Telefónica

Deutschland

Telefónica Deutschland Investor Presentation

September 2017

Telefónica Deutschland
Investor Relations

Public – Nicht vertraulich

WE CHOOSE IT ALL_

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The leading digital ‘onlife’ telco in Germany

Reasons to invest in Telefónica Deutschland

Germany
An attractive and dynamic telecoms market

- 4-2-3 merger results in rational market
- Strong segmentation between premium and non-premium
- Dynamic wholesale segment
- Average data usage below European average
- Strong data growth

Data monetisation potential

An established player
Multi-brand offering for a unique customer experience

- Multi-brand and multi-channel distribution strategy
- Strong premium proposition O_2 Free
- Mobile-centric approach with broadband/converged products for X-selling
- Added-value products and services e.g. Sky coop & O_2 banking

Unique business model

Operational excellence
Synergies and digital transformation drive growth

- Synergy case of EUR 900m OpCF savings by 2019
- Building a future-proof network
- Now shifting focus to long-term strategic transformation
- New growth areas Advanced Data Analytics and the Internet of Things

Synergies and transformation drive profitability

Value proposition
Attractive shareholder return on strong fundamentals

- Strong FCF trajectory to support dividend policy
- Committed to high payout ratio in relation to FCF
- Concrete guidance of dividend growth over 3 years (2016-18)
- Low leverage and conservative financial profile for flexibility

Commitment to dividend policy

From MIT to M+T: Focus on Momentum and Transformation

Achievements 2015 & 2016

Keep the Momentum

Integrate quickly

Transform the company

- Maintained **momentum**
- Relaunch of **major brands**
- Major **integration workstreams** completed, e.g. customer migration
- **Restructuring in line** with expectations
- **Synergy case upgrade**
- **Operational performance in line** with capital market guidance
- **Strong FCF trajectory**
- **Conservative balance sheet** and low leverage maintained
- **Commitment to mid-term dividend**

Focus 2017 and beyond

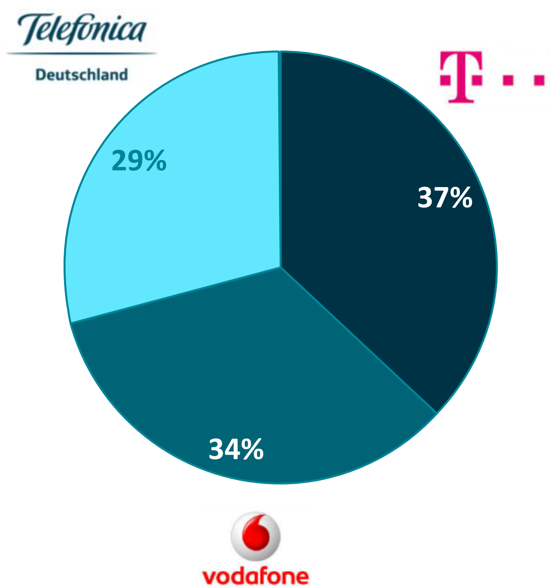
M + T

Keep the Momentum

Transform the company

Telefonica Deutschland is well positioned to lead the most attractive telco market in Europe

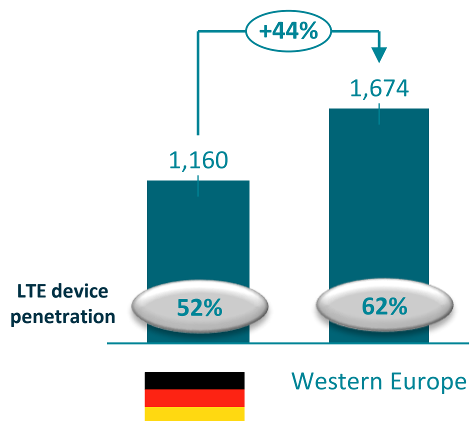
Rational and balanced market structure[1]



- Rational market following 4 to 3 consolidation
- Tiered mobile data portfolios enabling data monetisation

Data monetisation opportunity intact

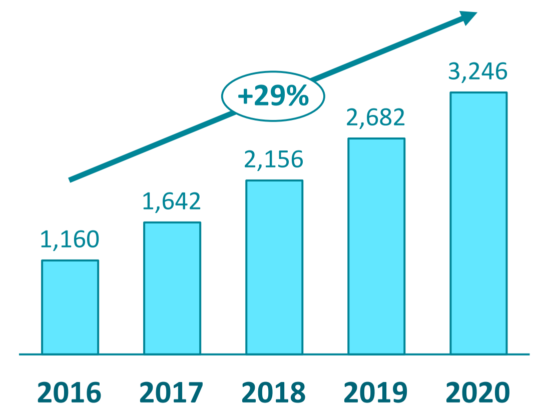
Average data usage in MB and LTE device penetration in %[2]



- Germany still a European laggard in terms of customer data usage
- Further opportunities from growing LTE adoption

Steady adoption of a digital lifestyle

3G/4G total cellular traffic in Germany in MB/customer (CAGR)[3]



- Music & video streaming as usage drivers
- Trend to 2 Gb/month for LTE customers

[1] Market share of MSR based on reported financials by MNOs for Q1 2017
[2] Source: Analasys Mason; Western Europe telecoms market: Interim forecast update 2016–2021; 4G connections in % of smartphone connections
[3] Source: Analysys Mason; Total cellular data traffic generated by 3G&4G handset connections, Dec 2016

Focus on stimulating data growth in a dynamic market; new European roaming legislation in place

Premium

Non-premium: Own secondary brands

Ethnic brands

Non-premium: Partner brands

MNVOs & Service Provider

Branded Reseller (selection)

Brands with access to Telefónica Deutschland network

Premium: Tangible benefits from bigger data buckets

- Successfully **upselling O_2 Free** to new and existing customers
- Celebrating **15 year anniversary** of O_2 brand with **O_2 Free 15**
  - Bigger buckets driving data usage
- New **DSL portfolio** with higher speeds

Non-premium: Shifting to higher price points

- **DRI/UTDI deal approved** at EGM
- **Larger data allowances** supporting shift to **higher price points**
- **Multi-brand approach** supports customer reach

O_2 Free 15: Bigger data buckets clearly stimulate data growth

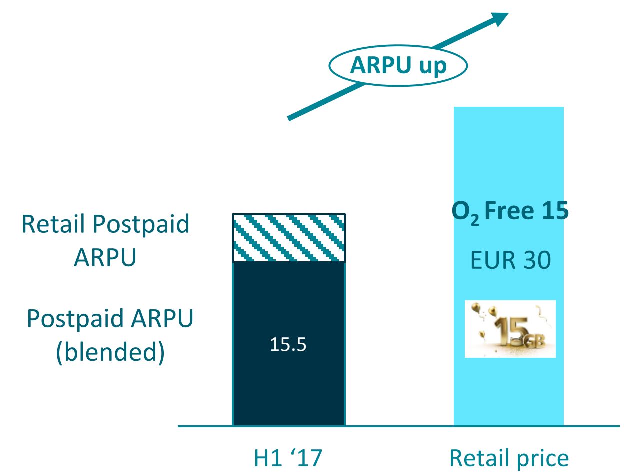
Commercial momentum benefitting from anniversary promotions

- O_2 Free 15 well received from new and existing customers
  - Clearly **ARPU-accretive**
- Bigger data buckets clearly **stimulate data growth**
  - Early stats show >3.0 GB data usage for O_2 Free 15
- Learnings to drive **portfolio review**

