

Telefónica Deutschland  
Magazine

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**SHAPING  
THE LEADING  
DIGITAL  
TELCO**

*Telefónica*

Deutschland



**The visualisation  
of an algorithm**

Data is an important raw material of digitalisation. Its true potential is revealed through the structuring force of algorithms. The latter transform large data volumes into insights on which many ideas and solutions for all areas of life will be based in the future – from mobility to health, private consumption to public administration. Our cover image shows you an algorithm in action. It factors lots of different data and parameters into its calculations, recognises clusters, pools trends and thus turns data into findings. The algorithm is a central design element of digitalisation and therefore a major design element for our Annual Report this year.

# SHAPING THE LEADING DIGITAL TELCO

The digital revolution is touching all areas of business and society. It is changing the way we live and work. The telecommunications industry is a significant driver behind making this digital future a reality. It is therefore undergoing a fundamental revolution itself – technologies, processes and business areas are changing at a tremendous pace. The use of mobile data services is constantly on the up. It is now possible to create new applications that nobody would have conceived of a few years ago. In addition, the Internet of Things is catapulting data traffic into a brand-new dimension.

Telefónica Deutschland is the pacemaker of digitalisation in this dynamic market. At the same time, our company is making great progress on the integration following the merger with E-Plus. In 2015, we laid the foundations and developed the blueprint for the future Telefónica Deutschland. In 2016, we will forge ahead with this integration and the digital reorganisation of the company. We are forming a new organisation that will allow us to best serve the changing telecommunications market of the future and offer our customers the best experience in every respect. We are shaping the digital transformation such that Telefónica Deutschland becomes one of the winners of the digital revolution.

This transformation centres on two key raw materials of digitalisation: IP connectivity, i.e. Internet-based connections, and data analysis. They form the core of our business and will be provided by a reliable and highly efficient factory in our future organisation. Our goal here is cost leadership and high performance. In future, we will make much greater use than we have before of the advantage of having large quantities of data that only we have access to as a network operator. By analysing this data, we can improve our own products and tap into new areas of business. At the same time, we will make sure people retain sovereignty over their data and remain the masters of their own digital lives. On the basis of these two raw materials, flexible, fast market units will bring attractive offers to market almost in real time. Alongside the three market units for our existing customer segments, Advanced Data Analytics and the Internet of Things are two additional units that will grasp the new opportunities provided by digitalisation.

This line-up gives Telefónica Deutschland a simple and clear structure. Thanks to our lean and efficient business model, we can increase profitability and free cash flow, maintain our financial flexibility and create attractive value for our shareholders. We will thus achieve our aim and become Germany's Leading Digital Telco.



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The Annual Report  
is available  
online in German  
and in English.

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# ***ENHANCE***

In the first year after the merger with E-Plus, we have considerably enhanced our performance. As the largest mobile telco player in Germany, we drive the momentum in the market place. We have delivered on our expectations and are making rapid progress with our integration program, which enables us to capture accelerated synergy contributions. In addition, we leverage our strong network and distribution assets to prepare the ground for the best digital customer experience. We have laid the solid foundation for becoming the Leading Digital Telco.

# » ***THE FOUNDATION IS LAID.*** «

— Five questions for Rachel Empey,  
CFO, Telefónica Deutschland



**» LOOKING AT 2015, THIS WAS A VERY SUCCESSFUL YEAR FOR US. WE HAVE MANAGED TO MEET OUR EXPECTATIONS AND EVEN TO EXCEED SOME. «**



— Rachel Empey is Chief Financial Officer (CFO) of Telefónica Deutschland Holding AG. She is responsible for Finance and Corporate Strategy.

Telefónica Deutschland has completed the first financial year following the merger with E-Plus. Where does the company stand today?

— Rachel Empey: Looking at 2015, this was a very successful year for us. We have managed to meet our expectations and even to exceed some. We are now on eye level with the competition, we even have the biggest mobile customer base now in Germany. In 2015, that has allowed us to really focus on our existing customers, and to save money by not needing to acquire as many new customers in the market place. Of course, we have also made great strides in capturing synergies and that has created a lot of value for us. We have been able to make a lot of progress integrating E-Plus and Telefónica Deutschland and that has really laid the foundations for us as a company to focus on transformation in 2016.



How did you proceed with the synergies?

— Empey: Of course, the synergies were strategically important to us in 2015 and we wanted to make sure that we maintained our focus on the important projects. We had the execution of the leaver program and here we were able to achieve more than half of the planned reductions for 2018 already in 2015. We



**» WE HAVE BEEN ABLE TO MAKE A LOT OF PROGRESS INTEGRATING E-PLUS AND TELEFÓNICA DEUTSCHLAND. «**

Telefónica Deutschland — 2015

also looked very closely at our distribution network and were able to hand over 300 stores to Drillisch and make a further reduction which was very important for establishing the right cost base going forward. So focussing on key projects that we were able to deliver very well helped us to hit that all important synergy target.

**So is the integration complete?**

— E m p e y : No, we still have a lot of work to do. Let me give you some examples of the projects we are working on in 2016: Firstly, we are working hard on bringing the networks together. That is going to give us a great customer experience as we will have a better, denser network infrastructure, but at the same time we are going to be able to realise those all important cost savings. Another example of a project we are working on is to streamline our IT systems and our brand infrastructure. That is going to be a great platform for us to create a more efficient and better set-up for cost savings going forward in terms of our IT

infrastructure. Thirdly, and very importantly of course, we want to complete the leaver program as soon as possible, to give clarity to all of our employees and to have a finalised structure for the organisation going forward. In particular within the call centre area, we are looking to carve out the call centres into individual subsidiaries to give us a common platform and comparability across all of our locations. And finally, another important project is the handing over of our IT operation activities to an external partner, which will also help us in having some consistency and a better set-up across the organisation.

**That means you will achieve the synergy targets?**

— E m p e y : We are very confident that we are going to meet the synergy targets with all of the projects that we have in place. It is clearly very important for us to focus on that. We already realised 35 % of those synergies in 2015 and there will be an incremental around 150 million of synergies in 2016 that will

take us to over 50% of the full synergy run rate already in 2016. That puts us in a great position to improve the profitability of the business – and of course to ensure financial flexibility and continue to deliver great shareholder remuneration.

What is your forecast for 2016 and what strategy is the company pursuing?

