December 2016 (2015: EUR 3 million) and related to the acquisition of frequencies on 26 June 2015. The Telefónica Deutschland Group based the capitalisation on an average borrowing rate of 1.3 % (2015: 1.4 %).

5.3. Property, plant and equipment

Property, plant and equipment consisted of the following as of 31 December 2016 and 2015:

(Euros in millions)	Land and buildings	Plant and machinery	Furniture, tools and other items	PP&E in progress	Property, plant and equipment
Cost					
As of 1 January 2015	**753**	**7,781**	**243**	**219**	**8,996**
Additions	11	698	47	(17)	739
Disposals	(35)	(289)	(60)	(0)	(384)
Reclassifications	0	71	2	(134)	(62)
Other	8	(45)	–	–	(37)
As of 31 December 2015	**738**	**8,216**	**231**	**68**	**9,252**
As of 1 January 2016	**738**	**8,216**	**231**	**68**	**9,252**
Additions	7	650	34	51	742
Disposals	(10)	(649)	(19)	(0)	(678)
Reclassifications	(6)	10	(0)	(4)	–
Other	18	140	–	–	158
As of 31 December 2016	**747**	**8,366**	**245**	**114**	**9,473**
Accumulated depreciation					
As of 1 January 2015	**(482)**	**(3,494)**	**(179)**	**–**	**(4,154)**
Additions	(79)	(869)	(28)	–	(977)
Disposals	32	289	60	–	381
Reclassifications	3	2	0	–	5
As of 31 December 2015	**(526)**	**(4,071)**	**(147)**	**–**	**(4,745)**
As of 1 January 2016	**(526)**	**(4,071)**	**(147)**	**–**	**(4,745)**
Additions	(61)	(816)	(32)	–	(908)
Disposals	9	368	19	–	397
Reclassifications	5	(6)	1	–	0
As of 31 December 2016	**(573)**	**(4,525)**	**(159)**	**–**	**(5,256)**
Net book value					
As of 31 December 2015	**212**	**4,144**	**84**	**68**	**4,507**
As of 31 December 2016	**174**	**3,841**	**87**	**114**	**4,217**

Property, plant and equipment amounted to EUR 4,217 million as of 31 December 2016 (31 December 2015: EUR 4,507 million). The decrease from the end of 2015 was attributable primarily to the sale of passive tower infrastructure with a net carrying amount of EUR 277 million to Telxius S.A For further information see Note 8, Disposal Groups. In addition, depreciation expenses amounted to EUR 908 million in the reporting year.

This was offset by additions of EUR 742 million in fiscal year 2016, which primarily related to the expansion of a faster network, including an increased LTE coverage, more IP technology and the additional mobile data services with even faster download speeds.

Furthermore, assets related to the asset retirement obligation increased by EUR 158 million, mainly due to the higher cost estimates based on new insights as well as changing interest rate. In the previous year, assets retirement obligations decreased by EUR 37 million due to higher costs estimates.

Property, plant and equipment from finance leases amounted to EUR 163 million as of 31 December 2016 and EUR 224 million as of 31 December 2015. The decline of EUR 61 million resulted primarily from depreciation. The obligations from finance leases resulted primarily from agreements for network elements that were concluded under sale and leaseback transactions and were classified as finance leases in accordance with their form. The most significant finance leases are disclosed in Note 5.10 Interest-Bearing Debt, Finance leases.

PP&E in progress resulted mainly from the expansion of the network.

As of 31 December 2016, EUR 73 million (2015: EUR 74 million) of land and buildings, EUR 30 million (2015: EUR 43 million) of plant and machinery and EUR 88 million (2015: EUR 94 million) of furniture, tools and other items have been fully depreciated but are still in use.

5.4. Trade and other receivables

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

	As of 31 December			
	2016		2015	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade receivables	84	1,591	169	1,648
Receivables from related parties (Note 13 Related Parties)	–	42	–	37
Other receivables	–	19	–	29
Allowances for bad debts	(7)	(192)	(13)	(194)
Trade and other receivables	**77**	**1,460**	**157**	**1,520**

Trade receivables include receivables from finance leases. For further information refer to Note 5.10 Interest-Bearing Debt, Finance leases.

The breakdown of trade receivables is as follows:

	As of 31 December			
	2016		2015	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade receivables billed	84	975	76	819
Trade receivables unbilled	–	615	93	829
Trade receivables	**84**	**1,591**	**169**	**1,648**

The following table shows the development of the allowances for the years ending as of 31 December 2016 and 2015.

(Euros in millions)	Non-current	Current
Allowances as of 31 December 2016	**(7)**	**(192)**
Additions	–	(83)
Release	–	–
Utilisation	6	86
Allowances as of 31 December 2015	**(13)**	**(194)**
Additions	–	(94)
Release	–	–
Utilisation	3	161
Allowances as of 1 January 2015	**(16)**	**(261)**

In 2016 and 2015, the Telefónica Deutschland Group sold installment receivables in order to optimise the working capital and to access an alternative source of funding. The nominal value of the receivables transferred in 2016 was EUR 517 million (2015: EUR 738 million) and the carrying amount was EUR 511 million (2015: EUR 725 million). The buyer of the receivables bears the risk of these receivables. The receivables sold were derecognised in full at the time of the sale. In the case of sales of receivables in financial years up to and including 2014, a small portion of less than 5 % of the receivables sold was not derecognised at the time of the sale due to a continuing involvement. The carrying amount of these assets that the Telefónica Deutschland Group recognised was EUR 8 million as of 31 December 2015. A liability was recognised in the same amount. The continuing involvement that was recognised was the maximum risk that remained with the Telefónica Deutschland Group and essentially resulted from a possible default on the receivables. The Group may be obligated to repurchase EUR 69 million of these receivables, if these customers were to default on their respective debts prior to the end of fiscal year 2018. Actual defaults are compared to the originally estimated amounts on a monthly basis, to monitor the associated risk.

In addition, the Telefónica Deutschland Group recorded a provision in the amount of the fair value of the guarantees given of EUR 2 million (2015: EUR 2 million).

The total loss on the date of the receivables transfer in 2016 was EUR 2 million (2015: EUR 3 million).

Consistent with prior year, the recognised profit from the continuing involvement following the completion of the transactions amounted to < EUR 1 million.

5.5. Other financial assets

As of 31 December 2016 and 2015, other financial assets consist of the following:

	As of 31 December			
	2016		2015	
(Euros in millions)	Non-current	Current	Non-current	Current
Investments in start-ups	21	–	18	–
Interest rate swaps	12	2	12	2
Reimbursement rights	9	–	9	–
Silent factoring deposit	17	19	22	8
Deposits	1	–	1	–
Loans	–	4	1	1
Other financial assets	**60**	**25**	**63**	**10**

Non-current other financial assets primarily consist of:

— Investments in start-ups of EUR 21 million (2015: EUR 18 million) (for further information see Note 10 Measurement Categories of Financial Assets and Financial Liabilities);
— Interest rate swaps of EUR 12 million (2015: EUR 12 million) belonging to the two issued bonds (for further information see Note 5.10 Interest-Bearing Debt);
— Reimbursement rights of EUR 9 million (2015: EUR 9 million) incurred to meet pension and partial retirement obligations but not constituting plan assets according to IAS 19. The recognised fair values are based on the values received from the insurance company, which are based on the insurance company's internal calculation models;
— A deposit of EUR 17 million (2015: EUR 22 million) This deposit was pledged as collateral to cover the maximum risk from silent factoring to be borne by the Telefónica Deutschland Group and the guarantee of the servicing of the receivables over the term of the sold receivables. The Telefónica Deutschland Group receives fixed interest on the deposit.

Current other financial assets primarily include the current portion of the security deposit for silent factoring of EUR 19 million (2015: EUR 8 million).

5.6. Other non-financial assets and other non-financial liabilities

Other non-financial assets were as follows:

	As of 31 December			
	2016		2015	
(Euros in millions)	Non-current	Current	Non-current	Current
Prepayments	128	61	160	46
Prepayments to related parties	–	1	–	0
Other tax receivables	–	1	–	15
Other non-financial assets	**128**	**63**	**160**	**61**

Non-financial assets primarily relate to prepayments for fees charged for leased lines.

Other non-financial liabilities were as follows:

	As of 31 December	
	2016	2015
(Euros in millions)	**Current**	Current
Payroll taxes and social security	13	11
Current tax payables for indirect taxes	64	34
Other current taxes	3	2
Other non-financial liabilities	**79**	**48**

5.7. Inventories

Inventories amounted to EUR 85 million as of 31 December 2016 (2015: EUR 123 million) and mainly consisted of smartphones and accessories.

	As of 31 December	
(Euros in millions)	**2016**	2015
Merchandise	89	130
Allowances	(4)	(6)
Inventories	**85**	**123**

The total cost of inventories recognised as an expense in the Consolidated Income Statement in the financial year 2016 was EUR 1,070 million (2015: EUR 1,271 million).

Consistent with common industry practices, the suppliers of inventories retain the title until to the items are paid in full.

5.8. Cash and cash equivalents

Cash and cash equivalents mainly includes deposits in connection with cash pooling agreements with Telfisa Global B.V., Amsterdam, Netherlands (Telfisa Global B.V.), receivables from banks with an original term of up to three months and cash in hand.

	As of 31 December	
(Euros in millions)	**2016**	2015
Cash at bank and in hand	13	11
Cash pooling	600	522
Cash and cash equivalents	**613**	**533**

5.9. Equity

Subscribed capital

The registered share capital of Telefónica Deutschland Holding AG amounts to EUR 2,975 million. The share capital is divided into 2,974,554,993 no-par value registered shares, each with a proportionate interest in the share capital of EUR 1.00 ("shares"). The registered share capital is fully paid.

As of 31 December 2016, Telefónica Deutschland Holding AG did not hold any of its own shares.

In accordance with section 6 para. 2 of the articles of association, the shareholders do not have the right to securitise shares. In general, each no-par-value share grants one vote at the Annual General Meeting. The shares are freely transferable.

Authorised capital

As of 31 December 2016, Telefónica Deutschland Holding AG had Authorised Capital 2016/I of EUR 1,487 million.

Conditional capital

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

Additional paid-in capital

As a result of capital increases for cash and for contributions in connection with the acquisition of the E-Plus Group, which were entered in the commercial register on 18 September and 7 October 2014, additional paid-in capital increased by EUR 4,800 million to EUR 4,800 million (unchanged) as of 31 December 2016.

Retained earnings

Legal reserve

Retained earnings contain a legal reserve in accordance with section 150 (2) of the German Stock Corporation Act (Aktiengesetz – AktG) of EUR 0.014 million (2015: EUR 0.014 million).

Proposed dividend for financial year 2016 to be paid in 2017

On 26 July 2016, the Management Board of Telefónica Deutschland resolved to propose a cash dividend of EUR 744 million or EUR 0.25 per share at the next Annual General Meeting, which is scheduled for 9 May 2017.

Annual General Meeting in 2016

The Annual General Meeting of Telefónica Deutschland took place on 19 May 2016. In addition to the approval of the actions of the Supervisory Board and the Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart (Munich office) as the auditor of the (Consolidated) Financial Statements, the Annual General Meeting elected Peter Erskine as successor to Antonio Manuel Ledesma Santiago, who departed as of the end of the Annual General Meeting, to the Supervisory Board. It was also resolved to distribute a dividend of EUR 0.24 per dividend-entitled share for a total distribution of around EUR 714 million for financial year 2015.

Annual General Meeting and dividend distribution in 2015

The Annual General Meeting of Telefónica Deutschland took place on 12 May 2015. In addition to the approval of the actions of the Supervisory Board and the Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart (Munich office) as the auditor of the (Consolidated) Financial Statements, the Annual General Meeting elected Laura Abasolo de Baquedano to the Supervisory Board and resolved to distribute a dividend of EUR 0.24 per dividend-entitled share for a total distribution of around EUR 714 million for financial year 2014.

5.10. Interest-bearing debt

	As of 31 December			
	2016		2015	
(Euros in millions)	Non-current	Current	Non-current	Current
Bonds	1,107	12	1,105	12
Promissory notes and registered bonds	299	4	299	4
Loans	298	0	250	251
Finance leases	17	15	32	180
Contribution and compensation obligations	–	6	–	3
Other financial liabilities	–	–	–	119
Interest-bearing debt	**1,721**	**37**	**1,686**	**568**

Bonds

This item contains two bonds with a carrying amount of EUR 1,119 million as of 31 December 2016 (2015: EUR 1,117 million), of which EUR 1,107 million (2015: EUR 1,105 million) is classified as non-current and EUR 12 million (2015: EUR 12 million) as current. Interest rate swaps belonging to the two issued bonds were reported under other financial assets in the year under review and the previous year (see Note 5.5 Other Financial Assets). The Telefónica Deutschland Group issued these bonds in November 2013, with an original nominal value of EUR 600 million, and in February 2014, with an original nominal value of EUR 500 million.

These bonds (except for EUR 350 million of the nominal value) are accounted for by using the effective interest method after deduction of the disagio and transaction costs. EUR 350 million of the nominal value of the bonds is accounted for as a fair value hedge with interest rate swaps.

The senior unsecured seven-year bond issued on 10 February 2014 has a nominal value of EUR 500 million. The bond has a maturity on 10 February 2021 and was issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375 % and the issue price 99.624 %. The issue spread was 100 basis points over the seven-year euro mid-swap rate, resulting in a yield of 2.434 %. The bond has a denomination of EUR 1,000 and was issued on the basis of a bond security prospectus. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general business purposes. In connection with this, an interest rate swap was concluded for a partial amount of EUR 150 million of the bond's nominal value. On the basis of this interest rate swap contract, the Telefónica Deutschland Group pays a variable interest rate based on the three-month Euribor on a nominal amount and receives a fixed interest rate of 1.268 % on the same amount in return.

In November 2013, the Telefónica Deutschland Group, via its subsidiary O2 Telefónica Deutschland Finanzierungs GmbH, Munich, issued an unsecured five-year bond (Senior Unsecured Bond) with a nominal value of EUR 600 million and a maturity on 22 November 2018 in the regulated market of the Luxembourg Stock Exchange. The bond is guaranteed by Telefónica Deutschland Holding AG. The annual nominal interest rate of the bond is 1.875 %. Based on the issue price of 99.162 %, the bond yields an annual return of 2.053 %. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. The net issuing proceeds generated by the bond will be used for general business purposes. In connection with this, an interest rate swap was concluded for a partial amount of EUR 200 million of the nominal value of the bond. On the basis of this interest swap contract, the Telefónica Deutschland Group pays a variable interest rate at the level of the three-month Euribor on a nominal amount and receives a fixed interest rate of 0.927 % on the same amount in return.

All factors that market participants would normally consider, are included in the measurement of the fair value of the interest rate swaps, including the credit risks of the contract parties. The fair value of the interest swaps results from discounting of the expected future payments over the remaining term of the contract using current market interest rates and yield curves.

The adjustments to the carrying amount of the non-current financial liabilities result in a cumulative loss of EUR 12 million (EUR 12 million cumulative loss in 2015 and EUR 0 million profit in 2016), while the corresponding clean prices of the interest rate swaps result in a cumulative profit of EUR 12 million (EUR 12 million cumulative profit in 2015 and EUR 0 million loss in 2016). Under the interest rate swaps, the Telefónica Deutschland Group pays a variable quarterly interest rate amounting to the three-month Euribor and receives fixed interest rates of 0.927 % and 1.268 %. The hedged nominal value of the financial liabilities amounts to EUR 350 million. Thus, 19 % (2015: 19 %) of the bonds of the company were switched from fixed interest to variable interest. The fair value of the dirty prices of the interest rate swaps that hedge financial liabilities amounted to EUR 14 million as of 31 December 2016 (2015: EUR 14 million) and is recognised as a financial asset. The fair value of the bonds is determined by discounting the expected future cash flows at currently applicable interest rates with comparable conditions and residual terms.

