Q2/H1 2019 preliminary results

Telefónica Deutschland Investor Relations

24 July 2019

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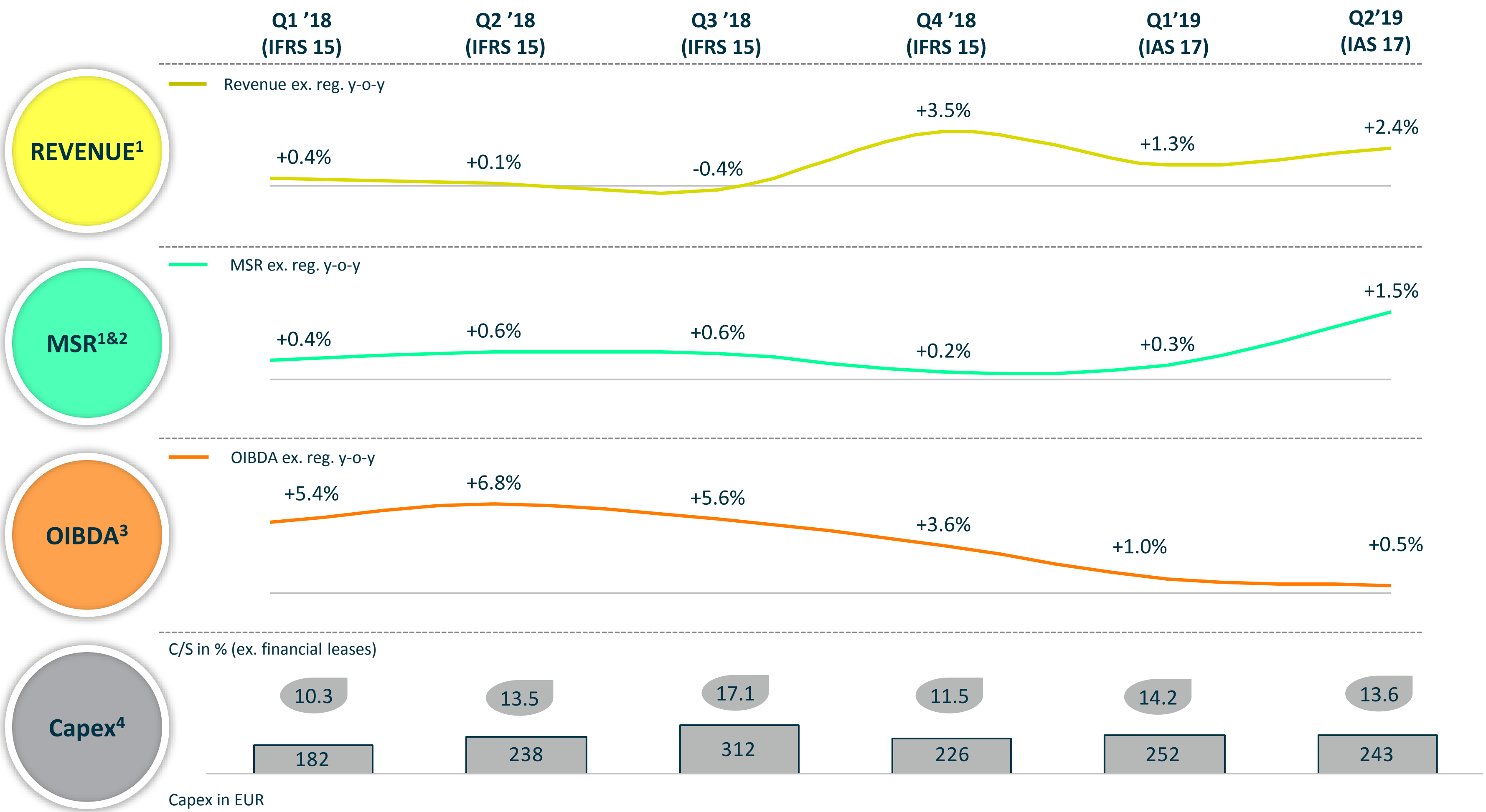
H1 2019 – Strong trading & financial momentum with revenue further improving

Trading	REVENUE[1]	OIBDA[2]	C/S
607k PO net adds	**+1.8%** y-o-y	**+0.7%** y-o-y	**13.9%** H1'19

- Strong trading momentum in O_2 and partner brands; LTE customer base up +21.6% y-o-y to 20.2 million
- Demand for O_2 Free continues to drive data usage growth with a CAGR of 50%
- Underlying[1] revenue trends supported by sustained demand for handsets & strong traction of O_2 Free portfolio
- Reported MSR up +0.6% in Q2'19, crossing the zero line for the first time in 15 quarters; underlying[1] MSR trends improve to +1.5% y-o-y in Q2
- OIBDA reflects ongoing market and transformation invest; ~EUR 45m benefit from roll-over synergies and transformation
- Capex phasing supports pace of LTE roll-out; mid-term expectations unchanged at approx. EUR 1 bn
- Re-iterating dividend commitment with a high pay-out ratio over FCF