4G high-speed volume
+ 3G flat throttled to 1 Mbps

Market shifting to bigger buckets

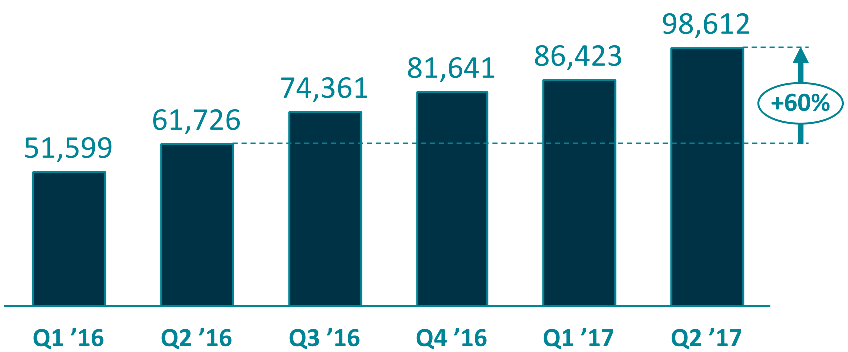
- Germany converging with other European markets
- Bigger data buckets a lever for significant revenue opportunities
- Markets investments needed to partake in this revenue opportunity
- Continued commercial investments in a rational environment:
  - Brand campaigns
  - Retail channels
  - Selected subsidies
  - Customer service



Data growth benefitting from LTE and bigger data buckets

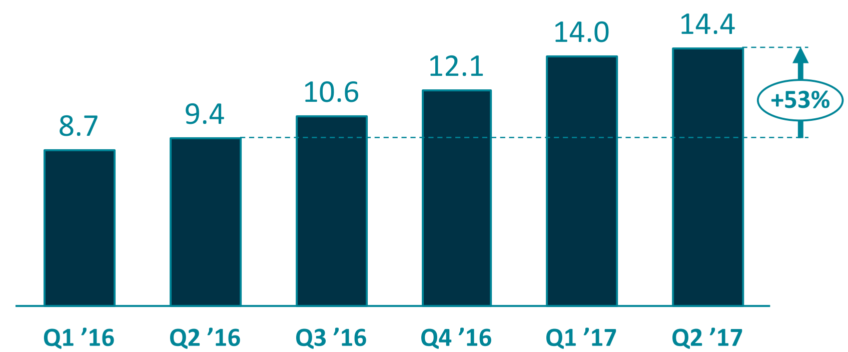
Data traffic continues to grow

Traffic (TB/quarter)



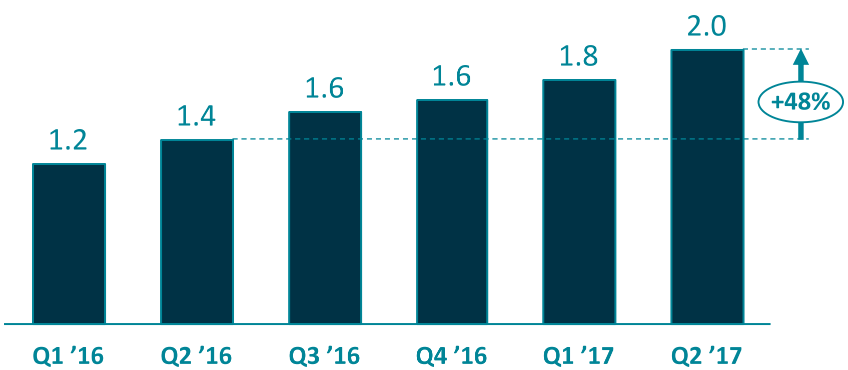
Sustained demand for LTE

LTE customers (million)



LTE usage driven by music and video streaming

Average data usage for O_2 consumer LTE customers (GB)

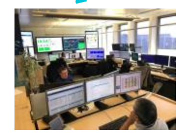


- LTE customer base up 53% y-o-y to 14.4 million in maturing market
- Music & video streaming key drivers of data traffic growth; up ~60% y-o-y
- Average monthly data usage for O_2 consumer LTE customers up ~48% y-o-y to 2.0 GB

Network integration on track; award for service-oriented monitoring of quality

Network integration timeline 2016 - 2019

Excellence Award 2017



- **3G National Roaming** for all customers — **April/May 15**
- Deal to **transfer 7,700 sites** to DTE — **July 15**
- **Sale of towers** to Telxius — **April 16**
- Consolidation & roll-out **4G network** — **July 16**
- Implementation of **SON** & **SOC** — **April 17**
- Implementation of **CEM** — **May 17**

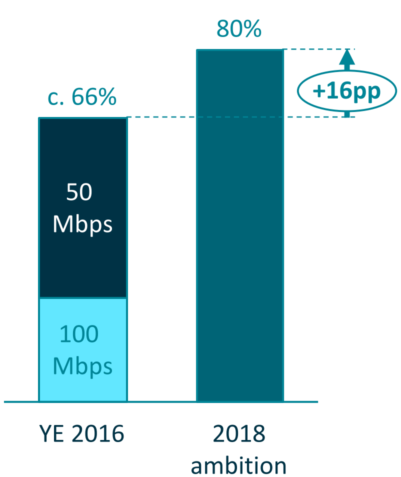
- Decommissioning of **14k sites**
- Roll-out of **30k LTE elements**
- Utilisation of **new licenses**
- Pilot network for **5G**

- Network consolidation entering ultimate phase; first cities completed
- Focus on customer experience: Customer Experience Management (CEM)-tool for real-time monitoring of service quality and remedies
- Steady quality gains again confirmed by latest independent network test

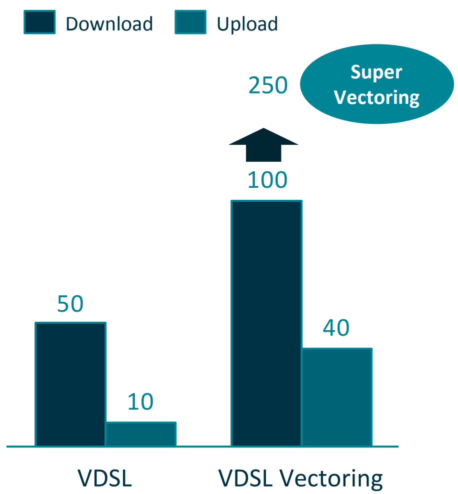
Fixed infrastructure model to complement our mobile network for best high-speed experience

Access to best available fixed NGA network[1]

NGA coverage targets
(% of covered households)



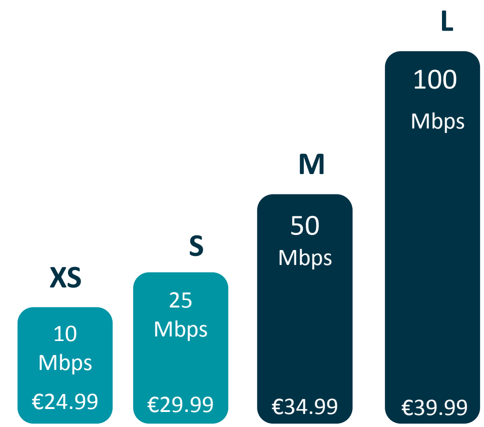
Maximum speed
(Up- & Download, Mbps)