Promissory notes/registered bonds
On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds with a volume of EUR 300 million.

The promissory notes placed have unsecured tranches with terms of five, eight and ten years, with both fixed and floating interest rates.

The nominal value of the promissory note with a term of five years is EUR 52 million for the fixed interest rate and EUR 60.5 million for the floating interest rate.

The nominal value of the promissory note with a term of eight years is EUR 19.5 million for the fixed interest rate and EUR 1.5 million for the floating interest rate.

The nominal value of the promissory note with a term of ten years is EUR 29.5 million for the fixed interest rate and EUR 9 million for the floating interest rate.

The registered bonds placed have terms of 12, 15 and 17 years and a fixed interest rate. The tranches amount to EUR 3 million, EUR 33 million and EUR 92 million, respectively, and bear interest at 2.000 %, 2.250 % and 2.375 %.

All tranches were issued at par.

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

Loans
As of 31 December 2015, this item included a loan of EUR 501 million, which included accrued interest and 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 was repaid in full and ahead of schedule on 21 April 2016.

As of 31 December 2015, EUR 250 million of the loan was classified as non-current and EUR 251 million as current. The current portion also included accrued interest for the aforementioned non-current loans.

The Group entered into a EUR 750 million revolving credit facility on 22 March 2016. EUR 50 million of this revolving credit facility (RCF) had been drawn as of 31 December 2016. The credit facility will expire 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. The RCF is included in non-current interest-bearing debt due to agreed-upon long-term time frame.

On 13 June 2016, the Telefónica Deutschland Group signed its first financial agreement with the EIB, which amounted to EUR 450 million. EUR 250 million of the facility with a fixed interest rate had been utilised as of 31 December 2016. This is intended 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 already provided by the EIB have a term until December 2024 and will be repaid annually in equal instalments of EUR 41.67 million starting in December 2019. The remaining credit facility may be drawn on via floating- or fixed-rate tranches. The floating-rate tranches bear interest at Euribor money market conditions plus an agreed-upon margin. The interest rate of the fixed-rate tranches is determined according to the principles defined by the bodies of the European Investment Bank for loans of the same type.

Finance leases

This item contains finance lease liabilities of EUR 32 million as of 31 December 2016 (2015: EUR 212 million), of which EUR 17 million (2015: EUR 32 million) is classified as non-current and EUR 15 million (2015: EUR 180 million) as current.

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.

In connection with these finance leases, the Telefónica Deutschland Group recognised the assets attributable to the network elements under property, plant and equipment in the Consolidated Financial Statements as of 31 December 2016 and in the previous year (for further information see Note 5.3 Property, Plant and Equipment). Mobile phones are not capitalised because they are passed on to end customers under a finance lease.

The breakdown of minimum lease payment obligations is as follows:

			As of 31 December 2016
(Euros in millions)	**Minimum future lease payments**	**Unamortised interest expense**	**Present value of future minimum lease payments**
Due within one year	16	1	15
Due between 1 and 5 years	17	0	17
Due in more than 5 years	–	–	–
Total	**33**	**1**	**32**

			As of 31 December 2015
(Euros in millions)	Minimum future lease payments	Unamortised interest expense	Present value of future minimum lease payments
Due within one year	183	3	180
Due between 1 and 5 years	32	1	32
Due in more than 5 years	0	0	0
Total	**216**	**4**	**212**

Receivables from finance leases (subleases)

The Telefónica Deutschland Group subleases mobile phones to its end customers. The Group thus acts as a lessor to the customers. The customer contracts included fixed lease payments over a term of two years. Contracts that were entered into prior to financial year end 2014, were then refinanced under sale and leaseback agreements.

The following table shows the expected minimum lease payments by end customers:

(Euros in millions)	Minimum future lease payments	Unrealised interest income	Present value of outstanding minimum lease payments
			As of 31 December 2016
Due within one year	99	0	99
Due between 1 and 5 years	8	0	8
Due in more than 5 years	–	–	–
Total	**107**	**0**	**107**
Accumulated allowance			(10)
Total after accumulated allowance			**97**

(Euros in millions)	Minimum future lease payments	Unrealised interest income	Present value of outstanding minimum lease payments
			As of 31 December 2015
Due within one year	224	2	222
Due between 1 and 5 years	94	0	94
Due in more than 5 years	–	–	–
Total	**319**	**2**	**316**
Accumulated allowance			(31)
Total after accumulated allowance			**286**

The impairment of receivables from finance leases is recognised as an expense. The credit risk is determined on the basis of past experience.

Renewal- and purchase options expected to be exercised are included in the calculation of the minimum lease payments to be made and those expected.

The receivables from finance leases are included in the trade receivables. For further information refer to Note 5.4 Trade and other receivables.

Contribution obligations
This item includes contribution obligations to partners in investments in start-ups that hold puttable shares.

Other financial liabilities
In order to obtain greater financial efficiency and cash flexibility, Telefónica Deutschland had reached agreements with certain commercial suppliers to extend payment terms during 2015 and 2016. Interests payments were expressly agreed for those agreements with extended payments terms beyond the standards terms. Invoices were reclassified to other financial liabilities in 2015 when the agreements of the interest-bearing extention of payment terms are concluded to reflect the change nature of these liabilities. The interest agreed for the delay in the payment is recognised as financial expense. Invoices, which were not affected by extended payment terms that exceeded industry standards, were included in trade payables. As of 31 December 2016, the invoices with extended payment terms exceeding industry standards have been paid in full.

5.11. Trade and other payables and deferred income

Trade and other payables and deferred income is as follows:

	As of 31 December			
	2016		2015	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade payables to third parties	–	897	109	573
Accruals	15	783	19	1.105
Payables to related parties (Note 13 Related Parties)	–	425	–	298
Trade payables	**15**	**2,105**	**128**	**1,975**
Other creditors non-trade	2	81	2	69
Other payables to related parties (Note 13 Related Parties)	–	41	–	53
Other payables	–	58	23	175
Other payables	**2**	**181**	**25**	**296**
Trade and other payables	**17**	**2,286**	**154**	**2,272**
Deferred income	**338**	**664**	**424**	**471**

Current trade payables to third parties include the present value of the outstanding payment obligations from the mobile phone frequency auction in the amount of EUR 110 million.

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

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

Besides debtors with credit balances, the other payables primarily include the 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 2016.

For the maturity profile of the listed liabilities, see Note 17 Financial Instruments and Risk Management.

Deferred income primarily includes advance payments received for prepaid credit and other advance payments received for future service performance. It also includes the payment from Drillisch received in connection with the Mobile Bitstream Access Mobile Virtual Network Operator (MBA MVNO) agreement.

Other advance payments received for future service performance and the payment received from Drillisch are broken down by maturity according to their expected utilisation. Advance payments received for prepaid credit are classified exclusively as current.

5.12. Provisions

The provisions are recognised at the following amounts:

	As of 31 December			
	2016		2015	
(Euros in millions)	**Non-current**	**Current**	Non-current	Current
Pension obligations	106	–	76	–
Restructuring	20	127	51	169
Asset retirement obligation	400	57	372	23
Other provisions	35	5	17	4
Provisions	**561**	**190**	**516**	**196**

Pension obligations

The Telefónica Deutschland Group has defined benefit plans. These primarily include defined benefit rights against an external provident fund (Gruppen-Unterstützungskasse), which is managed in accordance with its articles of association, and direct commitments.

The overriding investment policy and strategy for the defined benefit plans are based on the goal of generating returns from the plan assets as well as from the reimbursement rights deriving from insurance policies which, together with the contributions, are sufficient to meet the pension obligations.

The plan assets are invested in insurance policies that are taken out directly by the Telefónica Deutschland Group or indirectly by the provident fund. The reimbursement rights from insurance policies result from those insurance policies, which were not pledged to the employees.

The requirements for the financing of pension obligations arise from the financing strategy of the provident fund and are anchored in its guidelines. The guidelines define that the expected defined benefit obligation will be settled by the provident fund. They are fully financed by the Telefónica Deutschland Group.
The Telefónica Deutschland Group provides the provident fund with the necessary financial resources.

However, under its articles of association, the fund must cease or reduce its payments if the company does not make, or no longer makes, the necessary financial resources available to the fund. In this case, the employees can bring their legal right to post-employment benefits against the Telefónica Deutschland Group.

The amount of the committed benefits for the defined benefit pension plans essentially depends on the basic salary of the individual employee during the period of employment. The benefits paid include old age pensions, payments for the inability to work and benefits in the event of death to surviving relatives.

In order to minimise the biometric risks of the committed benefits (such as an early benefits claim through invalidity or death of the beneficiary), the pension or promised retirement capital is covered to the full extent (congruent) or in part by insurance policies. In addition, the pledging of the insurance policies to the pension beneficiary acts as security for the claims of the beneficiary in the event of the insolvency of the sponsoring company.

This defined benefit plan is subject to actuarial and financial risks such as life expectancy and interest rate risk.

In the financial year 2016, the employer's share of the statutory pension insurance amounted to EUR 41 million (2015: EUR 43 million).

Telefónica Deutschland Group has additional defined contribution plans. The expense for defined contribution plans recognised for the period amounted to EUR 3 million (2015: EUR 3 million).

The following table contains the key data for the defined benefit plans:

	As of 31 December	
(Euros in millions)	**2016**	2015
Defined benefit obligation from funded plans	(168)	(143)
Defined benefit obligation from unfunded plans	(65)	(55)
Defined benefit obligation	**(233)**	**(198)**
Plan assets	128	122
Deficit	**(106)**	**(76)**
Net defined benefit liability	**(106)**	**(76)**
Reimbursement rights	**8**	**8**

The development in the present value of the defined benefit obligation in 2016 and 2015 was as follows:

	As of 31 December	
(Euros in millions)	**2016**	2015
Defined benefit obligation as of 1 January	**(198)**	**(201)**
Current service costs (personnel expenses)	(6)	(7)
Interest expense (financial result)	(5)	(4)
Remeasurement of defined benefit obligation	(31)	12
thereof: actuarial gains/(losses) arising from changes in financial assumptions	*(31)*	*11*
thereof: experience adjustments	*1*	*1*
Benefits paid	3	2
Other	3	–
Defined benefit obligation as of 31 December	**(233)**	**(198)**

The present value of the defined benefit obligation is distributed as follows across the individual groups of those entitled to pensions:

	As of 31 December	
(Euros in millions)	**2016**	2015
Amounts owed to active members	(87)	(79)
Amounts owed to deferred members	(105)	(86)
Amounts owed to retirees	(42)	(33)
Defined benefit obligation	**(233)**	**(198)**

The development of the fair value of the plan assets was as follows in 2016 and 2015:

(Euros in millions)	**2016**	2015
Fair value of plan assets as of 1 January	**122**	**111**
Return on plan assets excluding amounts included in interest income (expense)	(2)	(1)
Interest income (financial result)	3	3
Employer contributions	9	9
Benefits paid	(2)	(1)
Other	(2)	2
Fair value of plan assets as of 31 December	**128**	**122**

In 2016, as in the previous year, there was no asset ceiling.

The fair value of the reimbursement rights from insurance contracts developed in 2016 and 2015 as follows:

(Euros in millions)	2016	2015
Fair value of reimbursement rights as of 1 January	**8**	**10**
Return on reimbursement rights excluding amounts included in interest income	(0)	0
Interest income	0	0
Employer contributions	0	0
Benefits paid	(0)	(0)
Other	(0)	(2)
Fair value of reimbursement rights as of 31 December	**8**	**8**

Net pension expense recognised in the Consolidated Income Statements is as follows:

(Euros in millions)	2016	2015
Current service costs (personnel expenses)	6	7
Interest expense (financial result)	2	2
Total amount of expense	**8**	**9**

Actual returns on plan assets were EUR 1 million for the financial year ending 31 December 2016 and EUR 1 million for 2015.

The main actuarial assumptions on which the determination of the present value of the defined benefit obligation as of the reporting date is based are provided in the following table (factors represent averages).

	As of 31 December	
	2016	2015
Discount rate	1.65 %	2.47 %
Nominal rate of pension payment increase	1 % – 1.75 %	2.00 %
Fluctuation rate	(0 % – 20 %)	(0 % – 20 %)

The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables. The mortality tables on which the actuarial calculation of the DBO as at the reporting date is based are the Heubeck Mortality Tables 2005G (Heubeck Richttafeln 2005G).

	As of 31 December	
(In years)	2016	2015
Life expectancy at age 65 for a retiree currently	21	21
Life expectancy of a currently aged 40 deferred member at age 65	24	24

An increase or decrease in the main actuarial assumptions would have had the following effects on the present value of the defined benefit obligation as of 31 December 2016:

(Euros in millions)	Increase in parameters	Decrease in parameters
Discount rate (+0.25 %/-0.25 %)	(13)	14
Nominal rate of pension payment increase (+0.50 %/-0.50 %)	10	(10)
Turnover rate (+1.00 %/-1.00 %)	(0)	0
Life expectancy (+1 year)	–	8

Increases and reductions in the discount rate and increases to pension payments do not have the same impact on the determination of the DBO due to the interest rate effects. If several assumptions are changed at the same time, the overall effect will not necessarily correspond to the sum of the individual effects due to the changes in the assumptions. In addition, the sensitivity of a change in the DBO only reflects each specific order of magnitude in the change of assumptions (for example 0.25 %). If the assumptions change by a different order of magnitude, the effect on the DBO does not necessarily have to be linear.

The following table contains information regarding the analysis of the due date of expected payments:

(Euros in millions)	**1 January to 31 December 2016**
Benefits expected to be paid within 1 year	2
Benefits expected to be paid within 2 years	2
Benefits expected to be paid within 3 years	3
Benefits expected to be paid within 4 years	3
Benefits expected to be paid within 5 years	3
Benefits expected to be paid within 6 to 10 years	22

The average of the expected term of the defined benefit obligation is 23.2 years.

The best estimate of the contributions that will be paid into the plans in the financial year ending 31 December 2017 amounts to EUR 9 million.

Other provisions

Other provisions include provisions for restructuring, asset retirement obligation, onerous contracts and others. The movement is as follows:

(Euros in millions)	Restructuring	Asset retirement obligation	Onerous contracts	Other	Total
As of 1 January 2016	**220**	**394**	**20**	**1**	**635**
Additions	89	3	3	31	126
Utilisation	(164)	(16)	(3)	–	(183)
Release	–	–	(12)	(1)	(13)
Reclassifications	2	–	–	–	2
Other	–	76	–	1	77
Accrued interest	–	1	–	–	1
As of 31 December 2016	**147**	**457**	**8**	**32**	**644**
thereof non-current	*20*	*400*	*2*	*32*	*454*
thereof current	*127*	*57*	*6*	*0*	*190*
As of 1 January 2015	**399**	**501**	**22**	**17**	**939**
Additions	73	4	–	–	77
Utilisation	(253)	(76)	(3)	(12)	(344)
Release	–	–	–	(3)	(3)
Reclassifications	–	–	1	(1)	–
Other	–	(37)	–	–	(37)
Accrued interest	1	2	–	–	3
As of 31 December 2015	**220**	**394**	**20**	**1**	**635**
thereof non-current	*51*	*372*	*15*	*1*	*440*
thereof current	*169*	*22*	*5*	*0*	*196*

The provision for restructuring primarily includes measures resulting from the transformation of the Telefónica Deutschland Group in connection with the integration of E-Plus that aim to increase profitability through synergies. The amount of EUR 147 million as of 31 December 2016 (2015: EUR 220 million) is allocated to personnel adjustments, the deactivation of a part of the mobile network, the suspension of contracts with sales representatives and other measures.