— E m p e y: We are very confident that 2016 will be another successful year for Telefónica Deutschland. We expect again a market that is fast moving, and particularly a very dynamic market in the non-premium segment that we have already seen in 2015. We will of course remain the market leader in terms of customer base. So with more than 48 million customers including more than 43 million mobile customers, we will continue the strategy of focussing on – and trying to drive incremental value from – the customer base, as well as trying to be active in the market place. Monetising data is another obvious opportunity that we want to grasp. As customers' usage continues to grow, we want to make sure that we are really capitalising on the data. Of course, we also want to use the assets that we have got – the great network that we are creating from integrating the network, the multiple brands and the great distribution that we have in place – we want to build on that to really drive the business forward. We have achieved a lot in terms of integration already and we will continue on this path in 2016, but we will of course be transitioning into a world where we can explore more digital transformation for Telefónica Deutschland. This means that 2016 will really provide the platform for us to drive the future growth of the business.



**» 2016 WILL REALLY PROVIDE THE PLATFORM FOR US TO DRIVE THE FUTURE GROWTH OF THE BUSINESS. «**



Telefónica Deutschland — 2015

—The interview with Rachel Empey was held at the Munich headquarters, one of Telefónica Deutschland's two primary locations.

# DIGITAL MOMENTUM\_

— In the digital world, there are myriad applications that make life easier, more exciting and more varied. In 2015, Telefónica Deutschland expanded its portfolio of products and services with which customers can design their digital lifestyles according to their wants and needs.

Telefónica Deutschland — 2015



## TIPS & ADVICE FROM PROFESSIONALS

O<sub>2</sub> Gurus are experts in hardware and technology. They know the latest trends and devices and can support customers with numerous practical tips and advice. They provide advice online, by phone and in many O<sub>2</sub> shops. In 2015, the O<sub>2</sub> Gurus travelled throughout Germany in a converted truck and distributed “snacks for the digital appetite”.

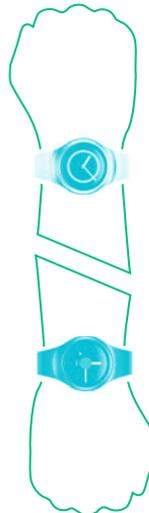
# GOODBYE TO SIGNAL BLACK SPOTS

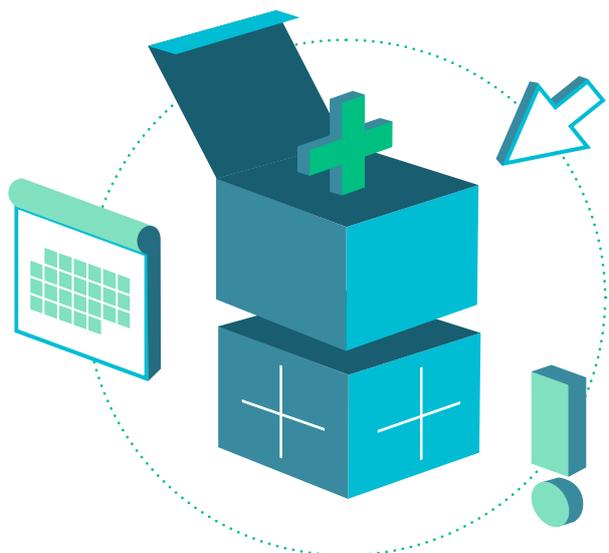
O<sub>2</sub> Message+Call makes signal black spots a thing of the past when Wi-Fi is available. Telefónica is the first telecommunications provider in Germany to offer an app for Android and iOS that allows you to make calls over Wi-Fi when there is no mobile network connection. It also has additional features such as video calling, chat and file sharing.



## SMART WRISTS

Smartwatches and wearables are becoming ever more widespread and the selection of apps is continuously growing. With devices such as the Apple Watch or Samsung Gear S2, you can control everything from your television to your personal fitness program from your wrist. Telefónica Deutschland not only offers the devices with the appropriate tariffs, but O<sub>2</sub> Gurus also give customers lots of useful tips regarding specific functions such as the Apple Watch's heart rate monitor.





## **SURF HAPPY**

By the end of the month, it is often the case that the data volume included in your tariff is used up and your mobile data speed has been reduced. Data automatic from O<sub>2</sub> solves this problem: once the included volume is used up, an additional data package is activated and the customer can keep surfing at a constant speed. If a customer does not want this, they can deactivate the data automatic.

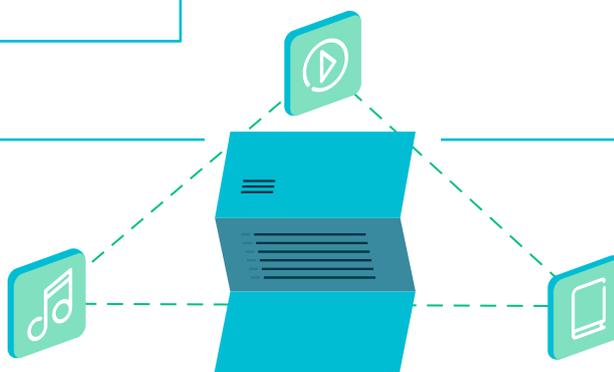
## **CHILDPROOFING FOR DIGITAL NATIVES**



In regular workshops, O<sub>2</sub> Gurus provide advice on the proper use of digital technology. For example, parents can set up safe "kids' corners" on their mobile devices in just a few clicks, where the little ones can only access certain applications such as games or photos.

## **SMART HOME**

The Smart Home HD Starter Kit from D-Link allows O<sub>2</sub> DSL customers to experience the possibilities of a connected home. For example, the coffee machine and lights turn on automatically when you enter the room in the morning. Devices at home can be controlled and monitored on the move via mobile app. The kit, consisting of a smart plug, motion sensor and camera, is included with selected O<sub>2</sub> DSL tariffs.



## **PAY FOR iPhone APPS VIA YOUR PHONE BILL**

Telefónica Deutschland is the first provider in the world to allow its customers to pay for their digital purchases from Apple via their mobile phone bill. This requires no additional registration. All future purchases using the customer's Apple ID will be settled automatically via the next bill or deducted from their prepaid credit.



# PARTNER FOR DIGITAL LIFE\_

— In the financial year 2015, Telefónica Deutschland's partner business again made a significant contribution to the company's success. Here, too, the company supports the digital lifestyles of millions of customers with innovative partner products and tariffs. Two successful examples are the partnerships with Media-Saturn and ALDI.