- Nationwide access to DT NGA network
- DT is currently upgrading larger cities to VDSL vectoring and 100 Mbps

With a competitive bundled offer

O_2 DSL all-in
(Download speed, Mbps)

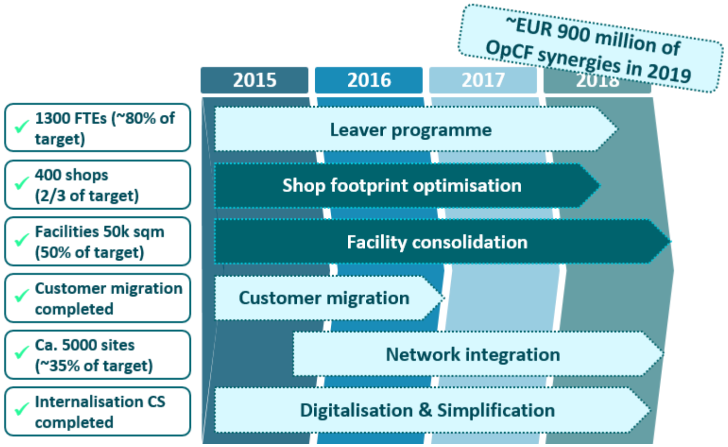


- O_2 Blue One offers flexible combination of fixed & mobile offers with progressive value-based discounts
- Active cross-selling of fixed & mobile propositions

[1] NGA: Next Generation Access including VDSL, Vectoring and future FTTX deployments

Our vision of the OnLife Telco:
We believe in the benefits of transformation

Integration | Today | Transformation



Integration nearing completion

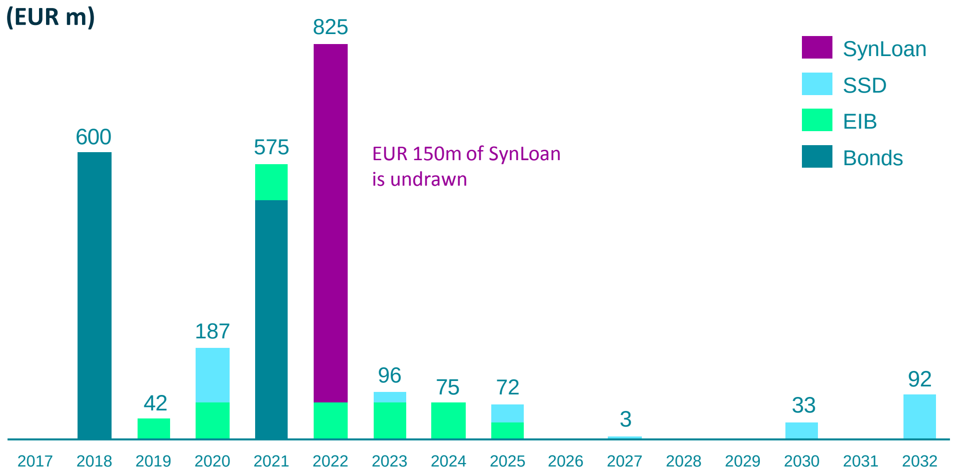
- Finalisation of integration workstreams by year-end 2018
  - FTE restructuring
  - Network integration
- On track to achieve 75% of total OpCF savings target of EUR 900 million by year-end 2017

Business model of the future

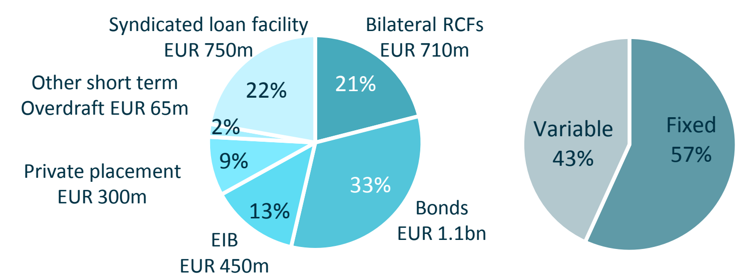
- Process of aggregating transformation initiatives into overall programme
- Telefónica NEXT successfully driving ADA and IoT initiatives
- Tangible transformation benefits for revenue and profitability

Comfortable liquidity position per 31.06.2017 and conservative financing policy

Smooth maturity profile and diversified financing mix

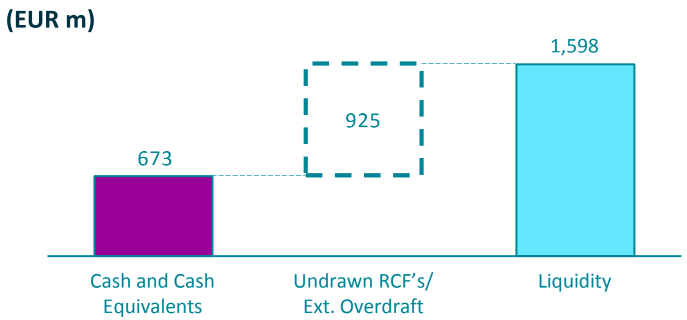


Financing and interest mix

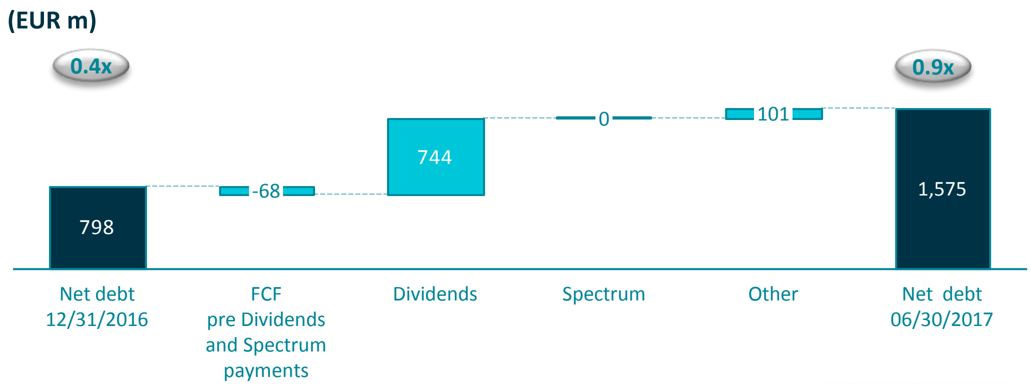


* Based on drawings
* Includes derivative hedging

Comfortable liquidity position



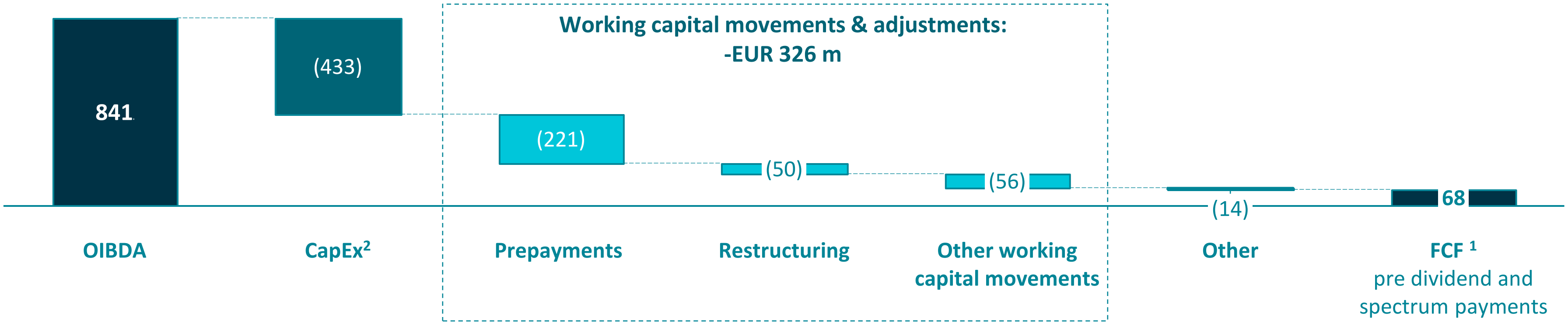
Leverage ratio at 0.9x[1]