The majority of the provision amount recognised as of 31 December 2016 is attributable to severance payments in connection with personnel adjustments.

The provisions for asset retirement obligations include the estimated costs for the dismantling and removal of assets (e.g. mobile masts and other fixed assets), partially based on the respective agreements with service providers. The timing of utilisation and the associated outflow of cash depends on the implementation of the current network consolidation strategy.

The onerous contracts provision essentially includes expected losses from the sub-letting of leased objects and for vacancies. The expected utilisation covers short- and mid-term periods depending on the date of the rent payment and the rental income.

The Other item primarily contains obligations for tax-audit risks in connection with the VAT treatment of prepaid contracts (see Note 18, Contingent Assets and Liabilities for further information).

As of 31 December 2016, changes in the composition of other provisions of the Telefónica Deutschland Group compared to 31 December 2015 resulted in particular from restructuring and dismantling obligations.

Under restructuring, a decline resulted from the scheduled utilisation of EUR 164 million, which was partly offset by additions of EUR 89 million. As in the previous year, these are recognised in other expenses and personnel expenses (for further information see Note 6.3 Personnel Expenses and 6.4 Other Expenses).

The EUR 63 million change in asset retirement obligations is due to the higher cost estimates based on new insights, which make up most of the increase, and the interest rate trend (EUR 158 million in total), 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 8, Disposal Groups).

6. Selected Explanatory Notes to the Consolidated Income Statements

6.1. Revenues

Revenues are comprised of the following:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Rendering of services	6,419	6,576
Other revenues	1,084	1,312
Revenues	**7,503**	**7,888**

Revenues from the rendering of services include mobile service revenues as well as revenues from fixed line/DSL business. The other revenues include handset revenues and miscellaneous other revenues.

None of the Telefónica Deutschland Group's customers accounts 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:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Mobile business	6,498	6,832
Mobile service revenues	5,437	5,532
Handset revenues	1,061	1,300
Fixed line/DSL business	981	1,043
Other revenues	23	12
Revenues	**7,503**	**7,888**

Mobile service revenues

The mobile service revenues are largely based on basic fees and the fees levied for voice (including incoming and outgoing calls), messaging (including SMS and MMS) and mobile data services as well as the revenues from service contracts. Alongside roaming revenues, mobile service revenues include access and interconnection fees that are paid for by other service providers for calls and SMS delivered via our network.

Handset revenues

Handset revenues include the income from the sale of mobile phones as part of the “O_2 My Handy” model, the hardware portion of bundle packages (hardware bundled offerings) for the former E-Plus brands and cash sales. In addition, handset revenues include further components from mobile business such as activation fees and accessories.

With the “O_2 My Handy” model, the customer can choose whether to pay the entire price of the mobile phone up front or to make an initial payment to start with and pay the remaining purchase price in twelve or 24 monthly instalments. Revenues from the “O_2 My Handy” model are discounted according to their term.

Regarding the hardware bundled offers provided by the former E-Plus brands, the customer can choose between the purchase or lease of a device.

Fixed line/DSL business

Fixed line/DSL business revenues comprise mainly revenues from DSL services for private customers, DSL activation fees for private customers, revenues from DSL products and non-recurring items (e.g. fees for change of address, number transfers, etc.), revenues from wholesale ULL (also known as wholesale DSL), revenues from the sale of the company’s own DSL network, from services and from hardware to other service providers who re-bundle these and sell them on to end customers, and data traffic revenues from carriers in connection with the sale and trade of minutes between carriers to connect their customer calls via the networks of other operators. DSL revenues also include fixed line revenues.

Other revenues

Other revenues relate to new businesses, such as advertising and financial services, e.g. the “O_2 More Local” mobile location-based services or the “mpass” mobile payment system.

6.2. Other income

Other income included the following in 2016 and 2015:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Own work capitalised and ancillary income	146	146
Gain on disposal of assets	356	15
Income from final purchase price adjustment E-Plus	–	104
Other income	**502**	**265**

Own work capitalised includes direct labour costs as well as the allocable portion of indirect costs in connection with investments in non-current assets.

The gain on the disposal of assets in the financial year 2016 resulted from the sale of passive tower infrastructure to Telxius S.A. Further information can be found in Note 8, Disposal Groups.

The income of EUR 104 million recognised in the financial year 2015 resulted from the agreement on the final purchase price for the acquisition of the E-Plus Group of EUR 104 million (see Note 7 Business Combinations for further information). In addition, gains on the disposal of assets resulting from the net gain on the disposal of yourfone GmbH of EUR 15 million were recognised in the financial year 2015.

6.3. Personnel expenses

In the financial year 2016, personnel expenses amounted to EUR 646 million (2015: EUR 655 million). Thereof EUR 562 million (2015: EUR 561 million) related to salaries and wages, EUR 77 million (2015: EUR 84 million) to social security and EUR 6 million (2015: EUR 10 million) to post retirement benefits. Personnel expenses from share-based payments is presented in Note 15 Share-Based Payments; personnel expenses relating to pension plans are presented in Note 5.12 Provisions.

In addition, restructuring expenses of EUR 46 million (2015: EUR 4 million) are recognised in personnel expenses. For further information, see Note 5.12 Provisions.

6.4. Other expenses

Other expenses mainly include costs incurred for sales and marketing, infrastructure, administration and other external services and the restructuring provisions recognised in connection with the integration. Other expenses as of 31 December 2016 include restructuring expenses of EUR 43 million (2015: EUR 69 million; for further information see Note 5.12 Provisions).

6.5. Financial result

For the current financial year, the Telefónica Deutschland Group's financial result amounts to EUR -36 million (2015: EUR -48 million).

The breakdown of the financial result is as follows:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Interest income from financial assets	11	10
Interest expenses from financial liabilities	(44)	(53)
Accretion of provisions and other liabilities	(4)	(3)
Other exchange gains (losses)	(0)	(1)
Financial result	**(36)**	**(48)**

Interest income from financial assets includes the interest income in connection with "O_2 My Handy" receivables, receivables from finance leases and interest income from VAT refunds.

Interest expenses from financial liabilities mainly include interest on the revolving credit facility entered into on 22 March 2016, the bonds issued in November 2013 and February 2014, the promissory notes and registered bonds issued in March 2015 and the loan borrowed from Telfisa Global B.V. in September 2012 and repaid in full on 21 April 2016.

Interest from finance lease obligations and from provisions for tax risks is also included.

6.6. Income tax

Consolidated income tax group

As of 31 December 2016, the consolidated income tax group of the Telefónica Deutschland Group consisted of 21 (2015: 24) companies.

Current and deferred taxes

The income taxes recorded in the Consolidated Income Statements consist primarily of deferred taxes:

	1 January to 31 December	
(Euros in millions)	2016	2015
Current tax	(0)	–
Deferred tax expense	(90)	(72)
Income tax (expense)	**(90)**	**(72)**

The movements in deferred tax assets are as follows:

(Euros in millions)	2016	2015
As of 1 January	**505**	**581**
Deferred tax expense	(90)	(72)
Movement in deferred taxes recognised directly in equity as shown in the Consolidated Statements of Comprehensive Income	11	(3)
As of 31 December	**427**	**505**

Tax loss carry forwards and temporary differences

Tax losses carried forward for which no deferred tax assets are reported as of 31 December 2016 amounted to EUR 13,781 million for corporate income tax and EUR 13,614 million for trade tax (2015: EUR 13,437 million and EUR 13,246 million).

Temporary differences arise due to the difference between the tax bases of the assets and liabilities and their respective carrying amounts. Deductible temporary differences and tax losses carried forward give rise to deferred tax assets in the Consolidated Statement of Financial Position. Taxable temporary differences in tax bases give rise to deferred tax liabilities in the Consolidated Statement of Financial Position.

The breakdown of deferred tax assets and deferred tax liabilities from temporary differences and tax losses carried is as follows:

	As of 31 December			
	2016		2015	
(Euros in millions)	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Goodwill and other intangible assets	1,129	(797)	771	(266)
Tangible assets	6	(246)	47	(378)
Trade and other receivables	12	(36)	32	(69)
Other current financial assets	8	(13)	29	(13)
Debt, trade and other payables	19	(6)	7	(10)
Provisions including pension provisions	105	(0)	198	(17)
Other current financial liabilities	64	(4)	101	–
Tax loss carry forwards	184	–	73	–
Deferred tax assets (liabilities)	**1,527**	**(1,101)**	**1,258**	**(753)**
Set off	(1,101)	1,101	(753)	753
Deferred tax assets (liabilities)	**427**	**–**	**505**	**–**

Reconciliation of profit before tax to income tax expense recognised

The reconciliation between profit before tax and the reported income tax for 2016 and 2015 is as follows:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Loss before tax	**(86)**	**(311)**
Tax expense at prevailing statutory rate (32 %)	28	99
Non-deductible expenses	(19)	(22)
Tax free income	–	5
Change in unrecognised temporary differences and tax loss carry forwards	(98)	(157)
Other	(0)	3
Income tax	**(90)**	**(72)**
Current tax (expense)	(0)	–
Deferred tax expense	(90)	(72)
Income tax (expense)	**(90)**	**(72)**

7. Business Combinations

In the financial year 2015, the preliminary purchase price allocation of the E-Plus Group acquired on 1 October 2014 was reviewed within the twelve-month period and adjusted on the basis of a final valuation in line with the provisions of IFRS 3. Comparative information for the period between acquisition and finalisation of the purchase price allocation are presented retrospectively as if the purchase price allocation had already been concluded at the date of acquisition.

An agreement on the final purchase price was reached with KPN in December 2015. The original purchase price was reduced by a total of EUR 134 million. A sufficiently secure agreement on the final purchase price was not reached at the end of the twelve-month period. Therefore estimates based on partial agreements and expert opinions were used in order to determine the purchase price within the final purchase price allocation at that time.

The remaining differences between the preliminary purchase price at the end of the twelve-month period and the final purchase price as of December was recognised in other operating income. For this reason, the payment received in the amount of EUR 104 million less expenses to reach the agreement in the amount of EUR 2 million was reported in the cash flow from operating activities. The remaining amount of EUR 30 million was included in the cash flow from investing activities because it was recognised within the twelve-month period and therefore had no impact on the Consolidated Income Statement.

The following table gives an overview of the differences between the preliminary and the final purchase price allocation:

(Euros in millions)	Preliminary fair values at acquisition date	Final fair values at acquisition date	Adjustments
Other intangible assets	4,328	4,182	(146)
Licences	1,342	1,057	(285)
Customer base	2,718	2,857	139
Other	268	268	–
Property, plant and equipment	1,931	1,742	(189)
Trade and other receivables	677	677	–
Other financial assets	19	19	–
Other non-financial assets	93	93	–
Inventories	21	21	–
Cash and cash equivalents	396	396	–
Interest-bearing debt	505	527	22
Trade and other payables	703	703	–
Other non-financial liabilities	6	6	–
Provisions	254	254	–
Deferred income	220	220	–
Net assets	**5,777**	**5,420**	**(357)**
Goodwill	928	1,256	328
Purchase price according to IFRS 3.45	**6,706**	**6,676**	**(30)**
Purchase price adjustments outside measurement period acc. IFRS 3.45	0	(104)	(104)
Final purchase price	**0**	**6,572**	**(134)**

As of 31 December 2015, the changes were primarily reflected in intangible assets and property, plant and equipment. They resulted mainly from new insights into the requirements of the German Federal Network Agency and from more detailed analyses of the fair values of the licences acquired. In addition, new insights relating to the underlying market conditions resulted in reduced values for the acquired property, plant and equipment.

As of 31 December 2015, the aforementioned revaluations resulted in an increase in goodwill and a change in the opposite direction in the fair value of the customer base.

The adjustments performed led to a reduction of depreciation and amortisation and interest expenses in subsequent periods.

8. 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 (formerly Telefónica Germany Vermögensverwaltungsgesellschaft mbH), 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 cellular 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 31 December 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
Net assets and liabilities	**(214)**
Service receivables from Telxius	1
Liabilities to Telxius	(17)
Effect on net assets excluding cash and cash equivalents	**(231)**
Fee included in cash and cash equivalents	587
Cash and cash equivalents disposed of	0
Net cash inflow	**587**

Subsequent to the spin-off, the Telefónica Deutschland 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 operating income, is offset by consulting fees that are reported in other operating expenses.

9. Earnings per share

Basic earnings per share are calculated by dividing the profit for the year after tax attributable to the ordinary shareholders of the parent company by the weighted average number of ordinary shares outstanding during the reporting period.

Diluted earnings per share are calculated by adjusting the profit after tax attributable to the ordinary shareholders of the parent company and the weighted average number of ordinary shares outstanding in the reporting period for the effects of any dilutive effects inherent in converting potential ordinary shares.

Both basic as well as diluted earnings per share attributable to the ordinary shareholders of the parent company are calculated based on the following data in accordance with IAS 33.

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Total profit (loss) attributable to equity holders of the parent for basic earnings	(176)	(383)
Total profit (loss) attributable to equity holders of the parent for diluted earnings	(176)	(383)

There were no dilutive equity instruments outstanding in the reporting periods shown.

In addition, the share capital of Telefónica Deutschland Holding AG is conditionally increased (see Note 1. Reporting Entity). Shares from the conditional capital of a stock corporation are not part of the calculation of the earnings per share as they can be contingently issued.

	As of 30 December	
(Number of shares in millions)	**2016**	2015
Weighted average number of ordinary shares for basic earnings per share	2,975	2,975
Weighted average number of ordinary shares for diluted earnings per share	2,975	2,975

Basic and diluted earnings per share attributable to the ordinary shareholders of the parent company amount to:

	1 January to 31 December	
(Earnings per share)	**2016**	2015
Basic earnings per share in EUR	(0.06)	(0.13)
from continuing operations	(0.06)	(0.13)
Diluted earnings per share in EUR	(0.06)	(0.13)
from continuing operations	(0.06)	(0.13)

10. Measurement Categories of Financial Assets and Financial Liabilities

In the following tables, the fair values 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 31 December 2016, the carrying amount of the financial assets and financial liabilities represents an appropriate approximation for the fair value (with the exception of the portion of the bonds that is not hedged – see below).

In addition, the tables show the categorisation of the financial assets and financial liabilities in accordance with the importance of the input factors that were used for their respective measurement. For this purpose, three levels or measurement hierarchies are defined:

- Level 1: Primary market value: quoted prices (unadjusted) in active markets for identical assets and liabilities;
- Level 2: Significant other observable input parameters: inputs observable, either directly or indirectly, which are subject to certain limitations;
- Level 3: Significant unobservable input parameters: all unobservable inputs, which might include the entity's own data as a starting point and which should be adjusted if reasonably available information indicates that other market participants would use different data.

(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 price)	Level 2 (Other directly and indirectly 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
	As of 31 December 2016									
	Financial assets									
					Measurement hierarchy					
Non-current trade and other receivables (Note 5.4)	–	–	–	77	–	–	–	77	77	–
Other non-current financial assets (Note 5.5)	12	21	–	18	–	12	21	51	51	9
Current trade and other receivables (Note 5.4)	–	–	–	1,458	–	–	–	1,458	1,458	1
Other current financial assets (Note 5.5)	2	–	–	23	–	2	–	25	25	–
Cash and cash equivalents (Note 5.8)	–	–	–	613	–	–	–	613	613	–
Total	**14**	**21**	**–**	**2,189**	**–**	**14**	**21**	**2,224**	**2,224**	**11**

(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 price)	Level 2 (Other directly and indirectly 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
	As of 31 December 2015									
	Financial assets									
					Measurement hierarchy					
Non-current trade and other receivables (Note 5.4)	–	–	–	157	–	–	–	157	157	–
Other non-current financial assets (Note 5.5)	12	18	–	23	–	12	18	53	53	9
Current trade and other receivables (Note 5.4)	–	–	–	1,519	–	–	–	1,519	1,519	1
Other current financial assets (Note 5.5)	2	–	–	8	–	2	–	10	10	–
Cash and cash equivalents (Note 5.8)	–	–	–	533	–	–	–	533	533	–
Total	**14**	**18**	**–**	**2,240**	**–**	**14**	**18**	**2,272**	**2,272**	**11**

As of 31 December 2016, EUR 12 million of the other non-current financial assets and EUR 2 million of the current financial assets are classified as financial assets at fair value through profit or loss. These relate to the swaps that the Group entered into in connection with the bond issuance (for further information, see Note 5.5 Other Financial Assets).

