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Telefónica Deutschland – preliminary results for January to December 2022

Confident FY23 outlook building on strong growth momentum & successful completion of 'Investment-for-Growth' programme

- **Delivered FY22 at top-end of double-upgraded outlook – continued growth path leveraging strong own-brand momentum including >1.2m postpaid net additions**
- **Revenue growth of +5.9% y-o-y driven by sustained MSR momentum & record handset sales**
- **OIBDA¹ grew +5.3% y-o-y on improved MSR quality & tight cost management**
- **Achieved >80% 5G pop coverage well ahead of target & with C/S of 14.7% within planned capex envelop - targeting ~90% by year-end 2023**
- **Extended ESG leadership & well on track to deliver a sustainable digital future**
- **Confident FY23 outlook building on strong operational & financial growth momentum and successful completion of 3-year 'Investment-for-Growth' programme**
- **2022 dividend proposal of EURc 18/share to AGM - in-line with minimum commitment for 2021-23**

Operating performance

Telefónica Deutschland delivered another quarter of robust commercial traction leveraging the third 'very good' rating in a row in the renowned connect magazine's annual network test. Consequently, the company achieved sustained financial momentum across FY22 with healthy revenue and OIBDA growth in all quarters.

Telefónica Deutschland successfully completed its 3-year 'Investment-for-Growth' programme within the planned CapEx envelope, making excellent progress with network modernisation and 5G roll-out as well as fulfilling the coverage obligations of the German regulator as far as technically and actually possible. 5G pop coverage was at >80% at year-end 2022, well ahead of plan driven by roll-out efficiencies. Telefónica Deutschland is targeting to achieve ~90% 5G pop coverage by year-end 2023 and nationwide coverage latest by year-end 2025.

Telefónica Deutschland's 'more-for-more' pricing strategy launched in Q4 22 reflects the widely acknowledged improvements of product, service & network quality as well as ESG leadership. In January 2023, the Company announced further details, i.e. new 'more-for-more' prepaid offers in its Blau brand as well as its revamped O₂ tariff portfolio. The new O₂ tariff portfolio, 'O₂ Mobile', will be commercially available as of 5 April 2023. The new tariffs include higher data volumes and/or higher speeds as well as the popular and innovative O₂ Grow feature while being priced on average around 10% above the current 'O₂ Free' portfolio. In fixed, the 'O₂ myHome' tariff portfolio remained attractive post withdrawals of some promotions with ongoing customer demand for high-speed cable & fibre connections as well as FMS.

In parallel, Telefónica Deutschland extended its ESG leadership through driving its ambitious ESG agenda, again achieving a 'low risk' rating with Sustainalytics and ranking 'Top 3' in its global sector. According to Sustainalytics, the Company scores particularly well in the categories of product responsibility, human rights and business ethics. Telefónica Deutschland has also been included in the Bloomberg Gender Equality Index for the fourth consecutive year, improving its' overall score by more than 2 p.p. to almost 73% on particular good results in the areas of disclosure, inclusive culture and equal pay. Moreover, Telefónica Deutschland

¹ Adjusted for exceptional effects. In FY22, exceptional effects amounted to EUR -16m, mainly restructuring costs. In FY21, exceptional effects mainly include a capital gain related to the spin-off and sale of the operations of the final tranche of ~4k mobile sites passive infrastructure to Telxius amounting to EUR +262m as well as restructuring costs and other exceptional items of EUR -19m.

remains committed to its climate protection goals. The Company strives to reduce its CO₂ emissions by 90% while neutralising residual emissions no later than 2025 and taking concrete actions to be net CO₂ neutral along its entire value chain by 2040.

Mobile business

Mobile postpaid maintained solid growth momentum in Q4 22, delivering +264k net additions (+518k in Q4 21) and +1,228k in FY22 (1,526k in FY21) with the high O₂ brand appeal in the market driving gross add momentum. Contribution of partner brands continued to be solid.

M2M recorded -20k net disconnections in Q4 22 vs. +40k in Q4 21 (+83k in FY22 vs. +203k in FY21) on a revenue-neutral technical base adjustment².