[1] Financial debt/OIBDA (last 12 months)

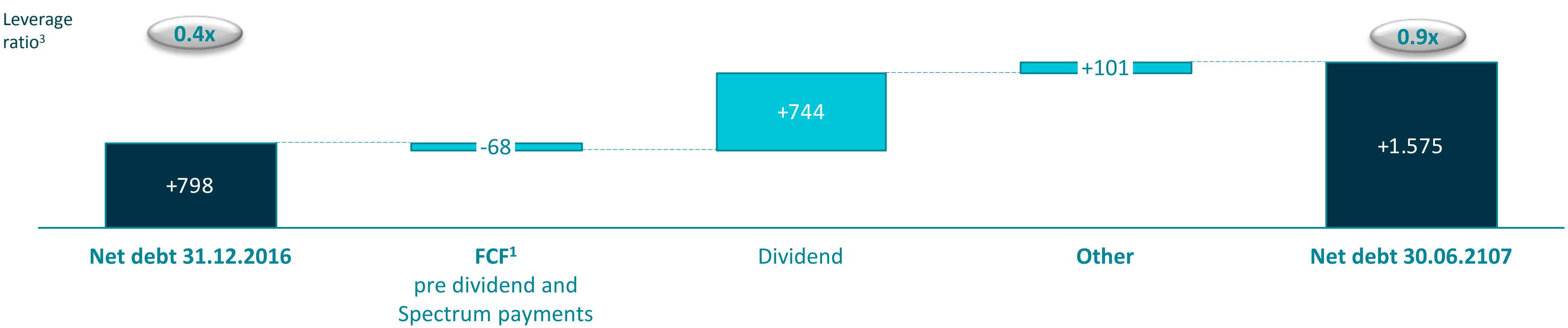
FCF affected by seasonality of rental payments

Evolution of Free Cash Flow (FCF)[1] YTD June 2017 (in EUR m)



[1] Free cash flow pre dividend and spectrum payment is defined as the sum of cash flow from operating activities and cash flow from investing activities
[2] Excluding additions from captalised finance leases and capitalised costs on borrowed capital for investments in spectrum

Evolution of Net Debt[3] (y-o-y in EUR m) – Leverage ratio[3] increases due to dividend payment



[3] For definition of net debt & leverage ratio please refer to Q2 2017 earnings release

We will maintain an attractive shareholder remuneration policy

Shareholder remuneration policy – Main guidelines[1]

- Maintain high payout in relation to FCF
- Consider expected future synergy generation in dividend proposals
- Keep leverage ratio at or below 1.0x over the medium term; target will be continually reviewed
- Annual dividend growth over 3 years, starting with of EUR 0.25 per share 2016

[1] Refer to the Telefónica Deutschland website for full dividend policy (www.telefonica.de)

Main takeaways

1

Drive momentum in an attractive and dynamic telecoms market

- Attractive and dynamic telco market
- Significant data monetisation opportunity
- Excellent competitive position

2

Shaping the digital transformation for an exceptional customer experience

- Multi-brand, multi-channel go-to-market strategy
- Successful up- and cross-selling mechanisms
- Digitalisation of customer relationships: Offering choice and value

3

Lean & efficient operations to drive growth in profitability and FCF

- Simplified and lean operating model
- 4G network integration in full swing
- Ambitious synergy target: EUR 900m OpCF savings in year 5

4

Attractive shareholder return & financial flexibility on strong fundamentals

- Commitment to attractive dividend policy
- Conservative financing policy
- High financial flexibility

Back-up

Q2 2017: Operating momentum & synergy capture on track

MSR -0.4% y-o-y
(excl. regulatory effects)

- MSR incl. regulatory effects -3.0% year-on-year; trends improving sequentially
- Tailwinds from O_2 Free, headwinds regulation & legacy base effect
- Recovery in discount pricing supports stable postpaid churn

Net adds
+197k postpaid
+88k VDSL

- Solid operational momentum in the quarter driven by O_2 Free & birthday promotions
- Share of postpaid wholesale trading stabilising on back of tariff adjustments
- Continued strong demand for VDSL; wholesale migration effects visible

OIBDA[1]
+5.0% y-o-y

- OIBDA benefitting from successful synergy capture; further margin improvement
- Approx. EUR 40 million of synergies, stemming from roll-over effects & additional savings
- Maintain focus on long-term strategic transformation activities

OpCF[2]
Stable y-o-y

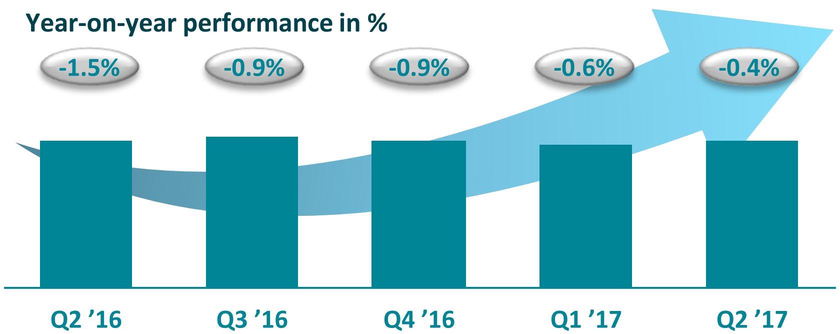
- OpCF benefits from additional EUR 10 million Capex synergies
- Cash flow trajectory supports dividend commitment
- Leverage at 0.9x, in line with target

[1] Excluding exceptional effects. For details please please refer to further materials of the 2017 results release
[2] Excluding the extraordinary gain related with the sale of passive tower infrastructure to Telxius in Q2-2016