In addition, EUR 21 million of the other non-current financial assets (see Note 5.5 Other Financial Assets) are classified as available-for-sale financial assets. These relate to investments in start-ups (for further information, see Note 5.5 Other Financial Assets). These assets were classified as level 3 due to the absence of quoted market prices. These entities generate start-up losses, and the existing business plans contain numerous unpredictable assumptions. For this reason, the measurement was made in accordance with IAS 39.46c. The increase of EUR 3 million concerns only investments in start-up companies. There were no gains or losses recognised in current year in relation to the investments in start-up companies.

All other financial assets as of 31 December 2016 were categorised as loans and receivables.

Please see the respective notes for further information.

The age structure of the financial assets that are overdue and not impaired was as follows:

	As of 31 December	
(Euros in millions)	**2016**	2015
Overdue for 1–90 days	15	38
Overdue for 91–180 days	1	1
Overdue for more than 180 days	14	14
Total	**30**	**53**

With regards to these financial assets, there are no indications of circumstances that could have a negative impact on their value as of the respective reporting date.

	As of 31 December 2016								
	Financial liabilities								
				Measurement hierarchy					
(Euros in millions)	**Financial liabilities at fair value through profit or loss**	**Liabilities at amortised costs**	**Finance Leases**	**Level 1 (Quoted prices)**	**Level 2 (Other directly and indirectly observable market inputs)**	**Level 3 (Inputs not based on observable market data)**	**Total carrying amount**	**Total fair value**	**Not in scope of IFRS 7**
Non-current interest-bearing debt (Note 5.10)	360	1,343	17	–	360	–	1,721	1,778	–
Non-current trade and other payables (Note 5.11)	–	15	–	–	–	–	15	15	2
Current interest-bearing debt (Note 5.10)	–	22	15	–	–	–	37	37	–
Current trade and other payables (Note 5.11)	–	2,218	–	–	–	–	2,218	2,218	68
Total	**360**	**3,599**	**32**	**–**	**360**	**–**	**3,991**	**4,048**	**70**

(Euros in millions)	Financial liabilities at fair value through profit or loss	Liabilities at amortised costs	Finance Leases	Level 1 (Quoted prices)	Level 2 (Other directly and indirectly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in scope of IFRS 7
	As of 31 December 2015								
	Financial liabilities								
				Measurement hierarchy					
Non-current interest-bearing debt (Note 5.10)	360	1,294	32	–	360	–	1,686	1,733	–
Non-current trade and other payables (Note 5.11)	–	151	–	–	–	–	151	151	2
Current interest-bearing debt (Note 5.10)	–	388	180	–	–	–	568	568	–
Current trade and other payables (Note 5.11)	–	2,203	–	–	–	–	2,203	2,203	69
Total	**360**	**4,036**	**212**	**–**	**360**	**–**	**4,608**	**4,655**	**71**

As of 31 December 2016, EUR 360 million of non-current interest-bearing debt is classified as financial liabilities at fair value through profit or loss. This relates to a portion of the bonds, which are each accounted for with an interest rate swap as a fair value hedge and therefore classified as financial liabilities at fair value through profit or loss (for further information see Note 5.10 Interest-Bearing Debt).

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

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.

11. Group Companies of the Telefónica Deutschland Group

In accordance with sections 285 and 313 of the German Commercial Code (HGB), the following table lists the companies making up the Telefónica Deutschland Group as of 31 December 2016.

For detailed information, please refer to the list of shareholdings published with the Annual Financial Statements of Telefónica Deutschland Holding AG in the German Federal Gazette.

Company name, registered office	Country	Consolidation	Share in % as of 31 December 2015
Parent company			
Telefónica Deutschland Holding AG, Munich	Germany	n/a	n/a
Subsidiaries			
Telefónica Germany Management GmbH, Munich[1]	Germany	Full financial year	100 %
Telefónica Germany GmbH & Co. OHG, Munich[2]	Germany	Full financial year	100 %
Telefónica Germany 1. Beteiligungsgesellschaft mbH, Munich[1]	Germany	Full financial year	100 %
Telefónica Germany Customer Services GmbH, Munich[1]	Germany	Full financial year	100 %
Telefónica Germany Next GmbH, Munich[1]	Germany	From July 2016	100 %
Telefónica Germany Retail GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
Wayra Deutschland GmbH, Munich[1]	Germany	Full financial year	100 %
O2 Telefónica Deutschland Finanzierungs GmbH, Munich	Germany	Full financial year	100 %
TGCS Bremen Contact Center GmbH, Munich[1]	Germany	Full financial year	100 %
TGCS Hamburg Contact Center GmbH, Munich[1]	Germany	Full financial year	100 %
TGCS Nuremberg Contact Center GmbH, Munich[1]	Germany	Full financial year	100 %
E-Plus Mobilfunk GmbH Düsseldorf[1]	Germany	Full financial year	100 %
E-Plus Services Treuhand GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
E-Plus Service GmbH & Co. KG, Potsdam[2]	Germany	Full financial year	100 %
E-Plus Customer Operations GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
E-Plus Customer Support GmbH, Potsdam[1]	Germany	Full financial year	100 %
Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH, Düsseldorf[1]	Germany	Full financial year	100 %
AY YILDIZ Communications GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
Cash & Phone GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
Ortel Mobile GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
Go Clever GmbH, Düsseldorf[1]	Germany	Full financial year	100 %
E-Plus Financial Services GmbH, Potsdam[1]	Germany	Full financial year	100 %
Shortcut I GmbH & Co. KG, Hamburg	Germany	Full financial year	90 %
Joint operations			
TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg	Germany	Full financial year	50 %
TCHIBO Mobilfunk GmbH & Co. KG, Hamburg	Germany	Full financial year	50 %

1 The entities are using the exemption provisions pursuant to section 264 (3) HGB.
2 The entities are using the exemption provisions pursuant to section 264b HGB.

Other investments			
MNP GbR, Cologne[3]	Germany	Full financial year	50 %
Mediakraft Networks GmbH, Munich[4]	Germany	Full financial year	29 %
tado GmbH, Munich	Germany	Full financial year	14 %
UppTalk S.L., Barcelona	Spain	Full financial year	18 %
Sum Up Holdings Ltd, Grand Cayman	Cayman Islands	Full financial year	4 %
Zen Guard GmbH, Berlin	Germany	Full financial year	6 %
So1 GmbH, Berlin	Germany	Full financial year	13 %
Stocard GmbH, Mannheim	Germany	Full financial year	17 %

3 The Company reported total equity of EUR 136 thousands as of 31 December 2015. Net income amounted to EUR 27 thousand for the financial year ended 31 December 2015.
4 The Company reported total equity of EUR -1,666 thousands as of 31 December 2014. Net income amounted to EUR -9,737 thousand for the financial year ended 31 December 2014.

12. Joint Operations

Telefónica Germany GmbH & Co. OHG jointly controls TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg, and TCHIBO Mobilfunk GmbH & Co. KG, Hamburg.

The business objective of TCHIBO Mobilfunk Beteiligungs GmbH is the holding of interests in other companies. The business objective of TCHIBO Mobilfunk GmbH & Co. KG, where TCHIBO Mobilfunk Beteiligungs GmbH is its personally liable shareholder, is the marketing and sales of mobile communications services to be rendered by third parties and the marketing and sales of hardware.

In application of IFRS 11.17 and the respective application guidelines, the companies were classified as joint operations considering other facts and circumstances. In particular, the fact that Telefónica Germany GmbH & Co. OHG and TCHIBO GmbH have rights to the entire production output generated by TCHIBO Mobilfunk Beteiligungs GmbH and TCHIBO Mobilfunk GmbH & Co. KG indicates that the arrangement constitutes joint operations.

As part of the joint operation in TCHIBO Mobilfunk GmbH & Co. KG, Telefónica Germany GmbH & Co. OHG reimburses the company for sales and marketing services provided by the latter, on the one hand and otherwise supplies the company with mobile communications devices. Telefónica Germany GmbH & Co. OHG has committed to providing the company with capital, if needed. As of 31 December 2016, EUR 1 million of that amount was still outstanding.

The share of the assets, liabilities and expenses and income to be attributed to the Telefónica Deutschland Group from both companies corresponds in each case to 50 %. Thus, the actual share is identical to the contractually agreed share of voting rights.

The shares of assets, liabilities, income and expenses before consolidation for 2016 and 2015 are comprised as follows:

TCHIBO Mobilfunk GmbH & Co. KG (Euros in millions)	2016	2015
Financial position		As of 31 December
Current assets	15	13
thereof cash and cash equivalents	*9*	*6*
Non-current assets	0	0
Current liabilities	(9)	(7)
Non-current liabilities	–	–
Income statement		1 January to 31 December
Revenues and other income	30	30
Expenses	(29)	(30)
thereof amortisation and depreciation	*(0)*	*(0)*
Operating income	1	0
Financial result	0	0
Income tax	(0)	(0)
Profit/(loss) for the period	0	0

The shares of assets, liabilities, income and expenses before consolidation in TCHIBO Mobilfunk Beteiligungs GmbH are not shown in detail because of their insignificance.

13. Related Parties

Related parties within the meaning of IAS 24 are defined as natural persons and companies that can be influenced by the Telefónica Deutschland Group, that can exercise a material influence over the Telefónica Deutschland Group, or that are materially influenced by another related party of the Telefónica Deutschland Group.

Transactions with related parties include transactions between the Telefónica Deutschland Group and the Telefónica, S.A. Group.

Telefónica Deutschland Holding AG is the parent company of the Telefónica Deutschland Group. It is included in the Consolidated Financial Statements of the ultimate holding company, Telefónica, S.A. The parent company of Telefónica Deutschland Holding AG is Telefónica Germany Holdings Limited, a subsidiary of O2 (Europe) Limited and an indirect subsidiary of Telefónica, S.A. The Telefónica, S.A. Group companies are related companies because Telefónica, S.A. controls the Telefónica Deutschland Group.

Note 11 provides an overview of the companies making up the Telefónica Deutschland Group. In 2015 and 2016, the following were related parties from the perspective of the Telefónica Deutschland Group:

— Telefónica, S.A. and its subsidiaries and significant associates interests of Telefónica, S.A. Group (see Note 13.1 Transactions with the Telefónica, S.A. Group)
— KPN and its subsidiaries and material equity interests and its related parties from 1 October 2014 to 12 November 2015 (see Note 13.2 Transactions with the KPN Group)
— Other persons influenced by the Telefónica Deutschland Group or that can exercise a material influence over the Telefónica Deutschland Group (see Note 13.4 Transactions with other related persons)
— Members of the Management Board and Supervisory Board of the Telefónica, S.A. Group and the members of the Management Board and Supervisory Board of the Telefónica Deutschland Group (see Note 14 Transactions with the Management Board and Supervisory Board)
— Joint ventures (see Note 13.3 Transactions with Joint Operations)

The extent of the transactions conducted with the Telefónica, S.A. Group and other related parties can be seen in the overviews below.

Intercompany charges are based on cost-plus or similar allocation methods.

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

Receivables from and liabilities to the Telefónica, S.A. Group
The Telefónica Deutschland Group reports the following receivables from and liabilities to the companies belonging to the Telefónica, S.A. Group:

	As of 31 December	
(Euros in millions)	**2016**	2015
Receivables from the Telefónica, S.A. Group	**643**	**558**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Cash and cash equivalents (cash pooling)	600	522
Trade and other receivables	43	37
Liabilities to the Telefónica, S.A. Group	**466**	**851**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Trade and other payables	466	351
Interest-bearing debt	0	501

Cash and cash equivalents (cash pooling)
The receivables from the Telefónica, S.A. Group as a result of cash pooling relate to the cash pooling agreement with Telfisa Global B.V.

Trade and other receivables
These receivables result from transactions involving goods and services, e.g. roaming and insurance services, and from licence agreements between the Telefónica Deutschland Group and the Telefónica, S.A. Group. As of the reporting dates of 31 December, the line item contains receivables due from Telefónica, S.A. of EUR 1 million in 2016 and of EUR 9 million in 2015.

Trade and other payablesn
This item primarily relates to liabilities sold by the suppliers of Telefónica Germany GmbH & Co. OHG to Telefónica Factoring España, S.A., in which Telefónica, S.A. has an interest. In addition the item includes licences agreements, social benefits and leased lines.

As of the reporting dates of 31 December, the line item contains other payables to Telefónica, S.A. of EUR 7 million in 2016 (2015: EUR 10 million).

Revenues, other income and expenses with the Telefónica, S.A. Group
The Telefónica Deutschland Group reports the following revenues, other income and expenses with companies belonging to the Telefónica, S.A. Group:

	Revenues, other income and interest income		Expenses	
	1 January to 31 December		1 January to 31 December	
(Euros in millions)	**2016**	2015	**2016**	2015
Telefónica, S.A. Group	400	15	(192)	(129)

Revenues are generated primarily from the sale of passive tower infrastructure, goods and services, e.g. roaming, mobile phone insurance, wholesale voice, etc.

Expenses include group fees totalling EUR 55 million in 2016 and EUR 54 million in 2015, together with expenses relating to the purchase of goods and services, as well as other expenses in connection with transactions with the Telefónica, S.A. Group, e.g. insurance and IT services.

13.2. Transactions with the KPN Group

On 16 November 2015, KPN, The Hague, Netherlands, informed the Telefónica Deutschland Group in accordance with section 21 (1) of the German Securities Trading Act (WpHG) that its share of the voting rights of Telefónica Deutschland Holding AG, Munich, Germany, had fallen below the threshold of 20 % on 12 November 2015 and amounted to 15.46 % on this date (corresponding to 459,783,774 voting rights). This meant that KPN was no longer a related party at the reporting date.

As of 31 December 2016, KPN held 15.46 % of the shares of the Telefónica Deutschland Group.

Revenues, other income and expenses with the KPN Group
The Telefónica Deutschland Group reported the following revenues, other income and expenses with companies belonging to the KPN Group for the period from 1 January to 12 November 2015:

	Revenues and other income	Expenses
(Euros in millions)	1 January bis 12 November 2015	1 January bis 12 November 2015
KPN Group	3	(31)

Revenues are generated primarily from the performance of services.

The expenses are incurred, among other items, due to the receipt of call centre services and voice interconnect.

13.3. Transactions with joint operations

The Telefónica Deutschland Group reports the following receivables from and liabilities to the joint operation TCHIBO Mobilfunk GmbH & Co. KG as well as revenues, other income and expenses:

	As of 31 December	
(Euros in millions)	**2016**	2015
Receivables from TCHIBO Mobilfunk GmbH & Co. KG	0	0
Liabilities to TCHIBO Mobilfunk GmbH & Co. KG	3	3

	Revenues and other income 1 January to 31 December		Expenses 1 January to 31 December	
(Euros in millions)	**2016**	2015	**2016**	2015
TCHIBO Mobilfunk GmbH & Co. KG	4	8	23	24

The Telefónica Deutschland Group reports no material transactions with the joint operation TCHIBO Mobilfunk Beteiligungs GmbH.