Mobile prepaid performance was also characterized by a revenue-neutral technical² base adjustment (-2,535k accesses) in Q4 22 in combination with the ongoing German market trend of prepaid to postpaid migration. As a result, the mobile prepaid base registered -2,911k net disconnections in Q4 22 (u/l -376k vs -188k in Q4 21) and -2,698k in FY22 (u/l -163k vs -310k in FY21).

Churn rates in Q4 22 remained slightly elevated due to the second wave of the European Electronic Communications Code (EECC) introduction with some early signs of normalisation towards year end. Still, **postpaid churn in the O₂ brand** stood at low rates of 1.2% in Q4 22 vs. 1.0% in Q4 21 (1.1% in FY22, +0.2 p.p. y-o-y) leveraging network and service quality.

Overall, Telefónica Deutschland's **mobile customer accesses** slightly decreased to 44.3m (-3.0% y-o-y) as of 31 Dec-22 on the back of the before mentioned technical² base adjustments. In contrast, the **mobile postpaid base** (ex M2M) continued its upwards trend (+4.9% y-o-y) driven by strong own-brand gross add momentum, reaching 26.3m accesses (59.4% of the company's total mobile access base, up +4.5 p.p y-o-y) at year-end 2022. **M2M accesses** totalled 1.7m (+5.1% y-o-y) while the **mobile prepaid base** declined -14.2% y-o-y to 16.3m as a result of the before mentioned technical² effects.

O₂ postpaid ARPU was -0.3% in Q4 22 and -0.7% y-o-y in FY22, mainly reflecting the accelerated MTR glidepath and some enhanced focus on customer loyalty while high value tariffs remained popular. Hence, underlying³ O₂ postpaid ARPU posted +0.4% y-o-y growth in Q4 22 (+0.1% in FY 22).

Fixed business

Fixed broadband customer base totalled 2.3m accesses at year-end 2022 (+1.4% y-o-y) reflecting the unabated success of the 'O₂ myHome' tariff portfolio with high-speed cable & fibre connections driving customer demand. Nevertheless, VDSL (1.8m accesses, -0.3% y-o-y) still maintained 80% share of total fixed broadband customer base. Also, FMS remained popular.

Fixed net additions were +18k in Q4 22 (+7k in Q4 21) and +32k in FY22 (+1k in FY21).

Fixed churn remained driven by legacy DSL net disconnections and was marginally up +0.1 p.p. y-o-y to 1.0% in Q4 22 (1.2% in FY22, +0.2 p.p y-o-y); also reflecting the anticipated temporarily higher churn on back of the second wave of the EECC introduction.

Fixed broadband ARPU grew +5.1% y-o-y to EUR 25.7 in Q4 22 (+3.3% to EUR 25.0 in FY22), benefitting from the increasing share of higher value customers connections in the base.

² Introduction of a stricter active SIM card definition.

³ Excluding MTR effects.

Financial performance

Revenues continued their healthy growth path, **up +6.6% y-o-y to EUR 2,190m⁴** in Q4 22 (+5.9% y-o-y to EUR 8,224m in FY22) driven by sustained mobile service revenue momentum and a record year for handset sales.

Mobile service revenues⁵ posted strong growth of **+8.8% y-o-y in Q4 22 to EUR 1,516m⁴** (+4.6% y-o-y in FY22 to EUR 5,742m). Excluding non-recurrent special factors⁴ underlying growth was +7.0% y-o-y in the quarter and +4.4% y-o-y in the full-year. Sustained MSR momentum was fuelled by the commercial success of the O₂ tariff portfolio and a solid contribution from partners, in combination more than compensating for the negative impact from the accelerated MTR glidepath⁶.

Handset sales in Q4 22 **grew +3.4% y-o-y to EUR 462m** (+13.9% y-o-y to EUR 1,652m in FY22) on continued demand for high value handsets while customers are increasingly opting for longer-term 'O₂ myHandy' contracts.