[1] Underlying: Excluding the negative impact from regulatory changes
[2] Adjusted for exceptional effects and excl. the negative impact from regulatory changes; y-o-y comparison based on IAS17 accounting standards for 2018 and for 2019. For details please refer to additional materials of the Q2 2019 results release

Operational and financial trends strong



[1] Excluding the negative impact from regulatory changes (mainly driven by the mobile termination rate cut to EURc 0.95 per minute as of 1 Dec 2018)

[2] Mobile service revenue include base fees and fees paid by our customers for the usage of voice, sms and mobile data services. Also, access and interconnection fees as well as other charges levied on our partners for the use of our network are included

[3] Exceptional effects were EUR 12 million of restructuring expenses in the period April to June 2019 (EUR 17 million based on IAS 17). The difference between restructuring charges under IAS 17 and IFRS 16 is due to the fact that certain IAS 17 operating lease commitments require the recognition of provisions, whereas those are recognised as lease liabilities under IFRS 16. Regulatory effects amounted to EUR 10 million in the period April to June 2019.

[4] Excluding additions from capitalised right-of-use assets (as of 1 January 2019) and excluding additions from capitalised finance leases (till 31 December 2018)

Mobile Customer & Digital Champion: Momentum in all key-areas

Quality

new LTE sites

~4.4k

YTD July 2019

"excellent network" by TUTELA

"winner" shop test

"winner" partner shops

"very good" fixed product

Trading

Postpaid	**Churn**	**Fixed**
+607k NA	**-15.1% H1'19 annualised**	**+82k NA**
22.8m customers	vs. -18.0% (FY'17)	2.2m customers

Financials

Revenue & MSR growth

OIBDA on track

Capex on track

Becoming the Mobile Customer & Digital Champion: All-round infrastructure player confirmed

Infrastructure

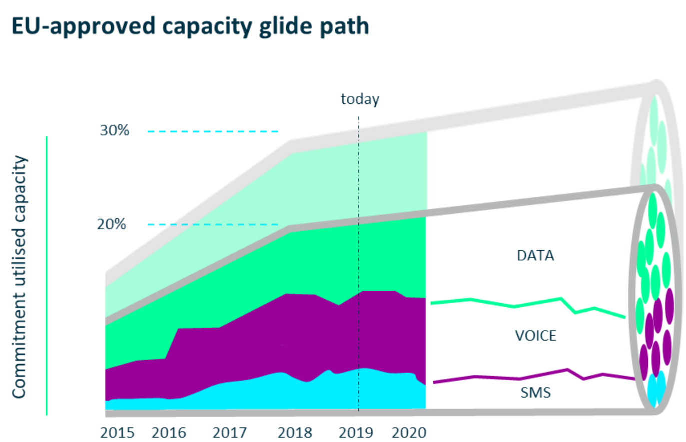
Mobile
- 4G ✓
- 5G ✓

Fixed
- VDSL ✓
- Cable ✓
- FTTH ✓

- **> 4,400 new LTE sites**; on track for FY 2019 target of 10,000k
- **Network churn receding**; improving overall O_2 churn and already reaching our CMD target of -2p.p. from -18.0% (FY’17 annualised) to -15.1% now (H1’19 annualised)
- **Exclusive cable wholesale access** to Vodafone's cable network in Germany; enhancing infrastructure footprint to give customers choice: Triple play offers via fixed & cable
- **Driving innovation in 5G**: Establishing the world's first 5G network for automobile production in Mercedes-Benz Cars “Factory 56”

Post German spectrum auction no short- to mid-term impact expected; long-term mitigation by own & other partner business

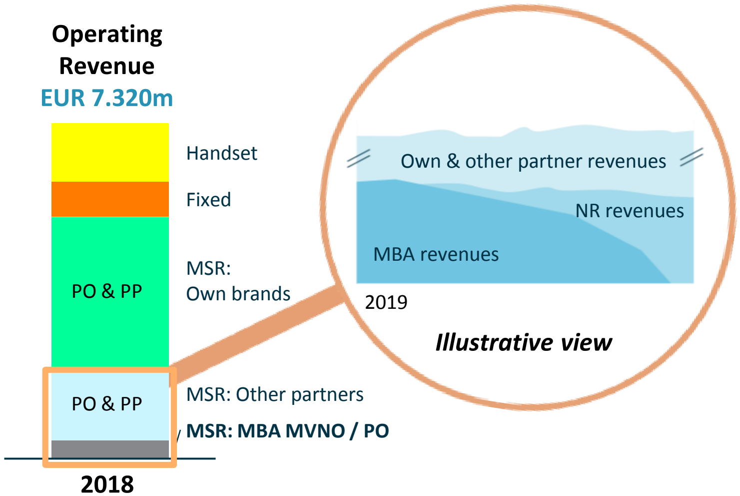
Scenario 1:
Continuation of MBA MVNO



Four levers for revenue growth

- Exponential **data** growth
- **Capacity** of 20% and potential upgrade to 30%
- Price tiering based on **speed**
- Price tiering based on **technology**