**»SUPER SELECT IS AN INNOVATION AND HITS THE CURRENT ZEITGEIST DEAD ON.«**

— Wolfgang Kirsch,  
CEO of Media-Saturn Deutschland GmbH

## Super Select – the first tariff in Germany under which users can share their data volume

Since October 2015, customers of the leading European electronics retailers Mediamarkt and Saturn have been able to choose the new Super Select tariff. What is special about the offer is that up to six people can flexibly share their mobile data volume via one contract. Telefónica Deutschland in partnership with Media-Saturn is therefore the first telecommunications company to offer a data-sharing model on the German market. The shared mobile data volume can be up to eleven gigabytes per month. Services such as voice and SMS options, EU roaming or additional SIM cards can be added according to individual preferences. The tariff has par-

ticular appeal for families and multi-person households. "Super Select is an innovation and hits the current zeitgeist dead on," says Wolfgang Kirsch, CEO of Media-Saturn Deutschland GmbH. He believes Telefónica Deutschland distinguishes itself as a wholesale-telecommunications partner through its high flexibility, efficient network and excellent service. The two companies' strategic partnership is to be built on in the future, as Markus Haas, COO of Telefónica Deutschland, also emphasises: "As Germany's leading electronics retailer, Media-Saturn is our ideal partner for making customers innovative offers that support them in their digital lives."

**» WITH THE MUSIC OFFER FOR ALDI TALK, WE ARE LIFTING THE LONG-STANDING AND SUCCESSFUL PARTNERSHIP TO A NEW LEVEL. «**

— Markus Haas,  
COO Telefónica Deutschland

## ALDI TALK with ALDI life Musik – now you can stream music from Germany's largest discount supermarket

The cooperation between Telefónica Deutschland and Medion AG together with ALDI, the market leader among discount supermarkets, began ten years ago. Since then, ALDI TALK has developed into one of the most successful telecommunications partnerships in Germany. In autumn 2015, the partnership was augmented by the music streaming service ALDI life Musik. Telefónica Deutschland thus gives ALDI TALK customers access to Napster's extensive streaming platform with 34 million songs and thousands of audio books. The offer is avail-

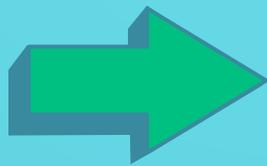
able as a pure music streaming service or in combination with an ALDI TALK mobile tariff. Telefónica Deutschland is therefore the first telecommunications provider on the market to open up its music partnership with Napster to wholesale customers. "With the music offer for ALDI TALK, we are lifting the long-standing and successful partnership to a new level," says Telefónica Deutschland COO Markus Haas. For the millions of ALDI customers, this means they can organise and enhance their digital lifestyles via their preferred discounter.



# ON THE WAY TO THE BEST NETWORK EXPERIENCE\_



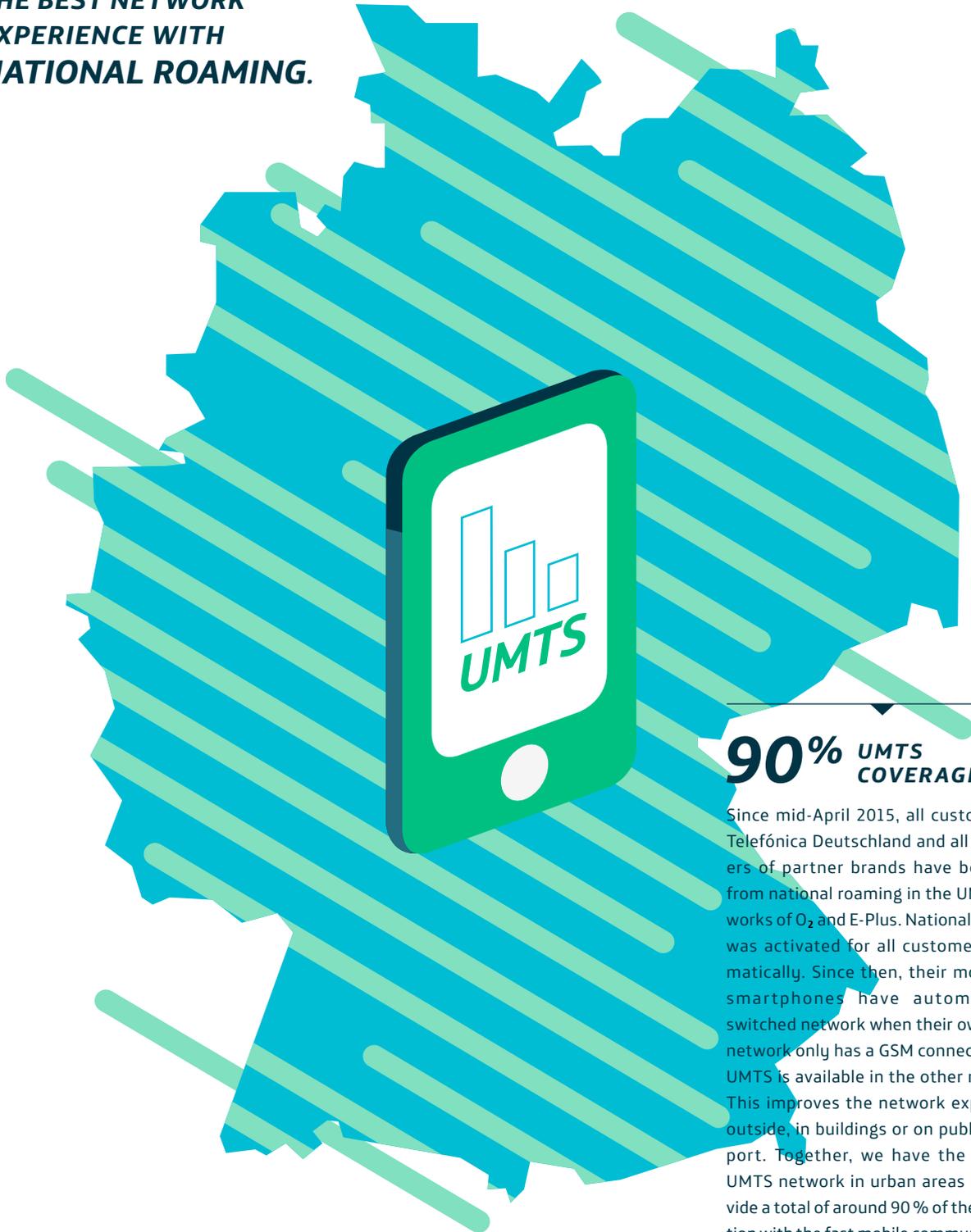
Telefónica Deutschland — 2015



— Following the merger of Telefónica Deutschland and E-Plus, we want to offer our customers the best network experience. This objective is one of the core elements of our strategy. Customers should perceive our network quality as being at least as good as that of our competitors. We are therefore making targeted investments in actual customer benefits and systematically aligning the network infrastructure to customer requirements. In addition, the integration of the two networks will make a considerable contribution to the achievement of the promised synergies over a period of five years.