Fixed revenues declined **-3.7% y-o-y to EUR 203m** (-1.0% y-o-y to EUR 806m in FY22) mainly as European termination rate cuts continued to weigh on the included international carrier business. **Fixed retail BB revenues** were facing tough comps in Q4 22 (-2.3% y-o-y) while they continued their growth path in FY22 (+0.8% y-o-y).

Other income was EUR 40m in Q4 22 and EUR 153m in FY22 compared to EUR 50m in Q4 21 and EUR 402m in FY21 driven by prior year's EUR +262m capital gain related to the spin-off and sale of the final tranche of ~4k mobile sites passive infrastructure.

Operating expenses⁷ were up **+6.0% y-o-y to EUR 1,574m** in Q4 22 and +6.2% y-o-y to EUR 5,854m in FY22 including restructuring expenses in the amount of EUR -11m in Q4 22 and EUR -16m in FY22.

- **Supplies** increased +2.8% y-o-y to EUR 655m in Q4 22 (+5.0% y-o-y to EUR 2,524m in FY22) with the positive effects from the MTR-cuts⁶ more than off-set by volume related higher hardware cost of sales. Connectivity-related cost of sales and hardware cost of sales accounted for 36% and 61% of FY22 supplies, respectively.
- **Personnel expenses** included EUR -3m of restructuring costs in Q4 22 and were up +10.1% y-o-y to EUR 171m, reflecting this quarter partially overlapping FY21/FY22 salary reviews⁸ as well as typical year-end entries somewhat compensated by a y-o-y lower FTE base. Underlying, personnel expenses in FY22 increased by +3.3% y-o-y while in reported terms they were up +6.2% y-o-y mainly due to received social security payments for employees of temporarily closed O₂ shops during the government enforced Covid-lockdown in H1 2021.
- **Other operating expenses** (other Opex) were up +7.5% y-o-y to EUR 722m in Q4 22 (+6.6% y-o-y to EUR 2,616m in FY22) reflecting higher energy costs, technology transformation and commercial activity. Commercial and non-commercial costs accounted for 63% and 33% of other Opex in Q4 22, respectively. Group fees came to EUR 9m in Q4 22 and EUR 35m in FY22 compared to EUR 9m in Q4 21 and EUR 33m in FY21.

⁴ Non-recurrent special factors amounted to EUR +26m in Q4 22 and EUR +14m in Q2 21

⁵ Mobile service revenue includes base fees and fees paid by the company's customers for the usage of voice, SMS and mobile data services; it also includes access and interconnection fees as well as other charges levied on partners for the use of the company's network.

⁶ MTR-cut from EURc 0.78 to EURc 0.70 per minute as of 1 Jul-21 and from EURc 0.70 to EURc 0.55 per minute as of 1 Jan-22.

⁷ Operating expenses include impairment losses in accordance with IFRS 9 in the amount of EUR 26m in Q4 22 (EUR 21m in Q4 21) and EUR 92m in FY22 (EUR 72m in FY21).

⁸ General pay-rise of +1.75% effective 1 Dec-21 and +3.4% effective 1 Sep-22 as well as a one-time payment of EUR 500 per employee in Jul-22.

OIBDA⁹ grew +6.8% y-o-y to EUR 667m in Q4 22 (+5.3% y-o-y to EUR 2,539m in FY22) and excluding non-recurrent special factors¹⁰ underlying growth was +2.6% y-o-y in the quarter and +4.7% y-o-y in the full-year. The strong y-o-y performance benefitted from improved operational leverage mainly in mobile on continued own brand momentum, tight cost management and some roaming support, in combination more than offsetting the anticipated increase of energy and personnel costs. **OIBDA⁹ margin** expanded +0.1 p.p. y-o-y to **30.4%** in Q4 22, while in FY22 OIBDA margin was -0.2 p.p. lower y-o-y to 30.9% mainly reflecting the strong growth of broadly margin-neutral hardware revenues.

Depreciation & Amortisation was lower -4.1% y-o-y reaching EUR 2,283m in FY 22 mainly as a result of the 3G sunset at YE21 in combination with prior year's decisions to shorten the useful life of assets in the context of investments in technology optimization and modernisation. This was partly offset by higher RoU asset amortisation and new additions in IT-architecture.