Scenario 2:
MNO remedy – gradual transition



Gradual transition of revenue streams

- **Commercial terms** derived from MBA MVNO
- **Sublease spectrum** for 2G/3G/4G national roaming
- MVNO and MNO only for a **transition period**
- Gradual ramp-up of **other partner & own business** to mitigate

Our key priorities for H2-2019

Drive commercial momentum with O_2 Free & partners

Finalise 5G strategy & network cooperations

Deliver FY 2019 outlook

Deliver total shareholder return

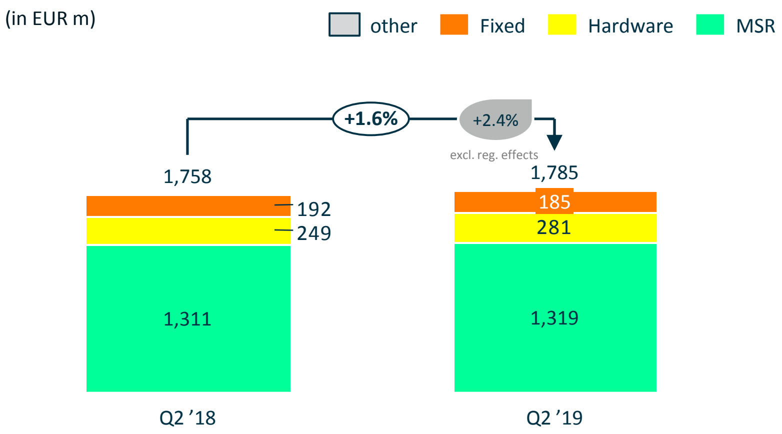
Q2 2019: Summary
Financial performance reflects strong trading in retail

Net adds **+301k PO** **+38k fixed BB**	• O_2 Free portfolio drives strong retail performance in a dynamic environment • Stronger partner trading primarily driven by an expansion of non-MBA partners and 4G related migration effects • Strong VDSL trading reflects customer demand for high-speed fixed BB services; ADSL migrations completed
Revenue[1] **+2.4% y-o-y**	• MSR broke the zero line and posted growth of +0.6% y-o-y in Q2'19; underlying MSR[1] improving to +1.5% y-o-y • Handset revenue with sustained demand for high value devices, +12.9% y-o-y • Fixed revenue reflects strong trading performance and higher bundle share: -3.5% y-o-y (vs. -8.6% y-o-y in Q1'19)
OIBDA[2] **(IAS 17)** **+0.5%[3] y-o-y**	• Ongoing market and transformation investment to drive future MSR growth; OIBDA[2] incl. IFRS 16 effects up +21.7% y-o-y • Incremental network synergies of ~EUR 10 million mainly roll-over effects and ~EUR 10 million transformation benefits • OIBDA[2] margin of 27.2% in the second quarter respective 32.9% incl. IFRS 16 effects
Leverage **(IAS 17)** **1.0x**	• Capex reflects ongoing push of LTE-rollout and incremental synergies of ~EUR 10m; EUR 243 million with a C/S ratio of 13.6% • Leverage (IAS 17) remains in line with target after dividend payment; leverage ratio increases to 1.9x under IFRS 16 • Committed to attractive shareholder remuneration; high confidence in FCF generation ability

[1] Excluding the negative impact from regulatory changes; EUR 14m in Q2 2019
[2] Adjusted for exceptional effects and excl. the negative impact from regulatory changes
[3] Under IAS 17 accounting standards
[4] Excluding additions from capitalised right-of-use assets (as of 1 January 2019) and excluding additions from capitalised finance leases (till 31 December 2018)

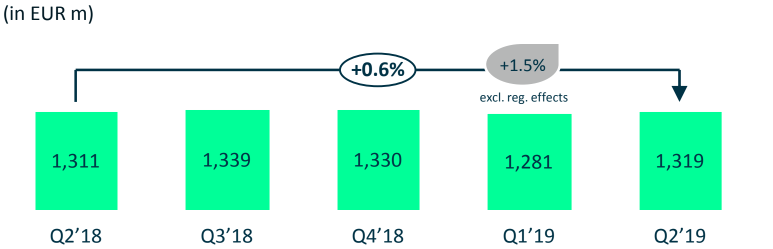
Revenue trends driven by MSR turnaround & continued demand for handsets