→ **IN 2015, WE REACHED THE FIRST MILESTONE ON THE WAY TO PROVIDING THE BEST NETWORK EXPERIENCE WITH NATIONAL ROAMING.**



**90% UMTS COVERAGE**

Since mid-April 2015, all customers of Telefónica Deutschland and all customers of partner brands have benefited from national roaming in the UMTS networks of O<sub>2</sub> and E-Plus. National roaming was activated for all customers automatically. Since then, their mobiles or smartphones have automatically switched network when their own home network only has a GSM connection and UMTS is available in the other network. This improves the network experience outside, in buildings or on public transport. Together, we have the densest UMTS network in urban areas and provide a total of around 90% of the population with the fast mobile communications standard. Therefore, many customers now often have UMTS coverage where that was previously not the case.

→ **WE BEGAN THE INTEGRATION OF THE TWO NETWORKS OF O<sub>2</sub> AND E-PLUS IN JANUARY 2016 – A MAJOR TECHNICAL PROJECT, WHICH IS THE FIRST OF THIS SIZE IN EUROPE.**



## **GOLDEN GRID**

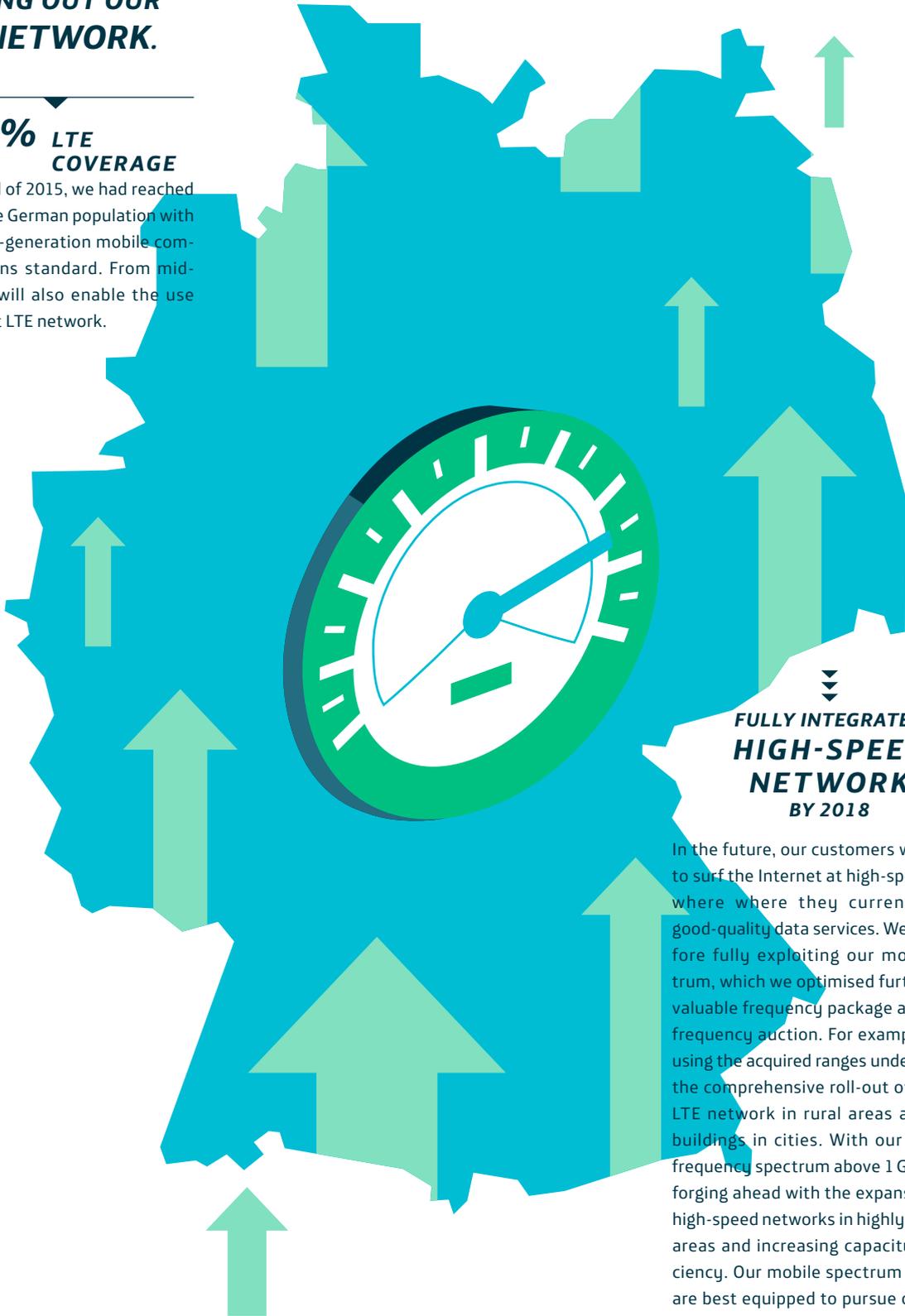
The joint network will comprise more than 25,000 mobile base stations, which are optimally spread throughout all of Germany. In the first year of network integration, we will already reach 60% of the German population with the new, integrated network.

The network integration in 2016 will focus on urban and suburban areas so that as many customers as possible can benefit rapidly from the improved performance of the joint network. We are starting with the technical merger of the UMTS and GSM networks. The network is expected to be completely integrated within a five-year period. The integration will make a sizeable contribution to the achievement of the promised synergies.

→ **IN PARALLEL TO THE NETWORK INTEGRATION, WE ARE STILL SWIFTLY ROLLING OUT OUR LTE NETWORK.**

**75%<sup>LTE</sup> COVERAGE**

By the end of 2015, we had reached 75% of the German population with the fourth-generation mobile communications standard. From mid-2016, we will also enable the use of the joint LTE network.