13.4. Transactions with other related persons

a) Management Board:
In the financial year 2016, the members of key management personnel included the following members of the Management Board:
— Thorsten Dirks (CEO),
— Rachel Empey (CFO),
— Markus Haas (COO).

In the financial years to which the accompanying Consolidated Financial Statements relate, the members of the Management Board have not carried out any transactions with the Telefónica Deutschland Group other than as part of the normal trading and business activity of the Telefónica Deutschland Group.

For further details, see Note 14 Transactions with Management Board and Supervisory Board.

b) Salaries and other benefits paid to the Management Board in 2016 and 2015
Salaries and other benefits according to IAS 24.17 that were granted to active Management Board members are composed as follows:

	1 January to 31 December	
(Euros in thousands)	**2016**	2015
Remuneration	**3,980**	**5,497**
thereof:		
Short-term employee benefits	3,558	4,322
Other long-term employee benefits	255	404
Share-Based Payments[1]	(22)	540
Service cost	189	231

1 Due to forfeited share options there is an income from share-based payments.

The defined benefit pension obligation for Management Board members totalled EUR 4,185 thousand in the financial year 2016 and EUR 3,161 thousand in 2015. For further details of the pension obligations of the Telefónica Deutschland Group, please refer to Note 5.12 Provisions.

c) Share options held by members of the Management Board in 2016 and 2015:
The following changes have occurred in the Telefónica, S.A. share options for the Management Board members (for further information see Note 15 Share-Based Payments):

(In units)	2016	2015
Share options as of 1 January	**266,661**	**212,636**
Forfeited share options	(133,176)	(3,399)
Share options granted due to capital increase	–	2,518
Addition of share options	–	88,375
Actual share assignment	(22,243)	(33,469)
Share options as of December 31	**111,242**	**266,661**

14. Transactions with Management Board and Supervisory Board

1. Management Board
According to the resolution of the Annual General Meeting adopted on 5 October 2012, Telefónica Deutschland does not disclose the additional disclosures for listed stock corporations (Aktiengesellschaften) in accordance with section 314 (1) no. 6 a) sentence 5 to 8 HGB.

The employment contracts of the members of the Management Board of Telefónica Deutschland Holding AG valid in the financial year 2016 were concluded on 2 July 2014 and became effective on 1 October 2014. New employment contracts were entered into with the Management Board members Markus Haas and Rachel Empey effective 1 January 2017 through 31 December 2018 (Rachel Empey) and 31 December 2019 (Markus Haas). The Management Board member Thorsten Dirks resigned as CEO and Management Board member effective 31 December 2016. He will leave the company by mutual agreement at the end of 31 March 2017. On 11 December 2016, the Supervisory Board appointed Markus Haas as CEO of Telefónica Deutschland Holding AG effective 1 January 2017.

In accordance with section 314 (1) no. 6a HGB, the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG for the financial year ended 31 December 2016 amounted to EUR 4,105 thousand. The total remuneration in the reporting year contains no share-based payments regarding the transfer of shares without consideration.

The Telefónica Deutschland Group has not currently granted the members of its Management Board any security or loans and have not assumed any guarantees for them.

The total remuneration granted to the Management Board in accordance with section 314 (1) no. 6a HGB in 2015 amounted to EUR 5,225 thousand. The total remuneration included share-based payments for 88,375 share options with a fair value of EUR 571 thousand at the grant date.

In the financial years 2016 and 2015, the total remuneration expenses for former directors and their surviving dependants was EUR 197 thousand in 2016 and EUR 424 thousand in 2015.

As of 31 December 2016 and 2015, the pension obligations for former directors and their surviving dependants were EUR 12,443 thousand and EUR 11,554 thousand respectively[1].

For more details of the pension obligations of the Telefónica Deutschland Group, please refer to Note 5.12 Provisions.

2. Supervisory Board

Name	Member of the Supervisory Board	Remuneration (in EUR)
Eva Castillo Sanz	since 5 October 2012	80,000
Laura Abasolo García de Baquedano	since 12 May 2015	2,000
Angel Vilá Boix	since 18 September 2012	2,000
Patricia Cobian González	since 18 September 2012	2,000
Michael Hoffmann	since 5 October 2012	70,000
Enrique Medina Malo	since 18 September 2012	2,000
Sally Anne Ashford	since 18 September 2014	20,000
Antonio Manuel Ledesma Santiago	18 September 2014 until 19 May 2016	2,000
Peter Erskine	since 19 May 2016	12,403
Imke Blumenthal	3 June 2013 until 30 June 2016	20,000
Christoph Braun	since 1 July 2016	19,125
Thomas Pfeil	since 3 June 2013	20,000
Dr. Jan-Erik Walter	since 3 June 2013	20,000
Marcus Thurand	since 3 June 2013	20,000
Christoph Heil	since 3 June 2013	20,000
Claudia Weber	since 3 June 2013	20,000
Joachim Rieger	since 31 October 2014	20,000
Jürgen Thierfelder	since 31 October 2014	20,000

The members of the Supervisory Board received remuneration for their activities of EUR 372 thousand in 2016 and EUR 342 thousand in 2015.

Members of the Supervisory Board who are also employees of the Telefónica Deutschland Group also receive remuneration from their employment relationship, including entitlements from share-based payment agreements, subject to compliance with the requirements for participation in each individual case, and are entitled to pension schemes. This remuneration comprises the following with effect from appointment to the Supervisory Board:

(Euros in thousands)	1 January to 31 December 2016
Remuneration	**707**
thereof:	
Short-term employee benefits	683
Share-Based Payments	3
Service cost	21

As of 31 December 2016, the Telefónica Deutschland Group has not granted the members of their Supervisory Board any securities or loans and has not assumed any guarantees on their behalf.

1 In order to ensure consistency, the disclosure only refers to the members of management of the former Telefónica Germany Verwaltungs GmbH, Munich.

15. Share-Based Payments

As of 31 December 2016, the Telefónica Deutschland Group had made the following agreement regarding share-based payments:

Description of the share-based remuneration plans

"Performance and Investment Plan" 2011 and 2014 (equity-settled)
The plan is a long-term, defined benefit remuneration plan for the Management Board and senior executives of Telefónica, S.A. Group companies, including the Telefónica Deutschland Group.

The "Performance and Investment Plan 2011" (PIP) is divided into three phases, each three years long, whereby the first phase began on 1 July 2011, and ended on 30 June 2014, and the third phase began on 1 July 2013 and ended on 30 June 2016. The subsequent "Performance and Investment Plan" 2014 is likewise divided into three phases, each three years long, whereby the first phase began on 1 October 2014 and will end on 30 September 2017, and the third phase began on 1 October 2016 and will end on 30 September 2019. However, the Executive Committee of Telefónica, S.A. decided that the PIP participants shall not be granted any shares for the third phase of the 2014 plan; the members of the Management Board of Telefónica Deutschland Holding AG shall therefore receive no remuneration from the PIP for the financial year 2016.

There are two versions of the "Performance and Investment Plan 2014", namely the version for members of the ExComm (Executive Committee) of Telefónica, S.A. and the version for senior management; the difference between the two versions is that members of the ExComm of Telefónica, S.A. – as described in greater detail below – may be allocated 125 % of the performance shares awarded.

At the beginning of each phase, the number of shares for each plan beneficiary is determined by dividing the amount that corresponds to a certain proportion of the fixed annual salary by the average share price of Telefónica, S.A. shares during the 30 days before the start of the phase. The shares are delivered no later than 90 days after each phase ends.

The shares are delivered by Telefónica, S.A. (this is the ultimate parent company which undertakes the settlement) if certain vesting conditions are fulfilled:

- The beneficiary is still actively employed by a company in Telefónica, S.A. Group at the end of the three-year phase period.
- The actual number of the shares awarded at the end of the phase is calculated by multiplying the maximum number of shares assigned to each beneficiary at the beginning of the phase by a percentage that reflects the performance of the Telefónica, S.A. share. The performance is measured by comparing the total shareholder return for Telefónica, S.A. shareholders (comprising both share price and dividends) with the total shareholder return of the peer group. The peer group comprises several listed telecom companies.
  - The allocation amounts to 100 % if Telefónica, S.A.'s total shareholder return is in the upper quartile of the peer group,
  - and 30 % if Telefónica, S.A.'s total shareholder return corresponds to the median.
  - On the basis of the "Performance and Investment Plan 2014", members of the Management Board of Telefónica Deutschland, who are also ExComm (Executive Committee) members of Telefónica, S.A., receive an allocation of 125 % if Telefónica, S.A.'s total shareholder return reaches at least the level of the total shareholder return for the upper decile of the peer group.
  - The percentage increases linearly for all points between the benchmarks.
  - If the total shareholder return of Telefónica, S.A. is below the median, no shares are awarded.

In addition, all plan beneficiaries have the opportunity to co-invest. In accordance with the co-investment condition, the plan beneficiary must personally own 25 % of the number of Telefónica, S.A. shares allocated to him or her under the Performance and Investment Plan. These shares must be owned by the plan beneficiary at the first anniversary of the beginning of each cycle and the plan beneficiary must hold them up until the vesting date in order to be entitled to receive a further 25 % of the number of the originally held Telefónica, S.A. shares. Thus the plan beneficiary receives, conditional on the performance of the company, one free Telefónica, S.A. share for every co-invested Telefónica, S.A. share.

The first phase of the 2011 plan ended on 30 June 2014, the second on 30 June 2015. The third and final phase of the 2011 plan ended on 30 June 2016. Telefónica, S.A.'s total shareholder return was below the median of the comparison group and comprised the following number of forfeired share options:

Phase	Maximum number of free shares yet to be assigned	Fair value per unit at allocation date	End date
Third phase of 2011 plan: 1 July 2013	120,739	6.40	30 June 2016

Phase	Number of shares (co-investments)	End date
Third phase of 2011 plan: 1 July 2013	15,811	30 June 2016

Phase	Total	End date
Third phase of 2011 plan: 1 July 2013	136,550	30 June 2016

The first allocation of share options of Telefónica, S.A. shares as part of the 2014 plan took place on 1 October 2014. As of 31 December 2016, the maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was:

Phase	Maximum number of free shares yet to be assigned	Fair value per unit at allocation date	End date
First phase of 2014 plan: 1 October 2014	251,379	8.60	30 September 2017

Phase	Number of shares (co-investments)	End date
First phase of 2014 plan: 1 October 2014	28,922	30 September 2017

Phase	Total	End date
First phase of 2014 plan: 1 October 2014	280,301	30 September 2017

The second allocation of share options of Telefónica, S.A. shares as part of the 2014 plan took place on 1 October 2015. As of 31 December 2016, the maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was:

Phase	Maximum number of free shares yet to be assigned	Fair value per unit at allocation date	End date
Second phase of 2014 plan: 1 October 2015	216,931	6.46	30 September 2018

Phase	Number of shares (co-investments)	End date
Second phase of 2014 plan: 1 October 2015	19,562	30 September 2018

Phase	Total	End date
Second phase of 2014 plan: 1 October 2015	236,493	30 September 2018

The third allocation of share options of Telefónica, S.A. shares as part of the 2014 plan would have taken place on 1 October 2016. However, the Executive Committee of Telefónica, S.A. decided that no allocation would be made for the third phase of this 2014 plan. As of 31 December 2016, the number of shares of Telefónica, S.A allocated under the plan was therefore zero.

The fair values of the equity instruments granted to plan beneficiaries is determined using the share price of the shares of Telefónica, S.A. at grant date under consideration of market conditions.

The plan is valued using the Monte Carlo method, thereby incorporating the performance target as a market condition. This method involves generating share prices and the total shareholder return of the Telefónica, S.A. Group for each company, based on dividend yield and volatility, taking into account the cross-correlations between stocks. The model is used to define the probability for the shares to vest and establish share price growth associated with different ranking positions.

The service condition which requires that the plan beneficiary must be employed by a Telefónica, S.A. company until the end of the vesting period is considered in determining the number of equity instruments to be taken into account at the grant date. The amount to be recognised is thus based on the number of ultimately exercisable equity instruments.

The co-investment condition, being a non-vesting condition, is taken into account in determining the number of equity instruments to be considered. In addition, in determining the fair value, a further non-vesting condition is taken into account, which provides that the shares must be held until the vesting date.

No compensation is paid for expected dividends from the shares that the employees do not receive before physical delivery of the shares. This fact is taken into account in determining the fair value.

Because this is a plan with settlement by equity instruments and because Telefónica, S.A. undertakes the settlement, the personnel expenses are recognised on a pro rata temporis basis over the vesting period with a corresponding entry in the equity of the Telefónica Deutschland Group.

There is a recharge agreement in place between Telefónica, S.A. and the Telefónica Deutschland Group in relation to the shares that are delivered to employees in Germany. This recharge is done by reducing equity and a corresponding increase of the liabilities to Telefónica, S.A.

(In units)	2016	2015
Share options as of 1 January	**818,268**	**809,453**
Addition of share options	–	310,239
Share options granted due to capital increase	–	11,603
Change in employees	(164,925)	(164,976)
Share options granted	–	(113,999)
Forfeited share options	(136,550)	(34,052)
Share options as of 31 December	**516,793**	**818,268**

“Talent for the Future Share Plan” (equity-settled)
The plan is a long-term, defined benefit remuneration plan of Telefónica, S.A., also applicable for the Telefónica Deutschland Group and implemented for employees with persistently outstanding performance, high potential and key qualifications who are expected to take leading roles in the future.

The “Talent for the Future Share Plan” is divided into three phases, each three years long, whereby the first phase began on 1 October 2014, and will end on 30 September 2017, and the third phase began on 1 October 2016 and will end on 30 September 2019. However, the Executive Committee of Telefónica, S.A. decided that the participants of the “Talent for the Future Share Plan” shall not be granted any shares for the third phase of the plan; the participants of the “Talent for the Future Share Plan” shall therefore receive no remuneration from this plan for the financial year 2016.

The number of shares to be assigned no later than 90 days after the end of each phase is determined at the beginning of each phase.

Phase	Maximum number of free shares to be assigned[1]	Fair value per unit at allocation date	End date
First phase 1 October 2014	45,000	8.60	30 September 2017
Second phase 1 October 2015	60,000	6.46	30 September 2018

1 The number of share options to be granted is in accordance with the original Plan. The development of obligations is shown in the following table.

The method of calculation for determining the Telefónica, S.A. shares that must actually be delivered is similar to the method used for the “Performance and Investment Plan”. The vesting condition for this plan that every plan beneficiary must be employed with the Telefónica, S.A. Group at the delivery date of each phase also applies.

No compensation is paid for expected dividends from the shares that the employees do not receive before physical delivery of the shares. This fact is taken into account in determining the fair value.

Because the “Talent for the Future Share Plan“ is a plan with settlement by equity instruments and because Telefónica, S.A. undertakes this settlement, the personnel expenses are recognised on a pro rata temporis basis over the vesting period with a corresponding entry in the equity of the Telefónica Deutschland Group.

There is a recharge agreement in place between Telefónica, S.A. and the Telefónica Deutschland Group in relation to the shares that are delivered to employees in Germany. This recharge is done by reducing equity and a corresponding increase of the liabilities to Telefónica, S.A.

(In units)	**2016**	2015
Share options as of 1 January	**98,395**	**45,000**
Addition of share options	–	60,000
Share options granted due to capital increase	–	395
Change in employees	(8,032)	(7,000)
Share options as of 31 December	**90,363**	**98,395**

“Restricted Share Plan” (equity-settled)
The “Restricted Share Plan” (“RSP” or “the plan”) is a long-term remuneration plan of the Telefónica, S.A. Group, also applicable for the Telefónica Deutschland Group and implemented for top talents and employees with key qualifications and optimally maintaining the motivation of employees in key positions and employees with high potential.