Turnaround in MSR & handset sales driving Q2 revenue

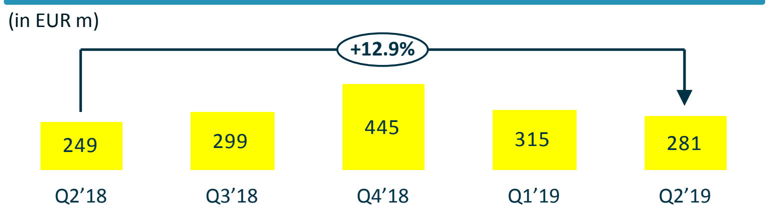


- MSR returns to growth on visible effects from O_2 Free new connector APRU & easing headwinds from legacy base rotation and retention focus in renewal cycles
- Handset revenue driven by continued strong demand
- Fixed revenue reflect higher share of bundle benefits in the retail base following strong VDSL trading performance

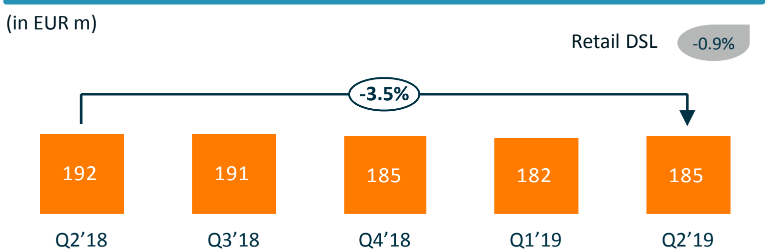
MSR breaking the zero-line



Sustained demand for high value devices

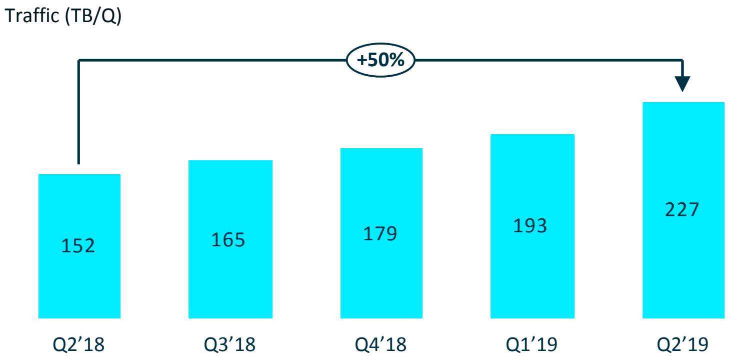


Strong demand for VDSL drives fixed revenue

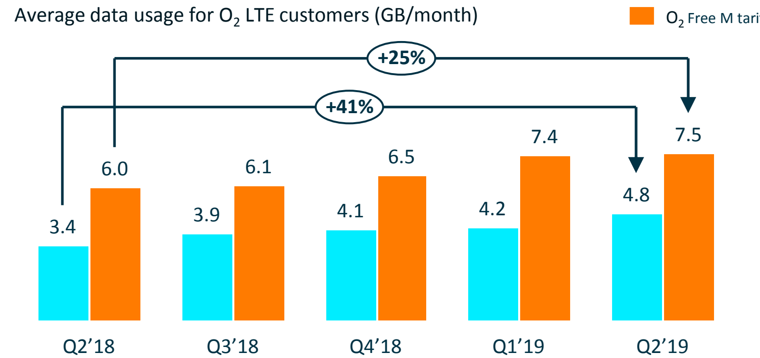


Sustained mobile data traffic growth, CAGR of 50%

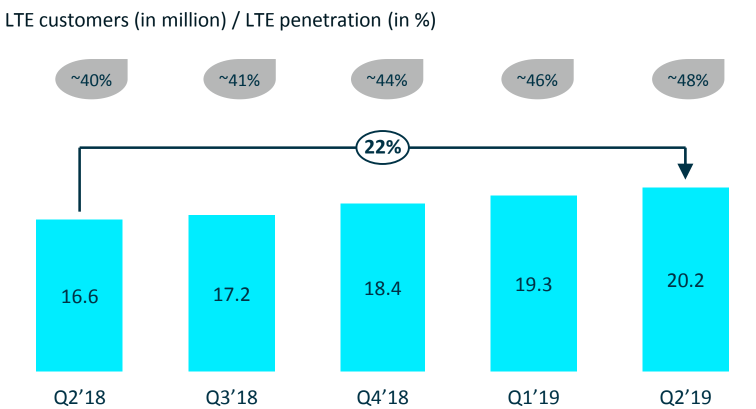
Mobile data traffic maintains growth rate