**FULLY INTEGRATED HIGH-SPEED NETWORK BY 2018**

In the future, our customers will be able to surf the Internet at high-speed everywhere where they currently enjoy good-quality data services. We are therefore fully exploiting our mobile spectrum, which we optimised further with a valuable frequency package at the 2015 frequency auction. For example, we are using the acquired ranges under 1 GHz for the comprehensive roll-out of the basic LTE network in rural areas and within buildings in cities. With our extensive frequency spectrum above 1 GHz, we are forging ahead with the expansion of our high-speed networks in highly populated areas and increasing capacity and efficiency. Our mobile spectrum means we are best equipped to pursue our goal of offering customers the best network experience going forward. Moreover, we are contributing to the roll-out of nationwide broadband in Germany.



# ***ENABLE***

Based on the solid foundation which we laid in the first year after the merger with E-Plus, we are now taking the next steps on our way towards being the Leading Digital Telco. Our focused multi-brand portfolio allows us to offer the right products for every customer group. We are creating simple digital processes, establishing end-to-end responsibilities and digital real-time decision-making procedures. At the same time, we are using advanced data analytics for optimum network expansion. We are thus enabling a superior customer experience and becoming the customers' first choice.

**» DIGITALISATION  
HELPS US IDENTIFY  
AND FULFIL OUR  
CUSTOMERS' NEEDS  
IN REAL TIME. «**

— Interview with Markus Haas,  
Chief Operating Officer



Telefónica Deutschland is transforming into the Leading Digital Telco. What does that mean specifically for the business?

— Markus Haas: It means that we want to offer the best customer experience on the German telecommunications market. This relates to our entire value chain from the network, through our brands and products, to purchase and service in-store or online. So it is not about becoming “digital” in some vague sense, it is about offering our customers real added value. You could put it like this – through digitalisation, we are increasing the individual customer benefit. We provide exactly what the individual customer wants at industrial, scalable conditions.

What does that mean for the products?

— Haas: Digitalisation offers us brand-new opportunities here. Comprehensive data analysis enables us to identify our customers' individual needs virtually in real time. On the basis of their personal user behaviour, we can make them offers that best meet their requirements. This gives rise to use cases that are available to customers at the right time.

How do you control this individual customer experience?

— Haas: We have established Digital Command Centres at both our primary locations in Munich and Dusseldorf for this purpose. They are the nerve centres of the digital customer journey, where all relevant information converges. We can already show all sales channels and regions on our monitors. So we are analysing the market in real time and will respond immediately to new customer requirements in the future. We can then even anticipate these requirements through intelligent data and context analysis and make our customers an appropriate offer before they



**» IT IS NOT ABOUT BECOMING DIGITAL IN SOME VAGUE SENSE, IT IS ABOUT OFFERING OUR CUSTOMERS REAL ADDED VALUE. «**



— Markus Haas is Chief Operating Officer (COO) of Telefónica Deutschland Holding AG and responsible for operating business.

have told us what they want. We will establish these Command Centres for all sales channels, not just online.

### What role do the shops play?

— H a a s : Our shops continue to play an important role in sales; they are and will remain part of our DNA. However, their function is changing with increasing digitalisation: they are increasingly becoming realms of experience. In the first step, we therefore converted all shops to the O<sub>2</sub> brand in order to present a unified image when addressing customers on the high street. In addition, we are strengthening our customers' emotional connection to our shops with a new concept. This begins by them arranging an appointment in the shop via their smartphone and being able to check in there. We are allowing customers to experience digitalisation in the shop with changing themes. Waiting times are being reduced through mobile checkouts. And the O<sub>2</sub> Gurus, specially trained experts in hardware and digital technology, advise our

customers on all questions regarding their products or specific services.

### How are online and offline channels connected?

— H a a s : We want to be the first telecommunications provider in Germany to offer a truly universal digital customer experience across all touchpoints. Our customers should be able to contact us seamlessly via all sales channels, however they like. Most will use digital channels. At the same time, they always have the option to obtain comprehensive advice in a shop, where they can select the best offer for them. Thanks to digital systems, no information is lost. Our online-chat experts, for example, know exactly what request the customer had on their last shop visit. In order to offer this, we are fundamentally reorganising our company and introducing simple processes. This is not least an important prerequisite for offering our customers the best value for money in the long term.



**» WE ARE FUNDAMENTALLY REORGANISING OUR COMPANY AND INTRODUCING SIMPLE PROCESSES. «**



—The interview with Markus Haas took place at the Telefónica BASECAMP. The BASECAMP in the Representative Office in Berlin is Telefónica's centre for the debate on digitalisation in Germany.



**» OUR SHOPS  
ARE BECOMING  
REALMS OF  
DIGITAL  
EXPERIENCE. «**

We have been talking about private customers so far. What does Telefónica Deutschland as a digital telco have to offer business customers?

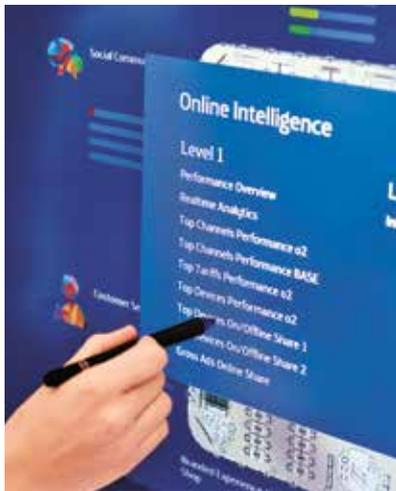
— Haas: Our business customers will also benefit from the extensive digital transformation. Network quality is an especially important factor for corporate clients. We are making great strides here. Our digital products also put us in a very good position: we offer O<sub>2</sub> Unite, for example, a quota tariff in which all of a firm's employees receive a specified volume of call minutes, mobile data and text messages, so a separate contract does not have to be taken out for each employee. Digital Phone by O<sub>2</sub> is another example, whereby we virtually relocate a company's telephone system to the cloud. In this segment, we will concentrate even more on small and medium-sized enterprises in the future. We see high potential for growth in this target group in particular.

What goals have you set for network expansion?