A restricted share option was only granted under the plan between 2011 and 2015. Within the Telefónica Deutschland Group, one member of the Management Board of Telefónica Deutschland Holding AG and one other employee are currently participating in the plan.

The Supervisory Board has set the level of the Restricted Share Plan at a fixed annual salary of the plan beneficiary. The shares are assigned no later than 90 days after the vesting period ends.

No compensation is paid for expected dividends from the shares that the participant does not receive before physical delivery of the shares.

The shares are allocated in three equal tranches over a period of three years, provided the plan beneficiary is in employment at Telefónica Deutschland Holding AG at the relevant allocation date (for each of the tranches as applicable).

The tranches granted increased by a total of 502 shares as a result of the capital increase of Telefónica, S.A. in 2015.

(In units)	Maximum number of free shares to be assigned	Fair value per unit at allocation date	End date
First commitment 1 October 2014	65,990	12.12	
First tranche	21,997		30 September 2015
Second tranche	22,248		31 January 2016
Third tranche	22,252		31 January 2017

(In units)	Maximum number of free shares to be assigned	Fair value per unit at allocation date	End date
Second commitment 1 January 2016	6,858	10.94	
First tranche	2,286		31 December 2016
Second tranche	2,286		31 December 2017
Third tranche	2,286		31 December 2018

(In units)	2016	2015
Share options as of 1 January	**44,495**	**65,990**
Addition of share options	6,858	–
Share options granted due to capital increase	–	502
Share options granted	(22,243)	(21,997)
Share options as of 31 December	**29,110**	**44,495**

Bonus II – "Deferred Bonus Plan" (cash-settled)
Bonus II (deferred bonus) was put in place to to avoid an excessive incentive effect through the PIP and thus too much of an incentive to pursue corporate goals. Bonus II provides the Management Board members with an amount equal to a share of the annually paid Bonus I as a prospective bonus. The amount of the share is determined by the Supervisory Board at the start of each new cycle. Since the implementation of the plan, it has amounted to 50 % of the annual Bonus I. Each Management Board member has the right to the full amount after a period of three years if the total shareholder return of Telefónica Deutschland Holding AG is in the upper quartile of the total shareholder return of a peer group comprising the DAX 30 companies. Each Management Board member has the right to 50 % of Bonus II if the total shareholder return of Telefónica Deutschland Holding AG corresponds to the median of the peer group. If the total shareholder return of Telefónica Deutschland Holding AG lies between the upper quartile and the median, Bonus II is

calculated on a linear proportional basis. If Telefónica Deutschland Holding AG lies below the median, there is no entitlement to payments.

At the time these Consolidated Financial Statements were issued, the Supervisory Board of Telefónica Deutschland Holding AG had not yet decided on the Bonus II amount for the current bonus cycle, which started in financial year 2016.

"Global Employee Share Plan" (equity-settled)
This plan is a share incentive plan for all employees of the Telefónica, S.A. Group, also applicable for the Telefónica Deutschland Group with certain exceptions. Under this plan, participants who meet the qualifying requirements are offered the opportunity to acquire shares of Telefónica, S.A. and to receive the same number of shares free of charge at the end of the period.

The shares are delivered by Telefónica, S.A. This is the ultimate parent company which undertakes the settlement.

The duration of the plan is two years. Employees who participate in the plan can acquire Telefónica, S.A. shares through monthly instalment payments of up to EUR 150 and up to a maximum of EUR 1,800 for a twelve-month period (acquisition period). The shares were purchased at fair value on the acquisition date. The employees who participate in the plan are entitled to dividend payments with respect the acquired shares. The shares are delivered as soon as the following vesting conditions are fulfilled:
— The beneficiary must be continuously employed during the two-year duration of the plan with a Telefónica, S.A. company (consolidation period), with the exception of employees leaving for a good cause.
— The beneficiary must retain the acquired shares for an additional twelve months after the end of the acquisition period.

The subscription period for this plan began on 1 August 2015 and ended on 31 July 2016. The vesting period will end twelve months after the end of the subscription period on 31 July 2017. The participating employees had acquired the following number of shares as of 31 December 2016:

As of 31 December	No. of shares delivered	Weighted average of grant date fair value per unit
2016	301,510	9.06

The fair value of the equity instruments granted to employees was determined by means of the share price of the Telefónica, S.A. shares at grant date.

The non-market-related vesting condition which requires that the beneficiary has to be employed by a company of the Telefónica, S.A. Group until the end of the vesting period is taken into account in determining the number of the equity instruments under consideration at grant date. The amount to be recognised is thus based on the number of ultimately exercisable equity instruments.

In determining the fair value, the holding condition was taken into account, which is a non-vesting condition.

No compensation will be paid for expected dividends from shares that the employee does not receive before physical delivery of the shares. This fact is taken into account in determining the fair value.

The Global Employee Share Plan is an equity-settled plan and is accounted for by a debit to personnel expenses and a credit to equity.

(In units)	2016	2015
Share options as of 1 January	**117,252**	**–**
Addition of share options	192,599	117,252
Change in employees	(8,341)	–
Share options granted	–	–
Share options as of 31 December	**301,510**	**117,252**

Personnel expenses arising from share-based payment transactions

In the financial year ended 31 December, the following personnel expenses resulting from share-based payment transactions were recorded:

	1 January to 31 December	
(Euros in millions)	2016	2015
Personnel expenses arising from share-based payment transactions	**3**	**2**
thereof from cash-settled plans	–	–
thereof from equity-settled plans	*3*	*2*

Telefónica, S.A. and Telefónica Deutschland Group have an agreement that stipulates the intercompany invoicing for share-based payment transactions to employees of the Telefónica Group. The amount, which is recognized in personnel expenses, is considered additional paid-in capital of Telefónica Deutschland Group until the amount is invoiced. After the invoice is received, the amount is reclassified from equity into a payable due to Telefónica, S.A.

Liabilities arising from share-based payment transactions

As of 31 December 2016, liabilities arising from share-based payment transactions amounted to EUR 0 million (2015: EUR 2 million).

16. Information Regarding Employees

The following table presents the breakdown of the Telefónica Deutschland Group's average headcount in 2016 and 2015 grouped with respect to their status under labour law:

Average headcount	2016	2015
Office staff	8,821	9,483
thereof from joint operations	11	11
Temporary staff	452	597
Total	**9,272**	**10,080**

17. Financial Instruments and Risk Management

General financial market risks

The Telefónica Deutschland Group is exposed to various financial market risks as part of its business activity.

If these financial risks occur, they may lead to negative impacts on the net assets, financial position and results of operations 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 interest and currency risks. The Telefónica Deutschland Group has developed guidelines derived from established standards for the evaluation of risks and monitoring with regard to the use of financial derivatives.

Market risk

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

Currency risk

The underlying currency of the financial reports of the Telefónica Deutschland Group is the euro. All financial statements of all subsidiaries of the Telefónica Deutschland Group are also prepared in euros; thus the Telefónica Deutschland Group is not subject to any translation risk. The regional focus of the Telefónica Deutschland Group's activities means that the transaction risk arising from the Group's business relationships with its suppliers or business partners in countries with a different national currency than the euro is not material. Because the Telefónica Deutschland Group finances itself exclusively through internally generated cash in euro as well as euro-denominated equity and debt, there is also no exchange rate risk.

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

The effects before taxes on the Consolidated Income Statement and thus equity of a simultaneous, parallel increase in the euro of 10 % as against all foreign currencies in the financial years 2016 and 2015 would have been as follows:

	1 January to 31 December			
	2016		2015	
(Euros in millions)	**Risk position**	**+ 10 %**	Risk position	+ 10 %
USD	12.4	(1.1)	(9.1)	1.2
GBP	0.6	0.1	(3.3)	0.8

Because the Telefónica Deutschland Group did not use cash flow hedge accounting, the effects of the sensitivity analysis only affected the Consolidated Income Statements.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument could fluctuate as a result of changes in market interest rates. The Group manages its interest rate risk by seeking to ensure it has a balanced portfolio of fixed-interest and variable-interest financing instruments. Where necessary, interest rate swaps are used in achieving this aim.

Interest-rate risks at the Telefónica Deutschland Group primarily arise from variable-interest loan agreements under which it is the borrower and from interest rate swaps, as well as its variable-interest cash pooling accounts with Telfisa Global B.V. In order to reduce existing interest-rate risks, interest rate swaps were concluded in November 2013 and February 2014 in connection with the issue of bonds for a partial amount of the bonds' nominal values. Under these interest rate swap contracts, the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. These interest rate swaps compensate, to the level of their nominal amounts, the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities from the bond issues (fair value hedge). Hedge accounting for these hedge relationships complies with IAS 39. The relationship between the hedge instrument and the underlying transaction as well as the goal and strategy of the hedge were documented at the inception of each hedge. A specific allocation of the hedging instrument to the corresponding liability took place and an estimate of the degree of effectiveness of the hedge was made. The existing hedge is continuously monitored for effectiveness.

The net risk position for variable interest for the Telefónica Deutschland Group as of the reporting dates 31 December 2016 and 2015 was EUR -142 million and EUR -388 million respectively; these figures are primarily attributable to the revolving credit facility, the interest rate swap and the cash and cash equivalents deposited with Telfisa Global B.V.

The effects before taxes on the Consolidated Income Statement of a change in the interest rates of variable interest-bearing financial instruments of +/-100 basis points as of the reporting dates 31 December 2016 and 2015 are shown below. There is no impact recognised directly in equity. This analysis assumes that all other variables remain unchanged.

	1 January to 31 December	
(Euros in millions)	2016	2015
+ 100 bp	1	(4)
– 100 bp	4	5

Credit risk

Credit risk describes the risk of financial losses due to the inability of contractual partners to repay or service debts in accordance with the contract. The Telefónica Deutschland Group's maximum credit risk initially corresponds to the carrying amount of its financial assets (excluding any guarantees or securities).

The Telefónica Deutschland Group considers the management of the commercial credit risk to be critical in order to achieve its goals for sustainable growth of the business and the customer base in harmony with its risk management guidelines. Suitable processes have been established for the management and the monitoring of the credit risk. These include the ongoing monitoring of the expected risks and the level of default. Particular attention is paid to customers who could have a significant effect on the Consolidated Financial Statements of the Telefónica Deutschland Group and for whom, depending on the business area and the type of business relationship, appropriate credit management instruments are used, such as credit insurance or security, to limit the credit risk. To control credit risk, the Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and recognises adjustments on doubtful receivables with a credit risk.

In accordance with Telefónica corporate policy, the Telefónica Deutschland Group has concluded cash pooling and deposit agreements with Telfisa Global B.V., a subsidiary of the Telefónica, S.A. Group, with regard to its cash surpluses and deposits its cash surpluses there. Telefónica, S.A. is rated by international rating agencies with an investment grade rating.

The financial assets for which the Telefónica, S.A. Group was a counterparty amounted to EUR 643 million as of 31 December 2016 and EUR 558 million as of 31 December 2015.

Liquidity risk

Liquidity risk encompasses the risk that the Telefónica Deutschland Group may be unable to sufficiently comply with its financial obligations. To safeguard liquidity, cash inflows and outflows are permanently monitored and controlled centrally on the basis of detailed financial planning. The Telefónica Deutschland Group works on its liquidity management closely with the Telefónica, S.A. Group and, in accordance with the corporate policy, has concluded cash-pooling and deposit agreements with Telfisa Global B.V., Netherlands. In addition to operating liquidity, the opportunities arising on the financial markets are continuously examined with a view to ensuring the financial flexibility of the Telefónica Deutschland Group.

As of 31 December 2016, Telefónica Germany GmbH & Co. OHG had undrawn credit lines from short-term overdraft facilities and revolving credit facilities and loans totalling EUR 1,675 million with a term of over one year; as of 31 December 2015, they amounted to EUR 750 million.

Cash and cash equivalents amounted to EUR 613 million as of 31 December 2016 and to EUR 533 million as of 31 December 2015.

The following table shows the maturity profile of the financial liabilities of the Telefónica Deutschland Group on the basis of the contractual undiscounted payments (including interest):

	As of 31 December 2016				
			Remaining term		
(Euros in millions)	**Total carrying amount**	**Gross cash outflow**	**< 1 year**	**1–5 years**	**> 5 years**
Non-current interest-bearing debt	1,721	1,860	79	1,433	348
Non-current trade and other payables	17	17	–	17	–
Current interest-bearing debt	37	37	37	–	–
Current trade and other payables	2,286	2,286	2,286	–	–
Financial liabilities	**4,061**	**4,200**	**2,402**	**1,450**	**348**

	As of 31 December 2015				
			Remaining term		
(Euros in millions)	Total carrying amount	Gross cash outflow	< 1 year	1–5 years	> 5 years
Non-current interest-bearing debt	1,686	1,850	23	1,090	737
Non-current trade and other payables	154	156	–	156	–
Current interest-bearing debt	568	571	571	–	–
Current trade and other payables	2,272	2,272	2,272	–	–
Financial liabilities	**4,679**	**4,849**	**2,866**	**1,246**	**737**

Capital management

The Telefónica Deutschland Group strives to guarantee the sustainability of its business and to maximise its enterprise value by permanently monitoring its capital costs, equity ratio and OIBDA.

As of 31 December 2016, the equity ratio amounted to 61.5 % compared with 62.0 % as of 31 December 2015. OIBDA amounted to EUR 2,069 million in 2016 and EUR 1,804 million in 2015.

18. Contingent Assets and Liabilities

Indirect claims against the frequency allocation at 800 MHz, 1.8 GHz, 2.0 GHz and 2.6 GHz could result in the reassignment of the 800 MHz, 1.8 GHz, 2.0 GHz and 2.6 GHz frequencies purchased at the 2010 frequency auction. The above frequencies were (indirectly) contested, as there was pending litigation from several cable network operators, broadcasting companies and Airdata AG against the terms and conditions, on which the frequency allocation was based. This litigation was primarily aimed at the allocation conditions for 800 MHz, but also alternatively involved the rescission of the entire allocation decision (i.e. also affecting 1.8 GHz, 2.0 GHz and 2.6 GHz). The claims have since been rejected in the final instance, meaning that the legal disputes have ended before the administrative courts. The possibility of additional legal proceedings due to as yet unasserted third-party claims against frequency allocations in connection with the aforementioned legal action cannot be ruled out. If the appeals are successful, this could result in the reassignment of the frequencies acquired at the 2010 frequency auction.

On 16 October 2013, the German Federal Fiscal Court (Bundesfinanzhof) passed a judgement regarding the free-of-charge provision of mobile communications devices by intermediaries, with a circular published subsequently by the German Federal Ministry of Finance (BMF) on the application of the judgement. The current standard sales model of the Telefónica Deutschland Group deviates from the situation covered in the judgement, as no IMEI commission is paid. Due to the complex and heterogeneous commission structure on the mobile market, it is not certain that this judgement would have applied to the Telefónica Deutschland Group for past situations. It is thus not yet possible to quantify any theoretical effects on taxation and potential recourse claims against retailers.

Proceedings are pending in the first instance before the finance court in connection with the VAT treatment of roaming revenues in third countries. They relate to the assessment of whether telecommunications services to private customers are subject to German VAT, even if these services are agreed on and billed separately for telephone calls to third countries. The potential amount of additional tax resulting is not material. It is deemed highly probable that the judgement and the pending proceedings will have no negative impact on VAT for the Telefónica Deutschland Group.

Based on current developments in the sector, the company re-evaluated the risks affecting the probability of contingent liabilities identified in connection with the VAT treatment of prepaid contracts as of 31 December 2015 and recognised them in profit or loss.