O_2 Free tariffs driving data growth



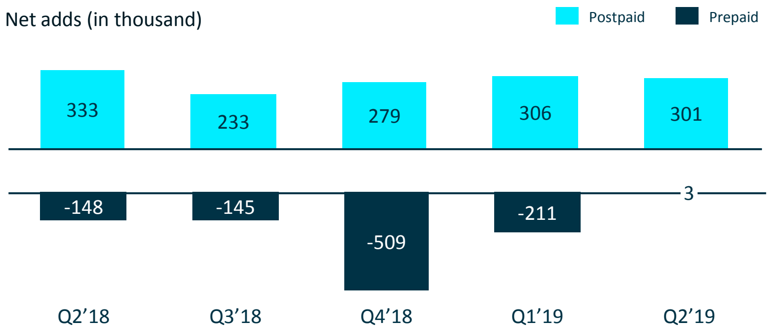
LTE customer base continues to grow



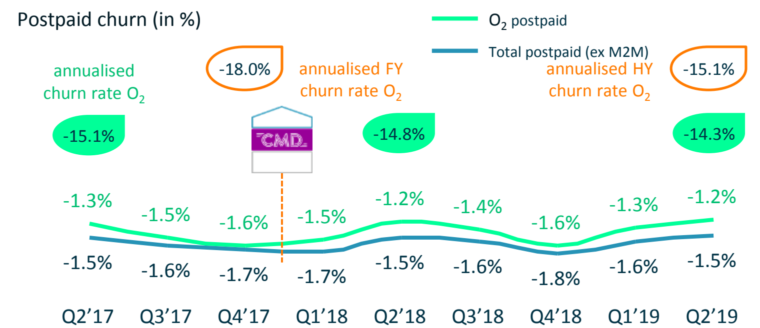
- Large data buckets and continuous LTE adoption driving data growth; CAGR of ~50% with streaming services as the major driver
- Average data usage of O_2 LTE customers close to 5GB per month, O_2 Free customers consume >7GB per month in the most popular M tariff
- LTE customer base up +21.6% y-o-y to 20.2 million
- LTE penetration up +8.3 p.p. y-o-y, while in postpaid LTE penetration already at ca. 65%

Strong operating performance in own brands on the back of portfolio initiatives and retention focus

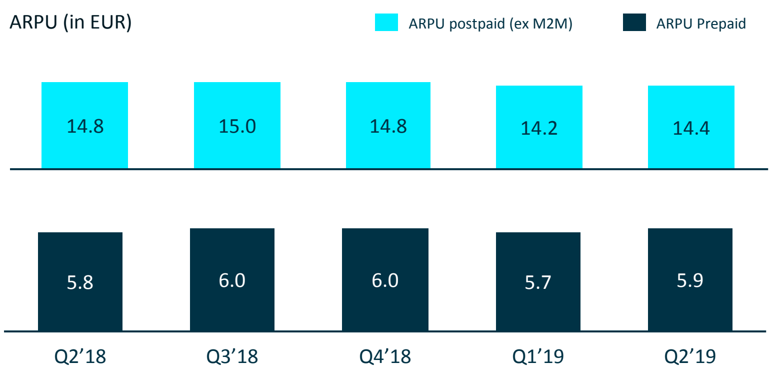
Focus remains on profitable growth



Annualised churn on track to achieve CMD target



O_2 Free drives postpaid ARPU uplift

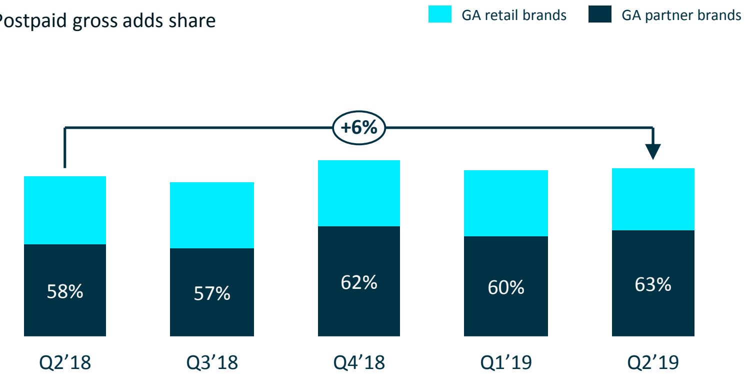


- Strong postpaid net adds driven by O_2 Free portfolio, customer retention focus and further helped by 4G focus in partner brands
- Already reaching CMD churn target of -2p.p. O_2 churn reduction; Q2 churn showing usual seasonality
- Postpaid ARPU with visible effects from O_2 Free portfolio and customer demand for value added services, while regulatory effects remain a headwind
- Prepaid with early signs of improving churn trends