— Haas: Since the start of the year, the technical integration of the two mobile networks of Telefónica Deutschland and E-Plus has been giving rise to a network that customers will perceive as at least as good as that of our competitors. The integrated network will have an optimum structure and an ideal distribution of mobile network sites. This is a major technical project, which is the first of its size in Europe. At the same time, we are investing in the accelerated roll-out of the turbocharged data service LTE. We will install more than 10,000 new LTE network elements this year. Our goal is for no provider to be better than us in cities and urban areas, i.e. where most of our customers use mobile services.

# ON THE PULSE OF DIGITAL LIFE

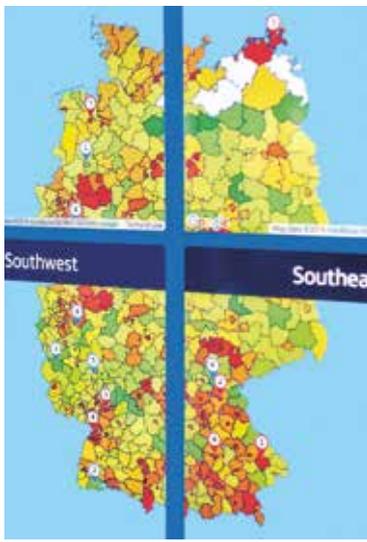
Telefónica Deutschland — 2015



— More than 48 million customers use Telefónica Deutschland's products and services. Digitalisation opens up brand-new opportunities to better know and understand their needs and requirements. We will anticipate our customers' desires in real time. We will manage our sales channels and customer contact points such that our services reach customers exactly when they need them. A visit to the Digital Command Centre – one of Telefónica Deutschland's important digital control centres.







Telefónica Deutschland — 2015



— Visit to the Digital Command Centre

# ***DIGITAL COMMAND CENTRE***



— Dr Juan Bernabé-Moreno, the manager responsible for the Web Intelligence unit.

Telefónica Deutschland, Munich site, 30th floor: numbers and diagrams flash up on around two dozen screens. In the foreground, employees deep in conversation. Millions of new pieces of data arrive here every minute. Which products are especially sought-after, and in which regions? Which tariffs attract the most enquiries? What are users writing on social media?

We are at the Munich Digital Command Centre, one of Telefónica Deutschland's digital control centres. A second centre commenced operations in Dusseldorf at the start of the year. Its Digital Command Centres make Telefónica Deutschland one of the first telecommunications companies in the world to be able to analyse all significant company and market data in real time. Most pieces of data are at most 20 seconds old when they appear on the screens. On this basis, employees can now react to developments immediately. "The Digital Command Centre is an important step towards the comprehensive digital controlling of our business. We can use the real-time data to fulfil our customers' needs faster and better," says Markus Haas, Chief Operating Officer of Telefónica Deutschland.

The Digital Command Centre is divided into five stations that correspond to the stages of the customer journey, which begins with the first customer contact, followed by the purchase decision and the purchase process, then the brand and shop experience, service and finally communication on social networks. All relevant data for every station is available at all times on its own separate screen. The Telefónica employees can thus optimise the use of the online portal in real time, for example. If a particular device is in especially high demand, additional tariff options and bundled offers can be made available in future.

The development and construction of the Digital Command Centre took around four months. A lot of data was already available in the company; new data was added. "By monitoring the entire customer journey and coming together at one location, we can exploit the full potential of the data," explains Dr Juan Bernabé-Moreno, the manager responsible for the Web Intelligence unit. "We now have much greater transparency across departments and can make better decisions more quickly."

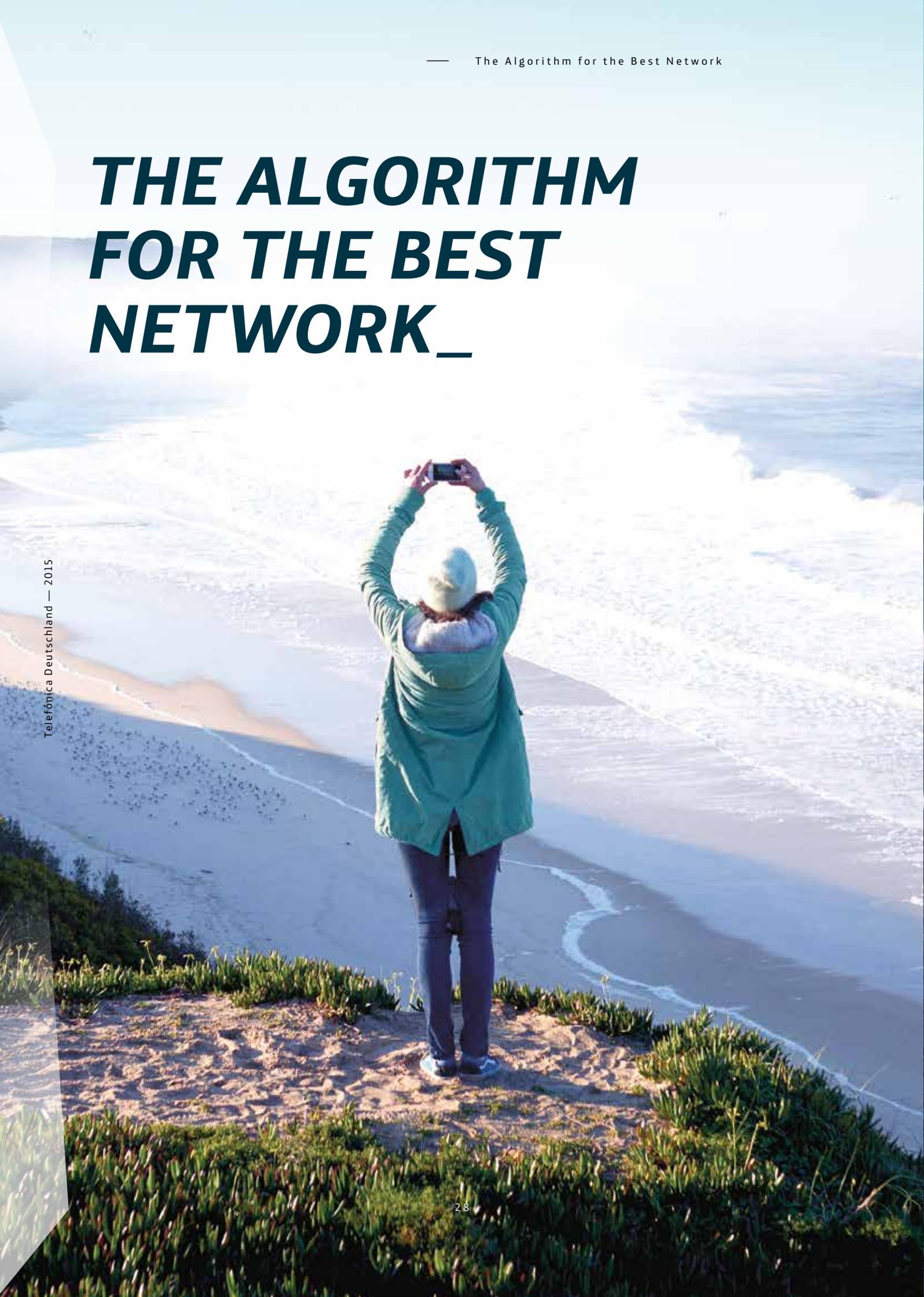
Telefónica Deutschland is a frontrunner in holistic view and the quality of analysis. But Bernabé-Moreno still sees lots of potential for the future: "With more refined data analysis and the use of self-learning systems, the quality of the data and the insights gained therefrom will continue to improve. We will thus enable customers to enjoy a better digital life."