As one of the leading network operators in Germany, Telefónica Deutschland Group is exposed to the risk of claims concerning 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.

19. Operating Leases and Sublease Agreements

19.1. Operating leases and purchase and other contractual obligations

The following expected maturity dates apply for the obligations from operating leases, purchase and contractual obligations:

	As of 31 December	
(Euros in millions)	**2016**	2015
Less than 1 year	535	513
1 to 5 years	1,265	1,164
Over 5 years	992	817
Obligation from operating leases	**2,793**	**2,494**

	As of 31 December	
(Euros in millions)	**2016**	2015
Less than 1 year	1,129	1,561
1 to 5 years	47	267
Over 5 years	692	701
Purchase and other contractual obligations	**1,868**	**2,529**

The following amounts are recognised in the Consolidated Income Statements:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Expenses for operating leases	543	584

The expenses for operating leases essentially include rental expenses (i.e. office buildings and shops), antenna sites, cars and network equipment (i.e. leased lines and cell sites). Some of the contracts contain renewal options. These relate primarily to lease contracts for network towers.

The Telefónica Deutschland Group provides absolute guarantees to secure rental obligations primarily for antenna sites. These guarantees are granted by external financial counterparts and are offered in the course of normal commercial activity.

The guarantees amount to EUR 105 million as of 31 December 2016 compared with EUR 74 million in 2015.

19.2. Subleases of operating leases

The Telefónica Deutschland Group has entered into various sublease agreements for office buildings, cell sites and shops. The estimated payment schedule for subleases is as follows:

	As of 31 December	
(Euros in millions)	**2016**	2015
Less than 1 year	15	31
1 to 5 years	20	75
Over 5 years	5	46
Income from subleases	**40**	**153**

The following amounts are recognised in the Consolidated Income Statements:

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Income from subleases	24	35

20. Total Auditor's Fees

The services listed below performed by the Group's auditor, Ernst & Young GmbH, were recognised in the Consolidated Income Statements in the financial years 2016 and 2015.

Because the Telefónica Deutschland Group conducts all of its business in Germany, the entire amount is incurred in Germany.

	1 January to 31 December	
(Euros in millions)	**2016**	2015
Types of fee:		
Audit fees	2	3
Other audit-related services	0	0
Total fee	**2**	**3**

The auditor's fees include especially the fees for auditing the Consolidated Financial Statements of Telefónica Deutschland Holding AG and fees for auditing the standalone financial statements. Other audit-related services were performed in the financial year 2016 only to a minor extent.

21. Events after the Reporting Period

There were no significant events after the end of the financial year 2016.

22. Declaration of Compliance with the German Corporate Governance Code

The Management Board and Supervisory Board of Telefónica Deutschland Holding AG previously issued the declaration of compliance in accordance with section 161 (1), section 76 (4) and section 111 (5) of the German Stock Corporation Act (AktG) on 13/14/17 October 2016. This declaration of compliance was renewed on 11/12 December 2016. The complete wording of the declaration of compliance and the related renewal is available Telefónica Deutschland's website
WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN/CORPORATE-GOVERNANCE/DECLARATION-OF-COMPLIANCE.HTML

Munich, 2 February 2017

Telefónica Deutschland Holding AG

The Management Board

Markus Haas   Rachel Empey

Further Information_

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pp. 156–177

Further Information_

Telefónica Deutschland Holding AG
Declaration of the Statutory Representatives

To the best of our knowledge, and in accordance with the applicable reporting principles, the Consolidated Financial Statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Combined Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Munich, 2 February 2017

Telefónica Deutschland Holding AG

The Management Board

Markus Haas   Rachel Empey

Audit opinion

We have audited the consolidated financial statements prepared by Telefónica Deutschland Holding AG, Munich, comprising the consolidated statement of financial position, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flows and the notes to the consolidated financial statements, together with the combined management report for the fiscal year from 1 January 2016 to 31 December 2016. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to section 315a (1) HGB ["Handelsgesetzbuch": "German Commercial Code"] are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

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

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to section 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements, complies with legal requirements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, 15 February 2017

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Dahmen	Vogel
Wirtschaftsprüfer	Wirtschaftsprüferin
[German public auditor]	[German public auditor]

Supervisory Board Report for the 2016 financial year_

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

Dear Shareholders,

In the interests of good corporate governance, the Supervisory Board collaborated well with the Management Board on the basis of trustful cooperation, advised it and fulfilled its controlling responsibilities in the reporting period with regard to all significant topics. The Supervisory Board of Telefónica Deutschland Holding AG consistently and responsibly performed its duties as set out by law, the Articles of Association and the by-laws.

Composition of the Supervisory Board

At the beginning of the 2016 financial year, the Supervisory Board consisted of 16 members, being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Angel Vilá Boix, Laura Abasolo García de Baquedano, Patricia Cobián González, Sally Anne Ashford, Antonio Manuel Ledesma Santiago, Michael Hoffmann and Enrique Medina Malo as well as the employee representatives Imke Blumenthal (Vice Chairperson of the Supervisory Board), Marcus Thurand, Thomas Pfeil, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Christoph Heil and Claudia Weber.

With effect of the end of the Annual General Meeting on 19 May 2016 Antonio Manuel Ledesma Santiago resigned as member of the Supervisory Board. Following the proposition of the nomination committee the Annual General Meeting elected Peter Erskine as new member of the Supervisory Board for the shareholder representatives. His term of office began with the end of the Annual General Meeting on 19 May 2016.

With effect from 30 June 2016 Imke Blumenthal left the Supervisory Board. Christoph Braun automatically succeeded her as a member of the Supervisory Board with effect from 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

In the Supervisory Board of Telefónica Deutschland Holding AG, Michael Hoffmann performs the function of the independent financial expert within the meaning of number 5.3.2

of the German Corporate Governance Code and has the knowledge as requested by section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

In 2016 the Management Board comprised three members: next to Thorsten Dirks as CEO, Markus Haas was responsible for the operative business as Chief Operating Officer (COO) and Rachel Empey for finance and strategy as CFO. Markus Haas also performs the function as Labour Director.

The supervisory board had approved on 21 November 2016 as per Thorsten Dirks' request an early termination of his contract. Thorsten Dirks left –as mutually agreed – by the end of 31 December 2016 the management board and as CEO.

The supervisory board appointed with resolution on 11 December 2016, Markus Haas as CEO of Telefónica Deutschland Holding AG effective as of 1 January 2017.

Rachel Empey, in addition to her previous responsibility for Finance and Corporate Strategy, is since 1 January 2017 also responsible for the areas of Transformation & Integration, Business Intelligence, Innovation and Telefónica Next.

Cooperation between the Management Board and Supervisory Board

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

The Chairperson of the Supervisory Board and the Management Board are also in constant contact outside Supervisory Board meetings. Here they discuss in particular the current position and future development of the company as well as the progress of current material projects, in the reporting period among others especially transformation and integration measures and digital development into an Onlife Telco. The Chairperson of the Supervisory Board informs the other members of the Supervisory Board of important issues discussed in that context.

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

Meetings of the Supervisory Board

In 2016, four ordinary meetings of the Supervisory Board took place, namely on 19 February (meeting on the financial statements for the 2015 financial year; "Bilanzsitzung"), 7 April, 18 July and 20 October 2016. Meetings of the Audit Committee were also held on these days. In addition, there were five extraordinary meetings of the Supervisory Board (sometimes by telephone, video conference, sometimes in person) and further resolutions of the Supervisory Board outside of meetings.

So far there has been one Supervisory Board meeting in 2017: on 16 February 2017 (meeting on the financial statements for the 2016 financial year; "Bilanzsitzung").

Fundamental issues dealt with by the Supervisory Board

The first ordinary meeting of the Supervisory Board in the 2016 financial year on 19 February 2015 was also the meeting regarding the financial statements for the 2015 financial year ("Bilanzsitzung"). In addition to the items associated therewith, such as the approval of the financial statements (Group and of the corporation) and the combined management report for the 2015 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), in particular the final agenda and resolution motions for the Annual General Meeting on 19 May 2016 were agreed, Corporate Governance topics and preparatory measures for the sale of passive tower infrastructure to Telxius Telecom, S.A. (Telxius S.A.), which ultimately took place in April, were discussed.

In addition to the financial data and the outlook, the ordinary meeting on 7 April 2016 discussed operational issues and the results of the employee survey as well as the change of auditor for the financial year 2017. The Supervisory Board also approved the sale of passive tower infrastructure to Telxius S.A.

Among other things, the ordinary meeting on 18 July 2016 addressed the half-yearly financial data, the election of Christoph Braun as the new Deputy Chairperson of the Supervisory Board, corporate culture, Advanced Data Analytics and Internet of Things, compliance and Supervisory Board efficiency.

The topics discussed at the ordinary meeting on 20 October 2016 included financial issues (especially the Q3 results and the business plan), the results of the Supervisory Board efficiency survey and diversity. It was also agreed that the

Annual General Meeting for the 2016 financial year would be held on 9 May 2017.

The Supervisory Board held extraordinary meetings in the reporting period (sometimes by telephone, sometimes via video or in person) during which, in particular, it approved the budget for the financial year 2017 and discussed matters relating to the Management Board (especially on 21 November 2016 the early leaving of Thorsten Dirks and on 11 December 2016 the appointment of Markus Haas as new CEO with effect as of 1 January 2017).

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, operational issues including the synergy reports and the market positioning were dealt with.

In June 2016, the Supervisory Board also held a strategy workshop together with the Management Board.

All Supervisory Board members in office for the entire 2016 financial year participated in more than half of the meetings in the reporting period.

Outside of the meetings the Supervisory Board passed resolutions to the extent required, especially by e-mail. For instance, inter alia the resolution on the Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG) in October 2016 were passed this way – following appropriate preparation at presence meetings.

Committees of the Supervisory Board

As determined in its by-laws, the Supervisory Board has a Nomination Committee, a Mediation Committee and an Audit Committee. Since 7 March 2016, there exists furthermore a Remuneration Committee.

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

The Committee consists of four members:
— Michael Hoffmann (Chairperson)
— Laura Abasolo García de Baquedano
— Thomas Pfeil and
— Christoph Heil.

In 2016, the Audit Committee met seven times. In addition to the regular topics financial results, auditing, risk management and compliance, it dealt in particular with the change of auditor for the financial year 2017.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:
— Eva Castillo Sanz (Chairperson)
— Christoph Braun (from 1 July 2016; Imke Blumenthal until 30 June 2016)
— Angel Vilá Boix and
— Marcus Thurand.

The Remuneration Committee for the Management Board was formed by the full Supervisory Board by e-mail resolution on 4/7 March 2016. The Remuneration Committee is responsible for preparing topics and details relating to Management Board remuneration. In particular, its preparatory work supports the decision making process of the full Supervisory Board.

The Remuneration Committee has the following members:
— Sally Anne Ashford (Chairperson)
— Eva Castillo Sanz
— Dr. Jan-Erik Walter and
— Claudia Weber.

Furthermore, there is a Nomination Committee. The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González is the Chairperson of the Nomination Committee. The other members were Eva Castillo Sanz and Enrique Medina Malo.

The Nomination Committee prepared the election proposal for the Annual General Meeting on 19 May 2016, at which Peter Erskine was elected as successor of Antonio Manuel Ledesma Santiago.

Corporate Governance

Good corporate governance is essential for corporate success and is therefore in the interest of the company's shareholders. Further details on the corporate governance of Telefónica Deutschland Holding AG can be found in the Management Declaration pursuant to section 315 para. 5 in connection with 289a German Commercial Code in the Annual Report and on the company's website at **WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION** and in the Corporate Governance Report in the Annual Report and on the company's website at **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT**

On 13/14 and 17 October 2016 the Management Board and the Supervisory Board approved a new Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG). It was updated on 11/12 December 2016. The Declaration of Compliance and its update were published respectively. You can find them in the Annual Report or at the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**. Earlier versions of the Declaration of Compliance can be also found at this website.

Six of the 16 members of the Supervisory Board hold positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies. Both the Supervisory Board members and the Management Board members disclose potential conflicts of interest promptly to the Supervisory Board.

In the reporting period, no conflicts of interest within the meaning of the German Corporate Governance Code arose.

The Supervisory Board fulfils the gender diversity quota of at least 30 % (at the start of the financial year 2016: 37.5 %; after Imke Blumenthal stepped down with effect from 30 June 2016: 31.25 % female members).

In the financial year 2016, one-third of the members of the Management Board were female. Since 1 January 2017, the quota is 50 % (one member of the two member Management Board is female), so the established gender diversity quota of at least 20 % for the members of the Management Board is still exceeded.

Review of the Financial Statements 2016

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Stuttgart, branch Munich, audited the annual financial statements and the consolidated financial statements as well as the combined management report as of 31 December 2016 of Telefónica Deutschland Holding AG and the Telefónica Deutschland Group and each provided with an unqualified audit opinion. The annual financial statements and the combined management report of Telefónica Deutschland Holding AG and the Telefónica Deutschland Group were prepared in accordance with German commercial law. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as they are applied in the European Union (EU) and the additional requirements which have to be applied in accordance with section 315a para. 1 German Commercial Code (HGB). The auditor carried out the audit in accordance with section 317 HGB considering German principles of proper auditing set by the Institute of Public Auditors in Germany (IDW) as well as for the consolidated financial statements.

The financial statement documentation of the corporation and the group and the Management Board's proposal for the distribution of profit and the respective auditor's reports were submitted to the Supervisory Board in due time prior to the meeting on 16 February 2017 ("Bilanzsitzung"). The Audit Committee and the full Supervisory Board thoroughly examined the reports and discussed them in detail together with the auditor on 16 February 2017.

The Supervisory Board acknowledged and approved the auditor's findings in the audit reports and had no objections. At its meeting on 16 February 2017, the Supervisory Board approved the annual financial statements of Telefónica Deutschland Holding AG and the consolidated financial statements together with the combined management report for the 2016 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Relations to affiliated companies

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

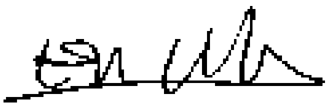
"Based on our audit and assessment, which were carried out in accordance with professional standards, we confirm that
1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,
3. there are no circumstances that would require a materially different assessment of the measures listed in the report than that of the Management Board."

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

The Supervisory Board thanks the former Management Board member Thorsten Dirks for the excellent and collegial collaboration. The Supervisory Board thanks also Markus Haas and Rachel Empey and all employees for their dedication and excellent work in the past year. With their commitment, which in the reporting period was influenced in particular by integration and transformation, they have contributed considerably to the success of the company.

Munich, 16 February 2017

On behalf of the Supervisory Board



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

Corporate Governance Report_

The German Corporate Governance Code establishes a standard for transparent control and management of companies. In accordance with 3.10 of the German Corporate Governance Code, the Management Board and the Supervisory Board of Telefónica Deutschland inform about Corporate Governance as follows. This Corporate Governance Report is also published together with the Management Declaration in accordance with section 315 para. 5 in connection with 289a German Commercial Code (HGB) on our website at **WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT**

Declaration of compliance

The Management Board and Supervisory Board of Telefónica Deutschland feel committed to the principles of transparent corporate governance and regularly consider the principles of the German Corporate Governance Code. On 13/14/17 October 2016 they last stated a declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG) which has been updated by resolution on 11/12 December 2016. The full text of the compliance declaration and its update may also be viewed on the company's website at **WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE**

The company's governing bodies

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

A — Management and governing bodies

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

The managing body is the Management Board. It manages the company in its own responsibility in the best interest of the company with the objective of sustainable value creation. The Management Board is monitored and advised by the Supervisory Board. Management Board and Supervisory Board work together closely in the interest of the welfare of the company. All transactions and decisions that are of fundamental or material importance to the company are carried out in close coordination between the Management Board and the Supervisory Board.