Expanding partnerships in the partner business

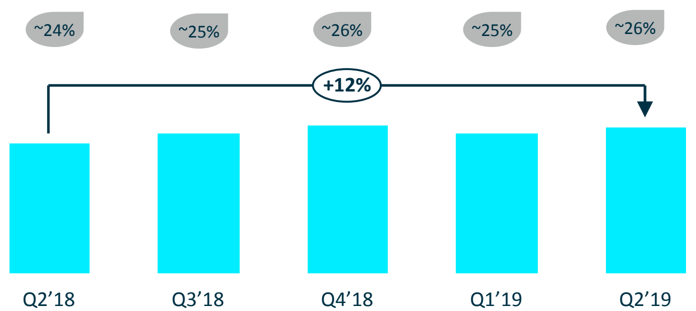
Partner trading reflecting seasonality

Postpaid gross adds share



Partner revenue growth in line with expectations

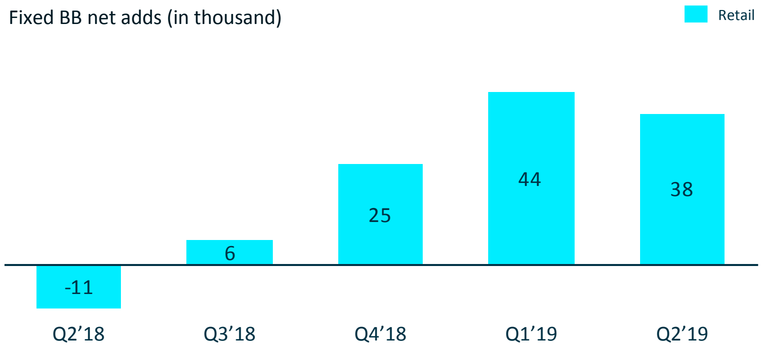
Postpaid partner MSR / Share over postpaid MSR (in %)



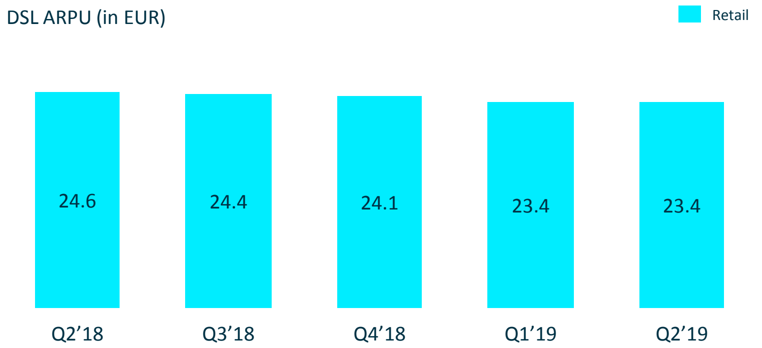
- Partner performance remains in line with expectation
- Stronger trading performance in Q2 primarily driven by expansion of non-MBA MVNO partnerships and migration effects
- Partner revenue growth in line with expectations, predominantly driven by the data dynamics of the MBA MVNO

Strong operating trends in fixed retail business

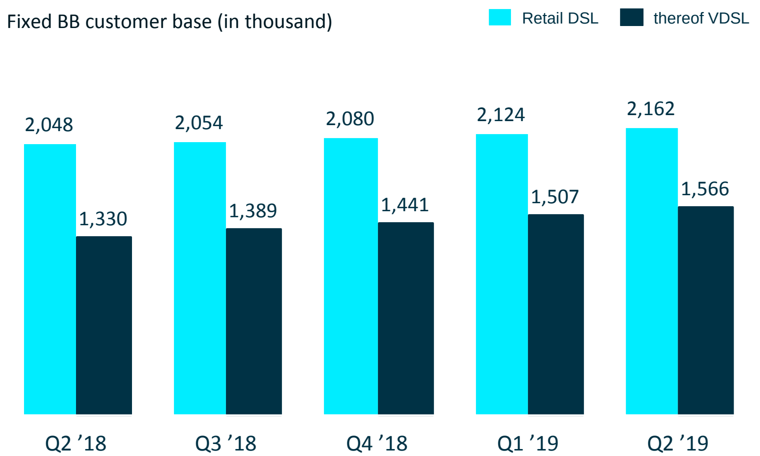
VDSL demand further drives fixed retail trading