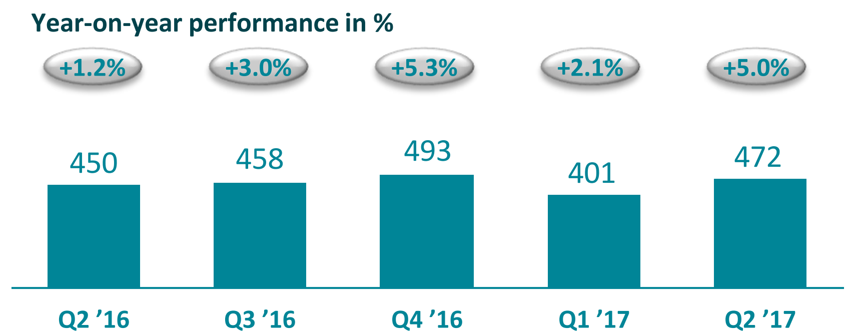
MOMENTUM TRANSFORMATION

Reiterating full-year 2017 outlook; positive trends intact

Underlying[1] MSR trends continue to improve



OIBDA[2] in line with guidance



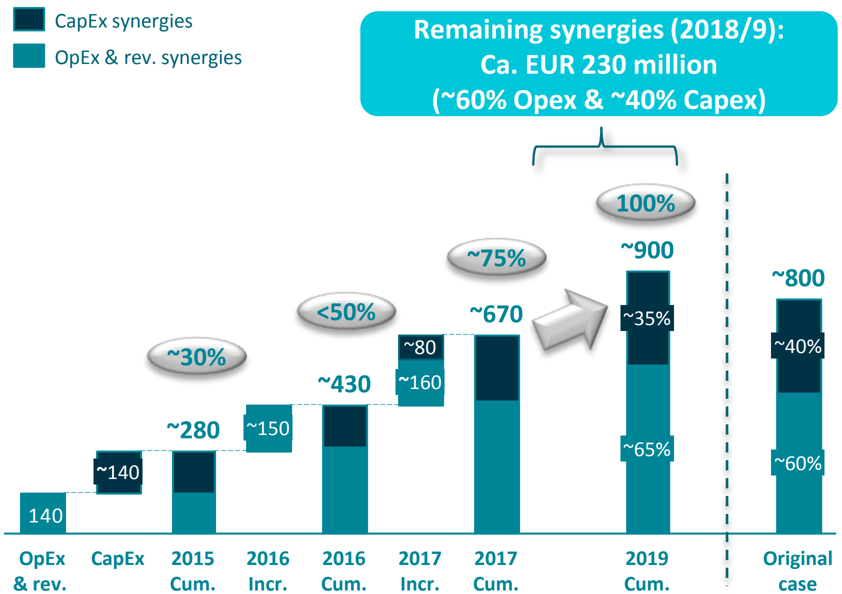
	Baseline 2016 (EUR m)	**Outlook 2017** (y-o-y pct. change)	**Actual H1 2017** (EUR m / y-o-y pct. change)	
MSR	5,437	**Slightly negative to flat[1]** Excluding the impact from regulatory effects	**2,681** / -0.5% **(excl. regulatory effects of EUR 70 million)**	✓
OIBDA	1,793[2]	**Flat to mid single-digit % growth[2]**	**873** / +3.6%	✓
CapEx	1,102	**Around EUR 1 billion**	**434** / +1.1%	✓
Dividend		**Dividend growth over 3 years** (2016-2018)	**EUR 0.25 per share for FY 2016** (Payout May 2017)	

[1] Excluding the impact from regulatory changes; for details please refer to further materials of Q2 2017

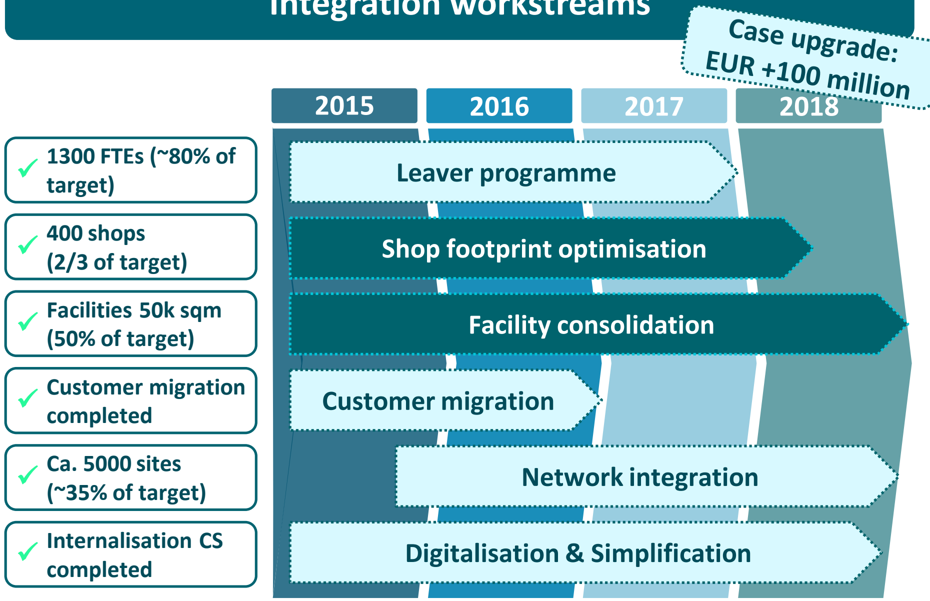
[2] Excluding exceptional effects; for details please refer to further materials of Q2 2017 results release. We have calculated a comparable for 2016; for details please refer to materials of the full year 2016 results release

Updating synergy case to EUR 900 million in 2019

Synergy case 2015 - 2019 (EUR m)