Operating income stood at EUR +240m in FY22 compared to EUR +272m in the prior year which included an EUR +262m capital gain related to the spin-off and sale of the final tranche of ~4k mobile sites passive infrastructure. Excluding this capital gain, operating income was substantially up year-on-year driven by revenue growth and lower depreciation & amortization as offsetting factors for the increase in operating expenses.

Net financial expenses accounted for EUR -36m FY22 vs. EUR -62m in the prior year.

Income tax was at EUR 42m in FY22 (current tax expenses in the amount of EUR -31m offset by deferred tax income of +73m) compared to EUR 5m in FY21 (current tax expenses in the amount of EUR -79m offset by deferred tax income of +84m).

As a result, **total profit for the period** improved to EUR +232m in FY22 vs. EUR +211m in the prior year which included the above-mentioned capital gain.

CapEx¹¹ amounted EUR 307m in Q4 22 (down -35.1% y-o-y) and EUR 1,209m in FY22 (-5.8% y-o-y) as Telefónica Deutschland successfully completed its 3-year 'Investment-for-Growth' programme as planned. **CapEx/Sales ratio** was 14.0% in Q4 22 and **14.7% in FY22**. The company continued to make excellent progress in network modernisation and 5G roll-out. 5G pop coverage was >80% at the end of 2022, well ahead of target and delivered within the planned capex envelop. Telefónica Deutschland is targeting ~90% of 5G pop coverage by year-end 2023 and nationwide coverage latest in 2025. The Company is well on track to complete the swap of its entire core network to Ericsson technology.

Operating cash flow (OIBDA minus CapEx¹¹) was EUR 1,314m in FY22, +18.6% y-o-y in underlying¹² terms, reflecting both, strong operating and financial performance as well as y-o-y lower Capex in the final year of the Company's 'Investment-for-Growth' programme. In reported terms, operating cash flow in FY22 was down -4.1% y-o-y mainly due to the before mentioned EUR +262m capital gain in Q3 21.

Free cash flow (FCF)¹³ amounted to EUR 1,093m in FY22 compared to underlying EUR 958m in prior year (reported EUR 1,502m in FY21 including EUR 540m proceeds mainly from the before mentioned sale of assets). Lease payments, primarily for antenna sites and leased lines, amounted to EUR -640m in FY22 (EUR -602m in FY21). As a result, FCFaL stood at EUR +453m for the reporting period compared to underlying EUR +360m in FY21 (reported EUR +900m in FY21 including before mentioned proceeds from the sale of assets).

⁹ Adjusted for exceptional effects. In Q4 22, exceptional effects amounted to EUR -11m of restructuring costs vs EUR -4m in Q4 21. In FY22, exceptional effects were EUR -16m while in FY21, exceptional effects mainly included a capital gain related to the spin-off and sale of the operations of the final tranche of ~4k mobile sites passive infrastructure to Telxius of EUR +262m as well as restructuring costs and other exceptional items of EUR -19m.

¹⁰ Non-recurrent special factors amounted to EUR +26m in Q4 22 and EUR +12m in Q2 21

¹¹ CapEx includes additions to property, plant and equipment and other intangible assets while investments for spectrum licenses and additions from capitalised right-of-use assets are not included.

¹² Excluding an EUR +262m capital gain related to the spin-off and sale of the final tranche of ~4k mobile sites passive infrastructure in FY21

¹³ Free cash flow pre dividends and payments for spectrum (FCF) 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.

Working capital movements were EUR -141m in FY22 vs. EUR -96m in FY21. The development in FY22 was mainly driven by a decrease in capex payables (EUR -169m), increased pre-payments (EUR -17m), net restructuring impacts (EUR +5m) as well as other working capital movements of EUR +40m.

Consolidated net financial debt¹⁴ amounted to EUR 3,212m as of 31 Dec-22. Leverage ratio of 1.3x¹⁵ remained well below the company's self-defined upper limit of 2.5x and leaves comfortable leverage headroom with regards to the company's BBB-rating with stable outlook by Fitch.