ARPU reflects higher bundle share



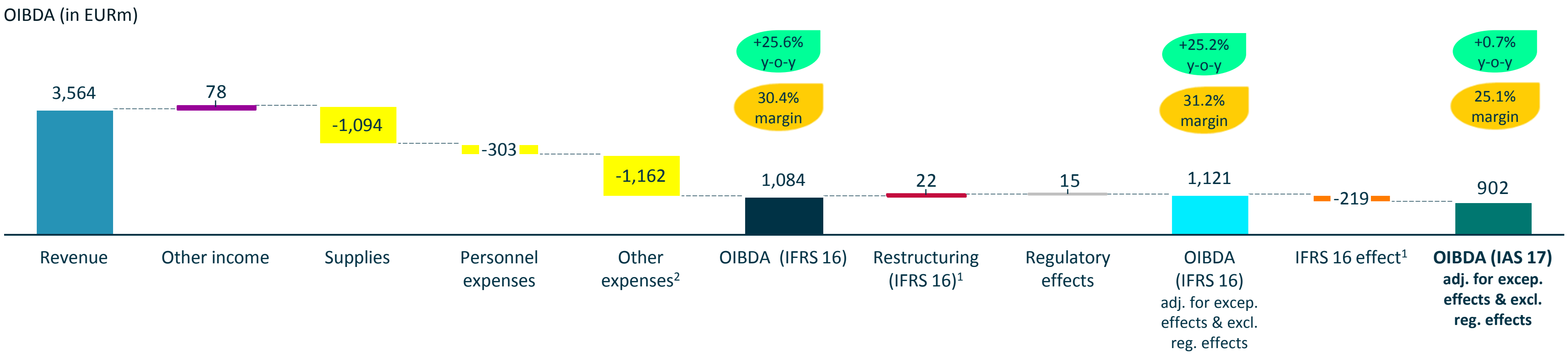
VDSL penetration continues to grow



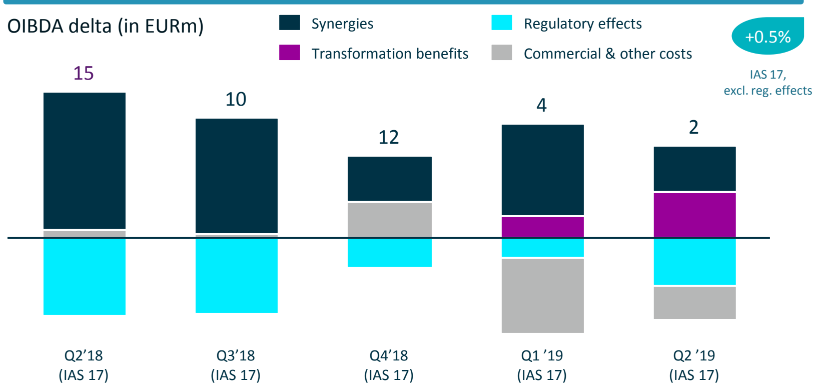
- Sustained demand for VDSL continues to drive fixed retail trading
- >72% of retail fixed BB customer base already on VDSL; up +18% y-o-y to 1.6 million
- Positive contribution from VDSL in retail fixed BB ARPU & revenue offset by higher bundle share in the base

OIBDA reflects investments into future growth & transformation focus

Structure of OIBDA for January to June 2019



OIBDA[1] reflects synergies & transformation



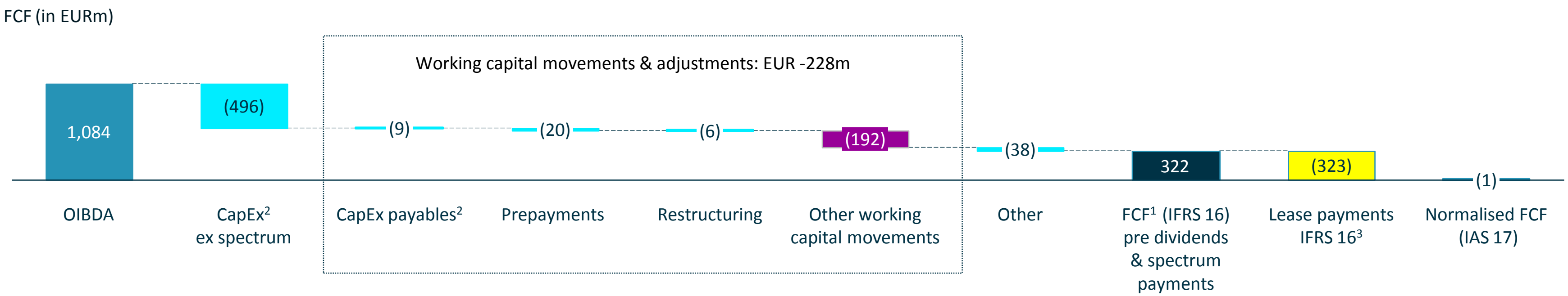
- Underlying OIBDA (IAS 17) +0.7% y-o-y in H1 19 driven by
  - Network synergies of ~EUR 30 million
  - Transformation benefits of ~EUR 15 million driven by O_2 consumer and IT cost savings
- Regulatory effects of EUR 15 million driven by usage elasticity effects from the RLH regime & intra EU calls (since 15 May '19)
- Restructuring[1] costs of EUR 22 million under IFRS 16
- Underlying OIBDA margin expands to 31.2% under IFRS 16 vs. 25.1% under IAS 17