Telefónica Deutschland — 2015



# ***THE ALGORITHM FOR THE BEST NETWORK\_***

Telefónica Deutschland — 2015





| Linie | Ziel   | Abfahrt   |
|-------|--------|-----------|
| U5    | Hönnow | In 3 min  |
| U5    | Hönnow | In 13 min |



— Telefónica Deutschland is one of the first telecommunications companies in the world to use modern data analysis techniques to optimally align network expansion to customer requirements. The company's data specialists have developed an algorithm that predicts the demand on mobile telecommunications services down to district and town level. The advantage for customers is that new technology such as the turbocharged data service LTE is first rolled out exactly where there is the greatest demand. The company can thus optimally control its investments and improve customer experience in a targeted manner.

Mathematicians, economists, sociologists, computer scientists, statisticians and geographers – two years ago, employees with utterly diverse qualifications met in Munich to tackle a special project. Their challenge: how to plan the expansion of the mobile network so that additional capacity is built up where customer demand is greatest. Correct prioritisation is particularly important for the current roll-out of the high-speed LTE network – for the customers' network experience as well as for the efficacy of the investments. The Telefónica team got to work and found the solution within a few months: the project group developed a mathematical formula, an algorithm, which the company can use to predict the use of mobile voice and data services for every region in Germany. On the basis of these forecasts, network expansion is driven forward according to demand.

The algorithm uses a sophisticated data analysis technique known as advanced data analytics. Up to 150 criteria are fed into the forecast formula: from population density, average age and the purchasing power of a region to the number of telephone calls per month and the current network expansion by competitors. An elaborate calculation results in a detailed map of Germany in which the most important roll-out locations are itemised for each region.

The analysis team divided Germany into around 500 areas, known as micromarkets. They also created four key categories for the expansion of mobile data capacity: alongside urban and suburban areas, these are tourist regions, motorways, railways, major buildings, shopping centres, airports, large train stations and football stadiums. The highest-priority areas appear in dark blue on the planning map, tourist areas in yellow, motorways turquoise and railways red. Optimum roll-out plans can be defined on the basis of this colourful map.

"The big advantage is that we can build up network capacity as a matter of priority where customers actually spend time and need the most data services," says Thorsten Kühlmeyer, Head of the Business Analytics unit at Telefónica Deutschland. In the past, telecommunications companies mostly built mobile masts where they supposed new customers would be or where lots of people were registered as living. "But most customers do not need a strong mobile data network at home, but on the high street, in the train station, at concert venues or at the lake in summer," explains Kühlmeyer. The algorithm not only allows Telefónica Deutschland to determine the right locations. The individual sites can also be ranked against each other so that Telefónica Deutschland can target its investments such that they always benefit the most people possible.

For this purpose, the analysis team also uses data from the Telefónica network that shows where most customers spend time and where they most often surf the mobile Internet. At the same time, nobody has to fear for their personal data. All information is fully anonymised according to the law; nothing can be traced back to individual persons. "Data protection is of the highest priority in our analyses," emphasises Kühlmeyer.

However, network planning using the algorithm is just the first step. The expansion of a mobile network that is used by many millions of customers every day is a logistical and technical challenge. At thousands of mobile masts, modules have to be replaced, new software uploaded and often the fixed line connection renewed. "This employs hundreds of network engineers and experts," says Kühlmeyer, "our colleagues do outstanding work."

He realises this himself when he travels to the somewhat more remote lakes around Munich to relax on weekends. Analyses using the algorithm showed, among other things, that demand on mobile data services is particularly high in these sparsely populated areas. Earlier models simply did not take weekend-trippers and holidaymakers into account, explains Kühlmeyer. "Now we have a superfast network at the lakes."





Blohm+Vor

*Fisch - Feldhusen*  
gegründet  
1994

*Aal-Kai*  
HAMBURG

Bekannt  
durch  
Qualität,  
Presse, Funk  
und  
Fernsehen.  
Oft kopiert,  
nie erreicht.