Financial Outlook FY23

In financial year 2023, Telefónica Deutschland will further pursue its growth path leveraging the good momentum of the past financial years and the successful completion of its 3-year 'Investment-for-Growth' program. The Company continues to build on the multiple "very good" awards winning O₂ network and its multi-brand and multi-channel strategy as the backbone of its go-to-market strategy. As a result, Telefónica Deutschland has been able to win back mobile market shares in financial year 2022 in a dynamic yet rational environment.

Postpaid remains the Company's strongest value generator, mainly driven by the high O₂ brand appeal while in the prepaid market the prepaid to postpaid migration trends continue. Within the technology-agnostic O₂ my Home portfolio, high-speed cable and fibre accesses as well as 4G/5G-based fixed-mobile substitution (FMS) tariffs are increasingly gaining traction.

Based on current market dynamics, Telefónica Deutschland expects a robust pricing environment both, in the premium and the discount segment in 2023. For its own brand portfolio, Telefónica Deutschland is focussing on the implementation of a 'more-for-more' strategy in new customer acquisition, reflecting the Company's continuous investments in the successful improvement of product, service and network quality as well as its ESG leadership.

Furthermore, Telefónica Deutschland expects regulatory changes to remain a headwind to its financial performance in financial year 2023. Revenues, and to a lesser extent OIBDA, will be impacted primarily by the reduction of the mobile termination rate from 0.55 EUR cents per minute to 0.40 EUR cents per minute effective 1 January 2023.

Telefónica Deutschland will continue to pursue its digital transformation path to generate revenues and efficiency gains. In doing so, the company is emphasising sustainable growth and is pushing the execution of its ESG strategy. Digitalisation is playing a key role in tackling climate change and achieving CO₂ neutrality targets. Telefónica Deutschland's business model continues to prove resilient despite a significant increase in inflation.

Continuous growth of Telefónica Deutschland's mobile service revenues remains the main driver of the Group's revenue and profitability trends, mainly reflecting the O₂ brand's commercial success. Hardware revenues are expected to remain volatile and dependent on market dynamics as well as launch cycles and availability of new smartphones. As in the past, hardware margins are largely OIBDA-neutral.

Fixed broadband offers are complementing Telefónica Deutschland's tariff portfolio and contribute to customer retention and loyalty. Hence, the Company can optimally meet customer needs through its technology agnostic approach, as all major infrastructures (i.e. VDSL, cable, fibre) can be offered via wholesale contracts in addition to FMS via its own mobile network.

¹⁴ Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing liabilities as well as cash and cash equivalents and excludes payables for spectrum.

¹⁵ Leverage ratio is defined as net financial debt divided by OIBDA of the last twelve months adjusted for exceptional effects.

In this context, Telefónica Deutschland expects for financial year 2023

Low single-digit percentage year-on-year growth for revenues and OIBDA adjusted for exceptional effects.

This forecast takes into account regulatory headwinds of ca. EUR -50m to -60m at revenue level and ca. EUR -10m to -15m at OIBDA level, as well as broadly stable energy costs at around prior year's level.

Following the successful completion of the 'Investment-for-Growth' programme in 2022, Telefónica Deutschland expects Capex-to-Sales ratio (C/S) to normalise at around 14% in financial year 2023.

Telefónica Deutschland's assumptions are based on current economic conditions and current competitive dynamics as well as existing wholesale relationships. At the same time, management is continuously monitoring and analysing business impacts of further macro-economic and geo-political developments and changes, especially in connection with the war in Ukraine.

	ACTUAL 2022 (1)	OUTLOOK 2023 (2)
Revenues	EUR 8,224 million	Low single-digit percentage year-on-year growth
OIBDA adjusted for exceptional effects	EUR 2,539 million	Low single-digit percentage year-on-year growth
CapEx to Sales Ratio	14.7%	Around 14 %

(1) Revenues and OIBDA include non-recurrent special factors in the amount of EUR +26 million in Q4 22.

(2) Incl. regulatory headwinds of ca. EUR -50m to -60m at revenue level and ca. EUR -10m to -15m at OIBDA level in FY23.

[Link to detailed Data Tables](#)

Further information

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