[1] According to IAS 17, restructuring costs were EUR 40 million. The total resulting IFRS 16 effect at reported OIBDA level comes to EUR 219 million. The difference between restructuring charges under IAS 17 and IFRS 16 is due to the fact that certain IAS 17 operating lease commitments require the recognition of provisions, whereas those are recognised as lease liabilities under IFRS 16

[2] Includes other expenses and impairment losses in accordance with IFRS 9

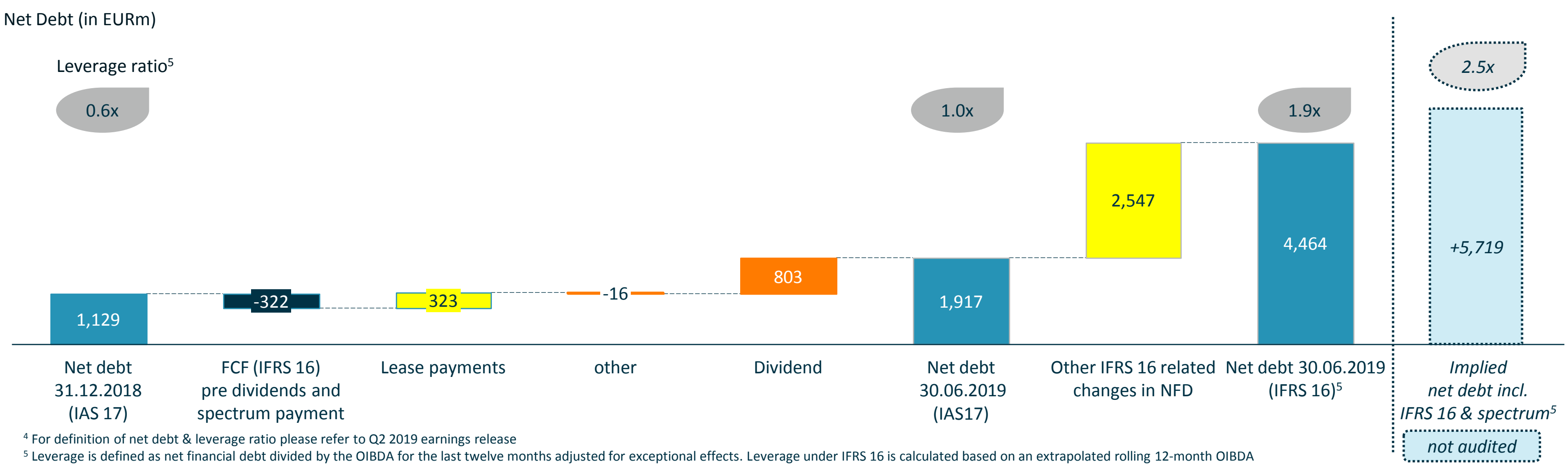
FCF dynamics reflect implementation of IFRS 16

Evolution of Free Cash Flow (FCF)[1] YTD June 2019



[1] FCF pre dividend & spectrum payments is defined as the sum of cash flow from operating activities & cash flow from investing activities
[2] Excluding additions from capitalised right-of-use assets (as of 1 January 2019) and excluding additions from borrowed capital for investments in spectrum
[3] Includes EUR 327 million of lease payments under IFRS 16 and –EUR 4 million of former IAS 17 finance lease payments

Evolution of Net Debt[4] – Leverage[4] in line with target



[4] For definition of net debt & leverage ratio please refer to Q2 2019 earnings release
[5] Leverage is defined as net financial debt divided by the OIBDA for the last twelve months adjusted for exceptional effects. Leverage under IFRS 16 is calculated based on an extrapolated rolling 12-month OIBDA
It will only be possible to report a leverage ratio based on actuals under IFRS 16 with the publication of the financial statements for 2019

Summary

Strong trading performance driven by high demand for O_2 Free & sustained retention focus

Revenue trends driven by MSR growth & continued demand for high-value handsets

OIBDA reflects investment in future growth & transformation focus

Normalised FCF dynamics show usual seasonality; leverage in line

Solid B/S, liquidity position and FCF generation ability support dividend commitment

Q2’19 results - Q&A session

Reach out to us for any follow-up questions

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