Integration workstreams

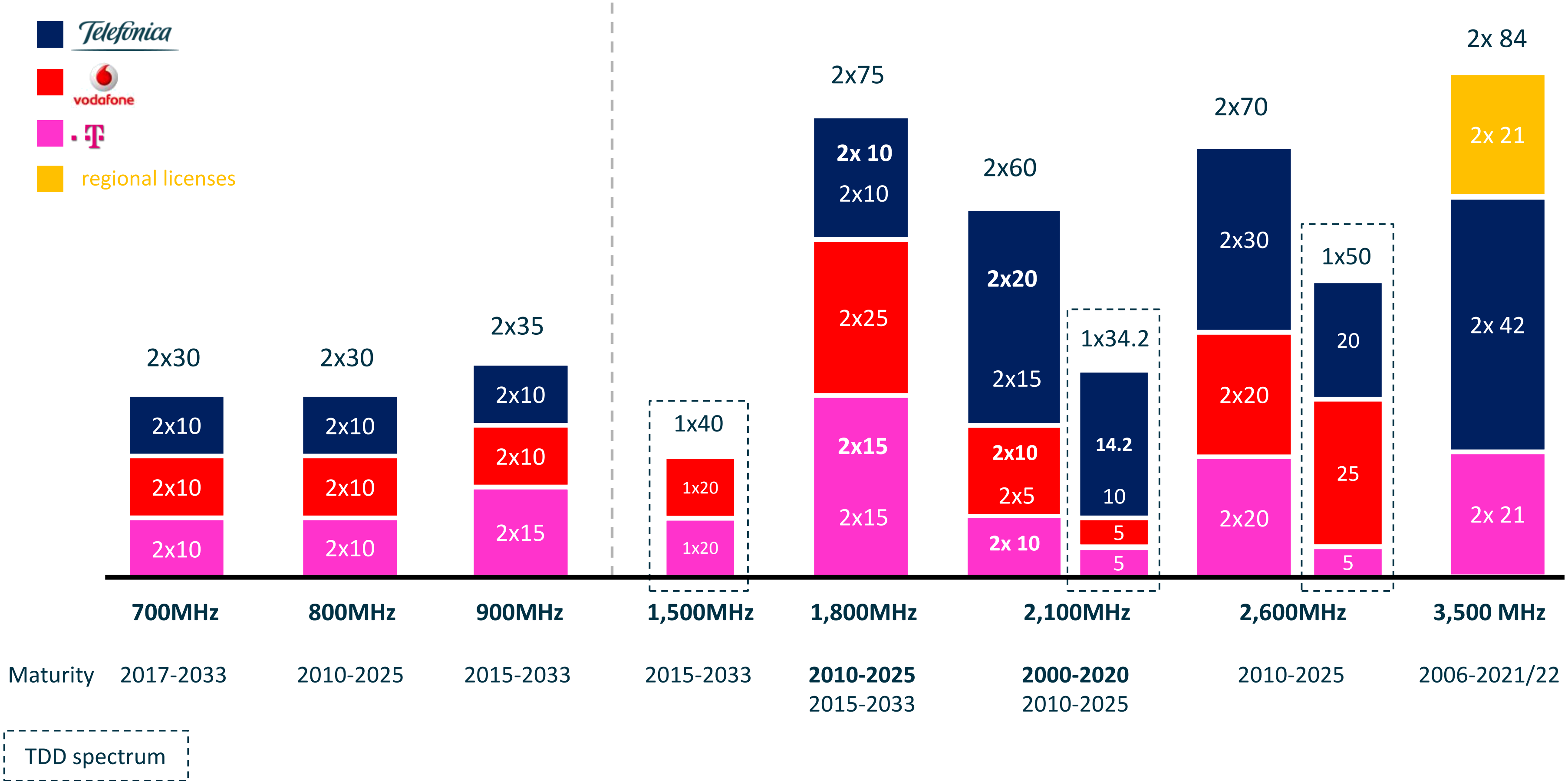


- **Successfully executing** on all initiatives
- New **total case of ~EUR 900 million OpCF synergies in 2019**, driven by improved visibility and the realisation of further synergy opportunities during the integration process, e.g. **additional OpEx savings from FTE restructuring and network** as well as simplification efforts
- **CapEx** synergies primarily driven by **rollout of a single LTE network**
- Expecting to reach **~EUR 670 million (~75% of new total target) by year-end 2017**, with OIBDA relevant synergies of ~EUR 160 million (mainly network and FTE restructuring) and Capex synergies of ~EUR 80 million

Strong spectrum post auction enables realisation of best network experience

Coverage – Level playing field

TEF D retains spectrum leadership for capacity



O_2 Free portfolio

O_2 Free

Jetzt mit noch mehr Highspeed-Datenvolumen[1]

Neu: mehr Datenvolumen[1]

In den neuen O_2 Free-Smartphone-Tarifen gibt es jetzt dauerhaft noch mehr Highspeed-Datenvolumen.[1] Immer inklusive: die O_2 Free Weitersurf-Garantie zum Endlos-Weitersurfen mit 1 MBit/s, auch wenn dein Highspeed-Datenvolumen verbraucht ist.[2]

	O_2 Free XL 25 GB	O_2 Free L 20 GB	Preis-Leistungs-Tipp O_2 Free M 10 GB	O_2 Free S 1 GB
Highspeed-Surfen (LTE Max.)[3]	✓	✓	✓	✓
Endlos weitersurfen mit 1 MBit/s[2]	✓	✓	✓	✓
Flatrate für Minuten/SMS in alle dt. Netze[4]	✓	✓	✓	✓
Extra-Festnetznummer[5]	✓	✓	✓	✓
EU Roaming[6]	✓	✓	✓	✓
Mtl. Grundgebühr reduziert für O_2 Kunden[7, 8]	44,99	34,99	24,99	14,99
Mtl. Grundgebühr (bei 24 Monaten Laufzeit)[8]	49,99	39,99	29,99	19,99

Preis in € inkl. MwSt.

⇨ **Flexibel bleiben:** O_2 Free ist auch ohne feste Laufzeit verfügbar.[9]

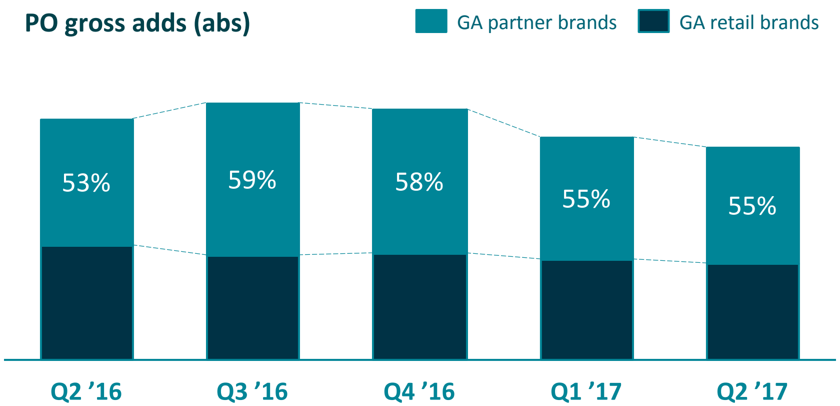
O_2 DSL All-in portfolio

O_2 DSL	XS	S	Tipp M	L
Flatrate ins dt. Festnetz und in alle dt. Mobilfunknetze	✓	✓	✓	✓
Unbegrenzt DSL-Surfen (mit bis zu 2.000 KBit/s)	✓	✓	✓	✓
Maximale Surf-Geschwindigkeit	bis zu 10 MBit/s (Upload: bis zu 2,4 MBit/s)	bis zu 25 MBit/s (Upload: bis zu 5 MBit/s)	bis zu 50 MBit/s (Upload: bis zu 10 MBit/s)	bis zu 100 MBit/s (Upload: bis zu 40 MBit/s)
Maximale Surf-Geschwindigkeit bis* (Inklusiv-Volumen)	100 GB	300 GB (mit Fair-Use-Mechanik**)	300 GB (mit Fair-Use-Mechanik**)	500 GB (mit Fair-Use-Mechanik**)
HomeBox 2	0,00 mtl.	0,00 mtl.	0,00 mtl.	0,00 mtl.
AVM FRITZ!Box 7490	2,99 mtl.	2,99 mtl.	2,99 mtl.	2,99 mtl.
Bereitstellungspreis DSL-Router	0,00 (statt 49,99)	0,00 (statt 49,99)	0,00 (statt 49,99)	0,00 (statt 49,99)
Anschlusspreis	49,99	0,00 (statt 49,99)	0,00 (statt 49,99)	0,00 (statt 49,99)
Mtl. Grundgebühr für Neukunden	9,99 ab 13. Monat 24,99 (ohne Laufzeit ab 7. Monat 24,99)	14,99 ab 13. Monat 29,99 (ohne Laufzeit ab 7. Monat 29,99)	19,99 ab 13. Monat 34,99 (ohne Laufzeit ab 7. Monat 34,99)	24,99 ab 13. Monat 39,99 (ohne Laufzeit ab 7. Monat 39,99)
Kombi-Vorteil Rabatt auf mtl. Grundgebühr für O_2 Kunden	–	bis zu 10,00	bis zu 10,00	bis zu 10,00
Rabatt auf mtl. Grundgebühr für Junge Leute*** (Promocode 65000970)	–	5,00 (in den ersten 3 Monaten)	5,00 (in den ersten 3 Monaten)	5,00 (in den ersten 3 Monaten)

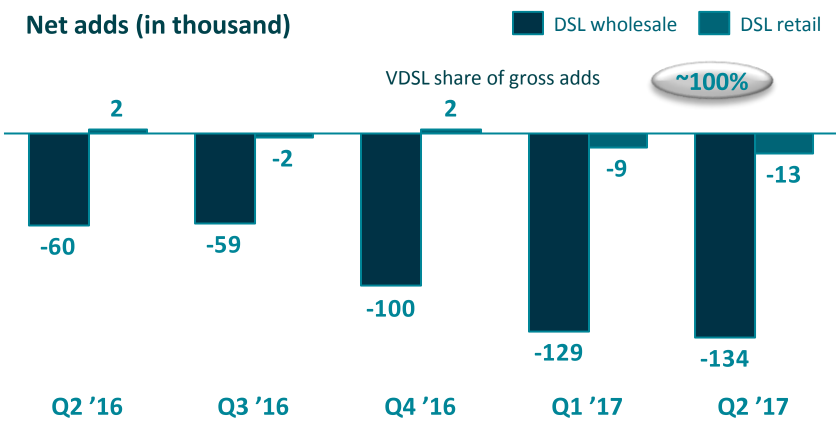
Preise in € inkl. MwSt.