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

Details regarding the composition and the operating principles of the Management Board, the Supervisory Board and the Supervisory Board's committees can be found in the management declaration in accordance with section 315 para. 5 in connection with 289a of the German Commercial Code (HGB) (Erklärung zur Unternehmensführung) in the Annual Report or on the Telefónica Deutschland website under **WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION**

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

— The Supervisory Board has at least one independent member (within the meaning of no. 5.3.2 sentence 2 and 5.4.2 sentence 2 German Corporate Governance Code) and should not include any persons who hold an office (e.g. at a significant competitor) which may create a material and not only temporary conflict of interest.
— At least 30 % of the members of the Supervisory Board should be female, at least 30 % male.
— At least one third of the Supervisory Board members to be elected by the General Meeting should have international working experience, knowledge of the English language as well as an understanding of global economic contexts ("internationality").

The Supervisory Board considers these concrete objectives as currently fulfilled.

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

Relationship to shareholders and the General Meeting

The shareholders are generally informed four times a year about the financial and earnings situation and business development.

The company provides for further information on its website (**WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN**), especially the financial calendar. Furthermore, analyst conferences, roadshows and meetings take place.

The shareholders exercise their rights according to the law and the Articles of Association before and during the General Meeting, especially by exercising their voting rights (amongst others on profit distribution, discharge and the election of the auditor).

Risk Management

For the management and supervisory board of Telefónica Deutschland Group, internal control and risk management are fundamental tools for the governance. The risk management department reports regularly to the management board and the audit committee on current risks, action plans and developments. Our risk management process is designed to timely identify, evaluate and mitigate company risks through constant communication with the relevant stakeholders. The risk management system is reviewed by the external auditor and is continuously improved.

You may find further details in the Section "Report on Risks and Opportunities".

Compliance

Telefónica Deutschland Group is committed to comply with all laws, regulations, processes, rules and enactments applicable to its business activity. The company has a compliance department that is concerned with the implementation and optimization of the compliance organization within the company, the coordination of compliance activities and advises employees on their questions. The approach pursued is preventive, raising awareness and informing employees in order to preclude potential violations of rules.

The compliance program focuses on behaviours protecting fair competition, avoiding corruption and conflicts of interests as well as on ethically appropriate behaviour. These topics are covered by mandatory online trainings, as are the areas of data protection, anti-discrimination and information security. Each employee is required to complete certain mandatory training sessions in regular intervals based on his or her job responsibilities. Clear guidelines and policies were established for the most important compliance matters.

The existing Compliance Management System is continuously developed further to adjust it to the changing legal and economic conditions. The Management Board and the Supervisory Board (especially the Audit Committee in charge of monitoring internal control systems and Compliance) is informed regularly on compliance activities.

In this overall context, the company has also a Capital Market Law department in the area of the General Counsel which ensures that the insider rules are complied with (including trainings and maintaining insider lists wherein any persons who act for the company and have authorised access to insider information are registered).

Management and Supervisory Board deal with the topic compliance on a regular basis.

Transparency and communication

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

Relevant shareholdings of Management and Supervisory Board

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

As per 31 December 2016, the Management Board held approximately 0.0015 % of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed – if applicable – as managers' transactions (former directors' dealings).

As per 31 December 2016, the Supervisory Board held approximately 0.0019 % of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed – if applicable – as managers' transactions (former directors' dealings).

Managers' Transactions (former Directors' Dealings)

According to section 19 Market Abuse Regulation (former section 15a of the German Securities Trading Act (WpHG)) persons discharging managerial responsibilities, as well as persons closely related to them are obliged to disclose transactions in shares or debt instruments of Telefónica Deutschland or other derivatives or financial instruments linked thereto if the value of these transactions reaches or exceeds EUR 5,000 per annum.

Respective declararations can be found on the Telefónica Deutschland website at **WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN/CORPORATE-GOVERNANCE/MANAGERS-TRANSACTIONS.HTML**

Accounting and auditing

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with seat in Stuttgart, branch Munich, has been appointed auditor and group auditor for the financial year 2016 by resolution of the annual General Meeting on 19 May 2016.

Management Declaration_

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

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

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

On 13/14 and 17 October 2016, the Management Board and Supervisory Board of Telefónica Deutschland Holding AG ("Company") issued a declaration of compliance pursuant to section 161 para. 1 German Stock Corporation Act (AktG). The present declaration of compliance refers to the German Corporate Governance Code ("GCGC") as amended on 5 May 2015 and published in the Federal Gazette on 12 June 2015.

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

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

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

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

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

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

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

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

8. Pursuant to 5.4.1, 2nd paragraph GCGC the Supervisory Board shall specify concrete objectives regarding its composition, considering an age limit and a regular limit of length of membership. Supervisory Board has resolved on concrete objectives regarding its composition, however without specifying a concrete objective regarding an age limit for Supervisory Board members. In the view of the Company, a fixed age limit for Supervisory Board members is not appropriate since the ability to control and supervise the Management Board is not necessarily restricted by reaching a certain age. Rather it may be necessary where appropriate in the interest of the Company to appoint persons of advanced age with extensive experience even after they reach a particular age limit. Supervisory Board has also not specified a general limit of length of membership to the Supervisory Board. The Company is of the opinion that the possibility to build on longtime expertise of individual members in the Supervisory Board serves the Company's interest to a greater extent.

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

There was an update of the declaration of compliance on 11/12 December 2016:

Management Board and Supervisory Board of Telefónica Deutschland Holding AG ("the Company") have last issued a Compliance Declaration according to section 161 para. 1 German Stock Corporation Act on 13/14 and 17 October 2016. As with the new management board service agreements the recommendation of no. 4.2.2., 2nd paragraph, sentence 3 of the German Corporate Governance Code ("GCGC") is complied with, a new sentence is added at the end of no. 1 of the Compliance Declaration.

The wording of no. 1 of the Compliance Declaration is updated as follows:

1. While determining the total compensation, the Supervisory Board shall, according to 4.2.2, 2nd paragraph, sentence 3 GCGC, consider the relationship between the compensation of the Management Board and that of the senior management and the staff over-all, particularly in terms of its development over time whereupon the Supervisory Board shall determine how senior managers and the relevant staff are to be differentiated. With regard to the Management Board member service agreements which have been signed in July 2014 and have become effective in October following closing of the acquisition of E-Plus, the Supervisory Board has deviated from this recommendation. Since the Company did not have, prior to closing of the acquisition of E-Plus, sufficient information regarding the remuneration structure at E-Plus, it could not consider the relationship between the compensation of the Management Board and that of the senior management and the relevant staff because this also would have required information on the remuneration structure at E-Plus. With regard to the Management Board member service agreements that will become effective on 1 January 2017 the above mentioned recommendation of the GCGC will be complied with.

Apart from the above, the Compliance Declaration dated 13/14 and 17 October remains unchanged.

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

2. Relevant disclosures of management practices

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

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

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

The company's compliance program includes the main areas of anti-corruption with clear guidelines and procedures and an external whistle-blower system **(WWW.TELEFONICA.DE/ OMBUDSMANN)**, competition law and ethically appropriate behavior. The company's data protection team ensures compliance with data protection legislation. This is a top priority for the company. The functions compliance, data protection, information security and internal audit form – as does the legal department – part of the department General Counsel Office which reports directly to the Management Board.

Further details regarding the compliance organization of the company are explained in the Corporate Governance Report which forms part of the Annual Report and is also available on the web site of the company at
WWW.TELEFONICA.DE/CORPORATE- GOVERNANCE-BERICHT

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

During the financial year 2016, there were three members of the Management Board of Telefónica Deutschland Holding AG (Thorsten Dirks, Rachel Empey and Markus Haas).

The Supervisory Board Meeting decided in accordance with section 111 para. 5 German Stock Corporation Act (AktG) a gender diversity quota of at least 20 % for the Management Board. Since then this quota is effective and is exceeded:

In the financial year 2016, one-third of the members of the Management Board were female. Since 1 January 2017, the quota is 50 % (one member of the two member Management Board is female).

The Management Board in its own responsibility manages the company's business with the objective of creating sustainable value in the company's interest, taking into consideration the interests of its shareholders, employees and other stakeholders of the company. The work of the Management Board is governed in particular by the by-laws of the Management Board enacted with Supervisory Board approval and by the company's Articles of Association. The Management Board develops the strategic direction of the company, coordinating this regularly with the Supervisory Board, and also ensures its implementation.

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

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

According to section 76 para. 4 of the German Stock Corporation Act (AktG) the Management Board set goals for the female quota of the two levels below the Management Board. The minimum gender diversity quota which has to be fulfilled until 30 June 2017 was determined at 16 %.

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

The Supervisory Board consists of sixteen members, eight shareholder and eight employee representatives. Antonio Manuel Ledesma Santiago left the Supervisory Board of Telefónica Deutschland Holding AG with effect 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 the same day.

In addition, the Deputy Chairperson of the Supervisory Board Imke Blumenthal left the Supervisory Board of Telefónica Deutschland Holding AG on 30 June 2016. Christoph Braun has been a member of the Supervisory Board of Telefónica Deutschland Holding AG as successor to Imke Blumenthal since 1 July 2016. Christoph Braun was elected Deputy Chairperson of the Supervisory Board at the meeting of 18 July 2016.

The current members of the Supervisory Board are: Chairperson Eva Castillo Sanz, Deputy Chairperson Christoph Braun and the Supervisory Board Members Angel Vilá Boix, Laura Abasolo García de Baquedano, Peter Erskine, Patricia Cobián González, Michael Hoffmann, Sally Anne Ashford, Enrique Medina Malo, Marcus Thurand, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Thomas Pfeil, Christoph Heil, and Claudia Weber.

The Supervisory Board consisted of six female and ten male members (i.e. of 37.5 % female and 62.5 % of male members) until 30 June 2016. Since 1 July, the composition is five female and eleven male members (i.e. 31.25 % female and 68.75 % of male members). Therewith the requirements of section 96 para. 2 German Stock Corporation Act (AktG) (30 % minimum gender diversity quota) are fulfilled.

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

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

The Supervisory Board reviews the efficiency of its activities at least once a year.

Composition and work of the committees of the Supervisory Board

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

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

— Michael Hoffmann (Chairperson)
— Laura Abasolo García de Baquedano
— Thomas Pfeil and
— Christoph Heil.

The Nomination Committee is responsible for proposing suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González was elected chairperson of the nomination committee. Further members are Eva Castillo Sanz and Enrique Medina Malo.

The Mediation Committee with the responsibilities as defined in section 31 Co-Determination Act (MitbestG) consists of the following members:

— Eva Castillo Sanz (Chairperson)
— Christoph Braun (since 1 July 2016)
— Angel Vilá Boix and
— Marcus Thurand.

Imke Blumenthal belonged to the Mediation Committee until 30 June 2016.

Sine 7 March 2016, there is a Remuneration Committee.
Its members are:

— Sally Ashford (Chairperson)
— Eva Castillo Sanz
— Claudia Weber
— Dr. Jan-Erik Walter.

More details on the composition and work of the Committees of the Supervisory Board are provided in the Supervisory Board Report.

30 January 2017

Management Board

Markus Haas (CEO)

Rachel Empey (CFO)

Supervisory Board

Shareholder representatives

Eva Castillo Sanz
(Chairperson of the Supervisory Board and Chairperson of the Mediation Committee)

Laura Abasolo García de Baquedano

Angel Vilá Boix

Patricia Cobián González
(Chairperson of the Nomination Committee)

Enrique Medina Malo

Michael Hoffmann
(Independent financial expert and Chairperson of the Audit Committee)

Sally Anne Ashford
(Chairperson of the Remuneration Comittee)

Peter Erskine

Employee representatives

Christoph Braun
(Deputy Chairperson of the Supervisory Board)

Marcus Thurand

Thomas Pfeil

Dr. Jan-Erik Walter

Christoph Heil (verdi)

Claudia Weber (verdi)

Joachim Rieger

Jürgen Thierfelder

Glossary_

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

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-Gremiums
Bitkom	Bundesverband Informationswirtschaft, Telekommunikation und neue Medien e.V., Berlin
BNetzA	Bundesnetzagentur
bp	Basis points
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
Brexit	British Exit –act of leaving by the United Kingdom from the European Union
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 authorized by the federal network agency
CF	Cash flow
cloud services	A dynamic infrastructure, software and platform services, which are available online
CO_2	Carbon dioxid
data upselling	Additional data volume available for purchase for customers
DSL	Digital Subscriber Line: technology to transmit data in the local loop to private end-customers
EU	European Union
Euribor	Euro Interbank Offered Rate
ExComm	Executive Committee
FCF	Free Cashflow
FTR	Fixed network Termination Rates
GfK	Gesellschaft für Konsumforschung (Consumer research association)
GHG	Greenhouse Gas
GSM	Global System for Mobile Communications
GSMA	Global System for Mobile Communications Association
GWh	Gigawatt hours
HGB	Handelsgesetzbuch (German Commercial Code)

IFRS	International Financial Reporting Standards
IoT	Internet of Things
ISIN	International Securities Identification Number
IT	Information Technology
Joint Venture	Two or more companies founding a new enterprise for cooperation
KPN	Koninklijke KPN N.V., The Hague, Netherlands
Leaver Programm	Severance payment program for the planned downsizing in the context of the merger of E-Pluss
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
MTR	Mobile termination rates
MVNO	Mobile Virtual Network Operator
Net Adds	New customers for the period less those customers leaving are designated as net additional customers
N2O	Nitrous Oxid
NFC	Near Field Communication: a short-range wireless connectivity standard
O2 (Europe) Limited	O2 (Europe) Limited, Slough, United Kingdom
O_2 Free	The O_2 Free data plan allows customers to remain online with speeds of up to 1 Mbit/s even after they have used all of their high-speed data
O_2 My Handy	Monthly payment model for mobile phones and other devices
OIBDA	Operating Income before Depreciation and Amortization
Opex	Operating expenses
OTT	Over The Top
OTT services	Over-the-top- services (e.g. WhatsApp, Facebook)
PIP	Performance and Investment Plan
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
Pure LRIC	Pure Long Run Incremental Costs – Benchmark to regulate costs associated with interconnection fees
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 Deutschland	Telefónica Deutschland Holding AG, Munich
Telefónica, S.A.	Telefónica , S.A., Madrid/Spain
Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telefónica NEXT	Telefónica Germany Next GmbH, Munich
Telxius S.A.	Telxius Telecom S.A., the infrastructure entity of Telefónica
TKG	Telekommunikationsgesetz
TSM-VO	Telecom 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 mobile communications standard of the third generation which unites mobile multi-media and telematics service under the frequency spectrum of 2 GHz.
VDSL	Very High Data Rate Digital Subscriber Line (see DSL)
VoLTE	Voice over LTE
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

Imprint_

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Telefónica Deutschland Holding AG
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80992 Munich, Germany
Phone: +49 89 2442 0
www.telefonica.de

Investor Relations
Telefónica Deutschland Holding AG
Investor Relations
Georg-Brauchle-Ring 23–25
80992 München
Phone: +49 89 2442 1010
E-mail private investors: shareholder-deutschland@telefonica.com
E-mail institutional investors: ir-deutschland@telefonica.com
www.telefonica.de/investor-relations

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www.telefonica.de/annualreport2016

Concept and design
Telefónica Deutschland Corporate Communications, Munich
Strichpunkt, Stuttgart/Berlin

#ShapingDigitalLives

Telefónica Deutschland Holding AG
Georg-Brauchle-Ring 23–25
80992 Munich, Germany
Tel. +49 89 2442 0
www.telefonica.de