Retail vs. wholesale trends stabilising; solid churn trends

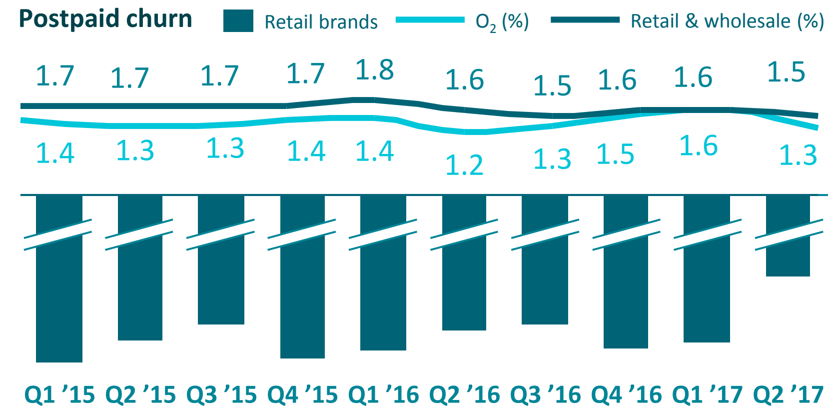
Visible effect from price increases



VDSL drives fixed trading



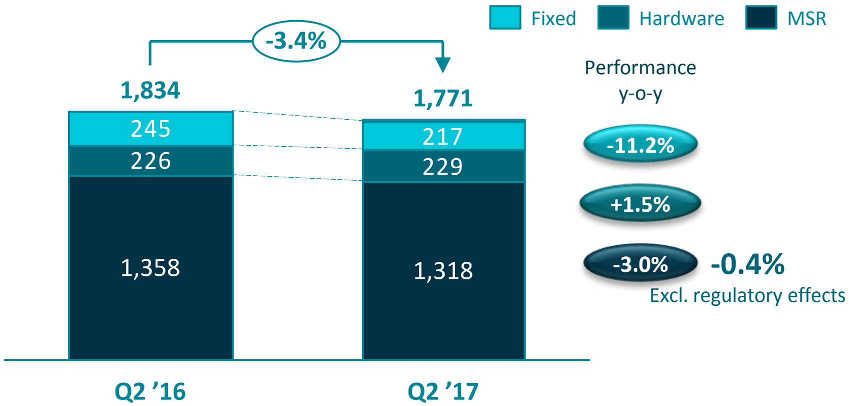
Maintaining retention focus



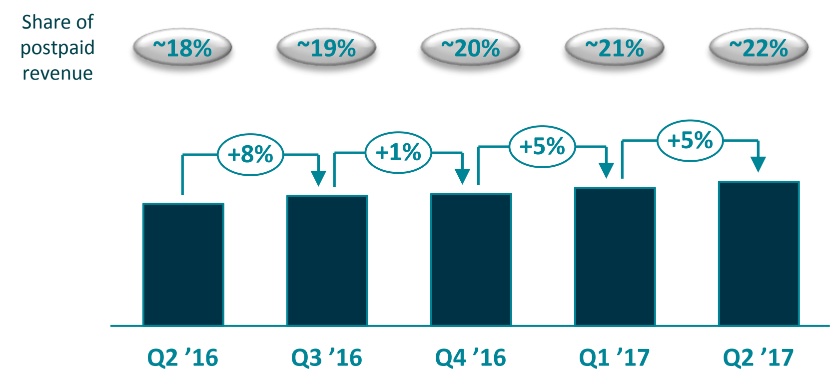
- Partner trading stabilising at prior quarter levels; reflecting changes in pricing
- Churn in O_2 consumer remains low, seasonal improvements in line with prior years
- Strong demand for VDSL with +88 thousand net adds, migration of wholesale customers continues as expected

MSR trends further improving, handset business stabilising

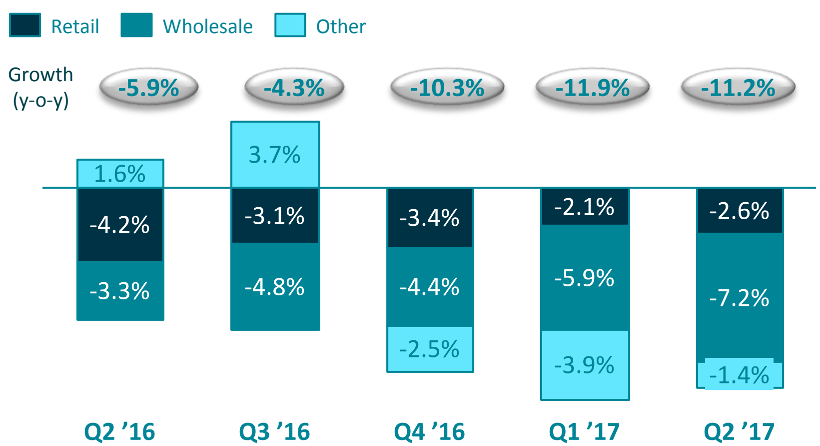
Revenue structure (in EUR m)



MSR from partner business (in EUR m)



Contribution to fixed revenue y-o-y[1] performance

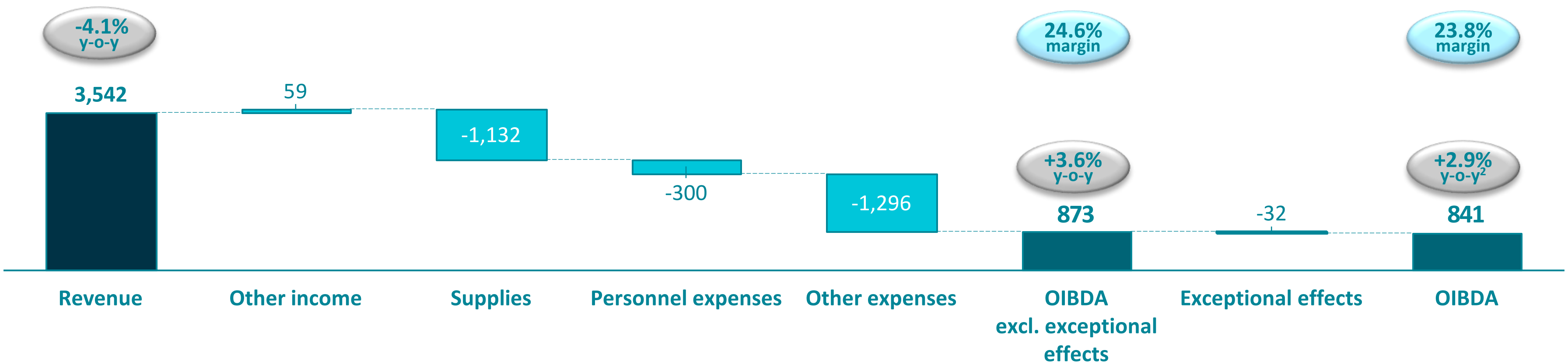


- MSR trends sequentially improving, both in reported terms and excl. regulatory effects
- Stable trend for partner share of postpaid MSR
- Handset revenue stabilising in a saturated market with continued longer replacement cycles from customers

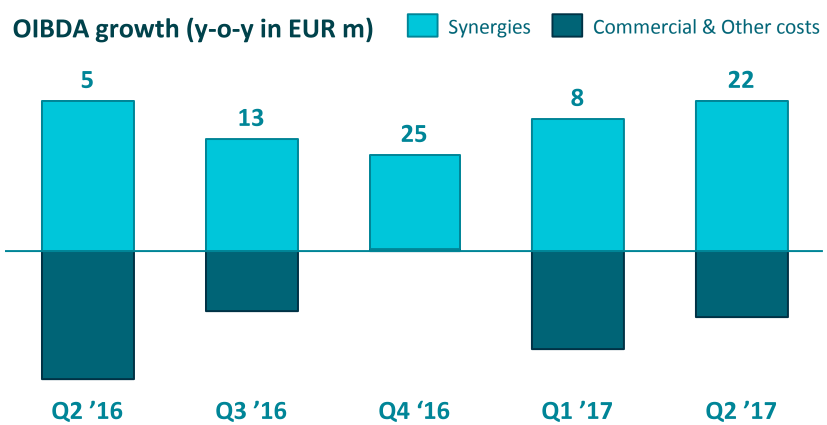
[1] Please note a change in the definition of the fixed retail/wholesale split, which better reflects revenue allocation across segments

OIBDA reflects successful synergy capture and investment activities

Structure of OIBDA for January to June 2017 (in EUR m)



Synergies driving OIBDA growth

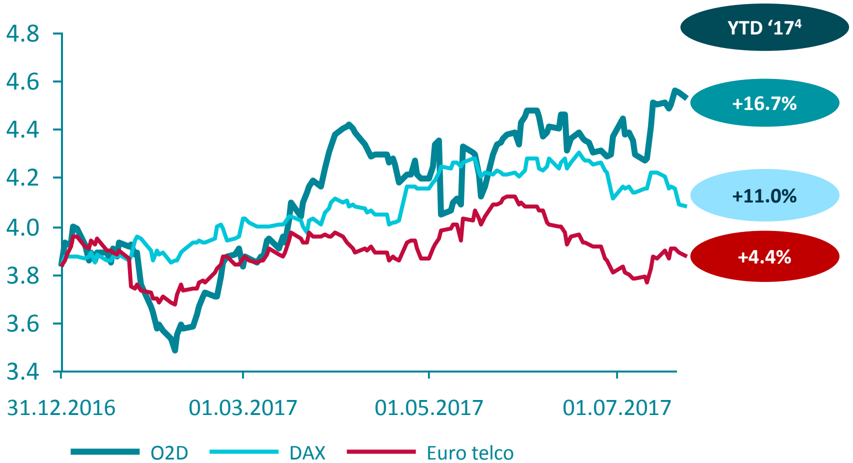


- Successful synergy capture with incremental savings of approx. EUR 40 million in Q2 from FTE restructuring and network consolidation
- Market focus on promotional activities with larger data buckets drives commercial costs; continued investments into O_2 Free
- OIBDA margin at 24.6%, up 1.8 pp y-o-y

[1] Excluding the extraordinary gain related with the sales of tower assets to Telxius in Q2 2016

O2D - Factsheet

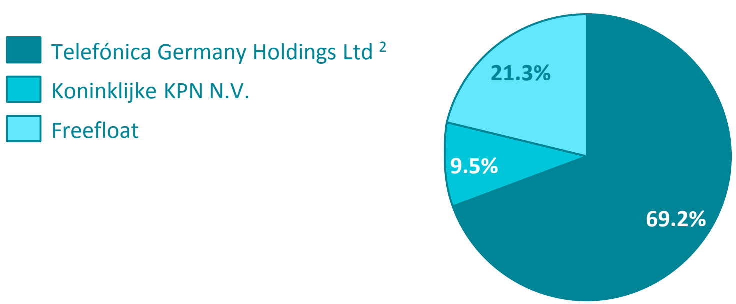
Share price development until 24.07.2017



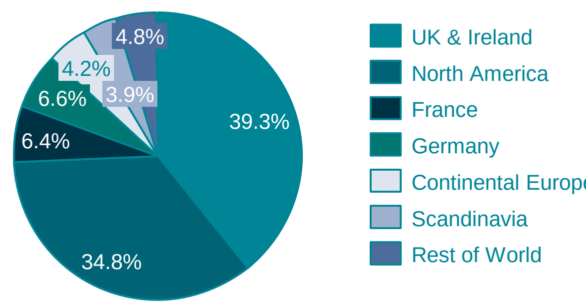
Telefónica Deutschland at a glance

Market segment	Prime Standard
Industry	Telecommunications
Shares outstanding	2,974,554,993 shares
Share capital	EUR 2,974.6 m
Market cap (as of 31.03.)	EUR 13,007.5 m
Share price (as of 31.03.)	EUR 4.373

Shareholder structure as of 30.06.2017[1]



Regional split of shareholder structure[3]



[1] According to shareholders register as of 31 March 2017
[2] Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica S.A
[3] Source: Ipreo; Shareholder ID as of April 2017
[4] O2D share price adjusted for dividend pay-out

Quarterly detail of relevant financial and operating data for Telefónica Deutschland

Financials (Euros in millions)	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2016 FY	2017 Q1	2017 Q2
Revenues	**1,858**	**1,834**	**1,876**	**1,936**	**7,503**	**1,771**	**1,771**
Mobile service revenues	**1,336**	**1,358**	**1,394**	**1,349**	**5,437**	**1,292**	**1,318**
Mobile service revenues (ex regulatory effects)	-	-	-	-	-	**1,328**	**1,353**
OIBDA post Group fees, pre exceptionals[1]	**392**	**450**	**458**	**493**	**1,793**	**401**	**472**
CapEx	**218**	**212**	**314**	**358**	**1,102**	**208**	**226**
Revenue and Opex related Synergies	**~55**	**~40**	**~30**	**~25**	**~150**	**~35**	**~40**

Accesses (EoP in k)	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2016 FY	2017 Q1	2017 Q2
Total Accesses	**48,252**	**48,605**	**49,196**	**49,346**	**49,346**	**49,550**	**49,907**
o/w Mobile	**43,008**	**43,417**	**44,074**	**44,321**	**44,321**	**44,675**	**45,194**
Prepay	23,744	23,814	23,873	23,784	**23,784**	23,967	24,289
Postpay	19,264	19,603	20,201	20,537	**20,537**	20,708	20,905

[1] 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 a pro-forma OIBDA of EUR 1,793m for 2016, which includes the operating lease-related effects related with the before mentioned sale of assets as if it had occurred on 1 January 2016

Telefónica

Deutschland

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