*Aal*

Alle  
Geräucher-

*Aal*  
*Laachs*

*butt*



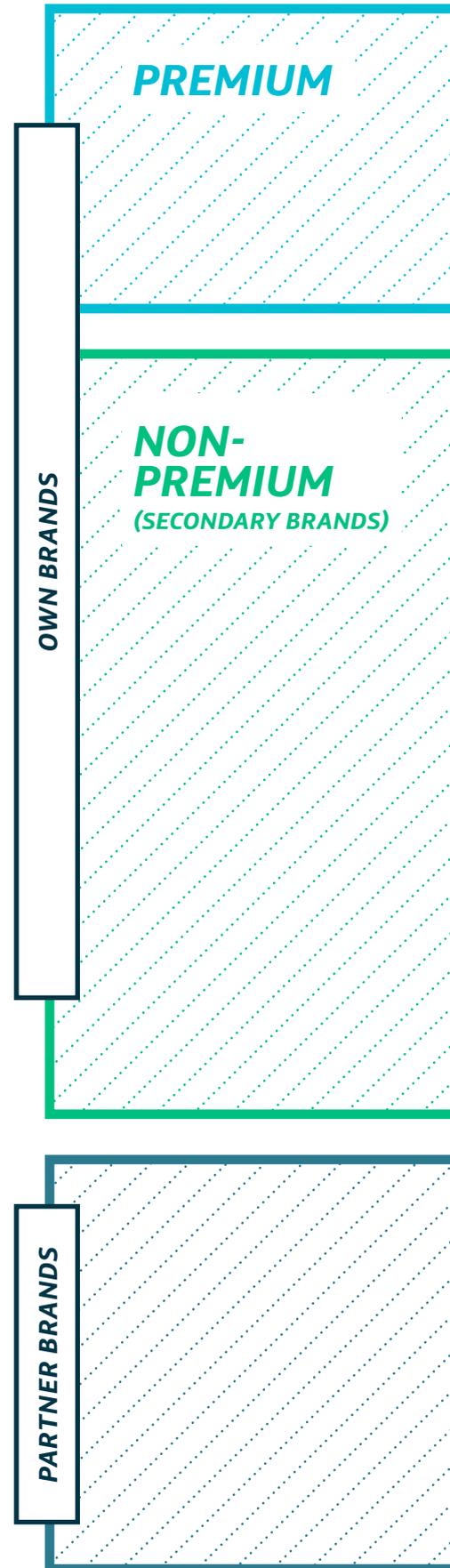
# THE RIGHT BRAND FOR EVERYONE\_

Telefónica Deutschland — 2015

— In the second year after the merger with E-Plus, Telefónica Deutschland has taken another important step in the alignment of its brands. The brand portfolio is consistently aligned to customers' different preferences and the requirements of the market.

The premium brand O<sub>2</sub> addresses a broad range of private and business customers as a multichannel brand. In the non-premium segment, the Blau brand plays a central role following its relaunch in autumn 2015. Alongside Blau, BASE will use its strength as an online brand. The portfolio is supplemented by further well-known secondary and partner brands.

This line-up puts Telefónica Deutschland in a very good position to benefit from growing data consumption in all customer groups. The market leader among mobile communications providers in terms of customer numbers will continue to flexibly adapt its multi-brand strategy to altered customer needs and market requirements.





- The O<sub>2</sub> brand is the digital companion in the lives of our customers. We use it to inspire, support and enable them to shape their digital lives freely and with confidence. Products and services from O<sub>2</sub> are available via all channels.



- The Blau brand gets to the heart of mobile communication. It mainly appeals to customers looking to enter the digital world easily and at excellent value for money. Like O<sub>2</sub>, Blau is also a multichannel brand.
- BASE is highly digitally literate and is the right brand for all customers who prefer shopping online and are looking for excellent value for money. We therefore position BASE as a focused online brand.
- simyo, Fonic, netzclub, AY YILDIZ and Ortel Mobile are further secondary brands in Telefónica Deutschland's portfolio. They cover additional target groups and ensure that Telefónica Deutschland is also well positioned in the intensely competitive non-premium segment.



- An important mainstay of Telefónica Deutschland is successful partner business. We are active on the market with a great many partner brands, reaching millions of customers via diverse channels and segments. The share of partner business in total revenues is steadily growing.

(Selection of partner brands)



# ***EMPOWER***

We are pursuing a clear strategy for the digital transformation of our company. It empowers us to take the huge opportunities offered by the digital revolution. IP connectivity and data analytics are the essential raw materials of digitalisation and stand at the core of our future business concept. We are constructing a lean and efficient factory for connectivity and data and founding new market units to tap into the attractive growth areas arising from digitalisation. We are distinct here because our customers retain control and sovereignty over their data.

# » ***THE FUTURE IS NOW!*** «

— Thorsten Dirks, Chief Executive Officer  
talks to Employees



Life is becoming increasingly digital. What does that mean for the telecommunications industry?

— Thorsten Dirks: Digitalisation is changing the world forever. It is affecting not only the telecommunications industry, but also the economy and society. We in telecommunications provide the foundation for digitalisation: connectivity, i.e. the networks and interconnection. The social challenges of the future cannot be solved without digital technology. Some examples: In health care, this includes predictive diagnostics and the electronic health record. Mobility will only work with intelligent transport networks and digitally assisted traffic control in the future. We, the telecommunications industry, are enabling this trend, because we are constructing and upgrading the networks it requires. The future is now, and we now have to ensure that we assist humanity on its way to digitalisation.

What role are we, Telefónica Deutschland, playing in this?

— Dirks: The telecommunications industry, and therefore we as Telefónica Deutschland, makes digitalisation possible in the first place. We use our network infrastructure to provide IP connectivity, but this alone will not suffice in the future. We are shaping digitalisation by providing more than just the network capacity. I am thinking beyond the interconnection of people to the interconnection of things – under the catchword "Internet of Things". In five years, there will be many



**» THE TELECOMMUNICATIONS INDUSTRY MAKES DIGITALISATION POSSIBLE IN THE FIRST PLACE. «**

— Lively discussion: CEO Thorsten Dirks (second from left) talks to employees (from left to right) Dirk Volkmann (Network), Janina Merkle (Marketing), Marc Rösler (Customer Service) and Nanne von Hahn (Human Resources).





— How is Telefónica Deutschland positioning itself for the digital future? In this interview, Dirks outlines the company's new strategy.



more connected devices in the world than there are people. And I am also thinking about data analytics, because this kind of analysis gives rise to lots of new insights and business models that we, Telefónica Deutschland, want to use.

#### How do we need to position ourselves for this?

— Dirks: I'll sketch it out (reaches for a napkin, begins to draw ...). Today, we have an essential raw material for digitalisation, namely connectivity. We produce this raw material in a factory, where network and IT cooperate closely. In future, we will add a second raw material, data. Connectivity and data form the core of our business. The data contains insights about the users of our network and how they use it. In the future, we will supply our market units with this data via an interface. We have three traditional market units – the B2C private customer business, the B2B business with corporate clients and the B2P partner business. We are already serving consumers via B2C. Alongside this, we will continue working very closely and intensively with partners in the B2P business. Business customers will become increasingly important in the future. We place particular emphasis on German SMEs here. In addition,

we will establish another two market units to handle the exploitation of data.

#### What are the two new market units we are founding?

— Dirks: The first new market unit is ADA, which stands for Advanced Data Analytics. This unit's task is to analyse the data that comes out of the factory and make the findings available to customers. The second unit we will found will be known as IoT. This stands for Internet of Things. This market unit will deal with solutions for the interconnection of devices, machines and vehicles. In the future, we will not only have self-driving cars and smart houses. We will connect billions of different things, right down to the manhole cover that transmits the current water level on the street. We will establish the two new business units in the next few months.

But aren't customers very sensitive when it comes to their data?

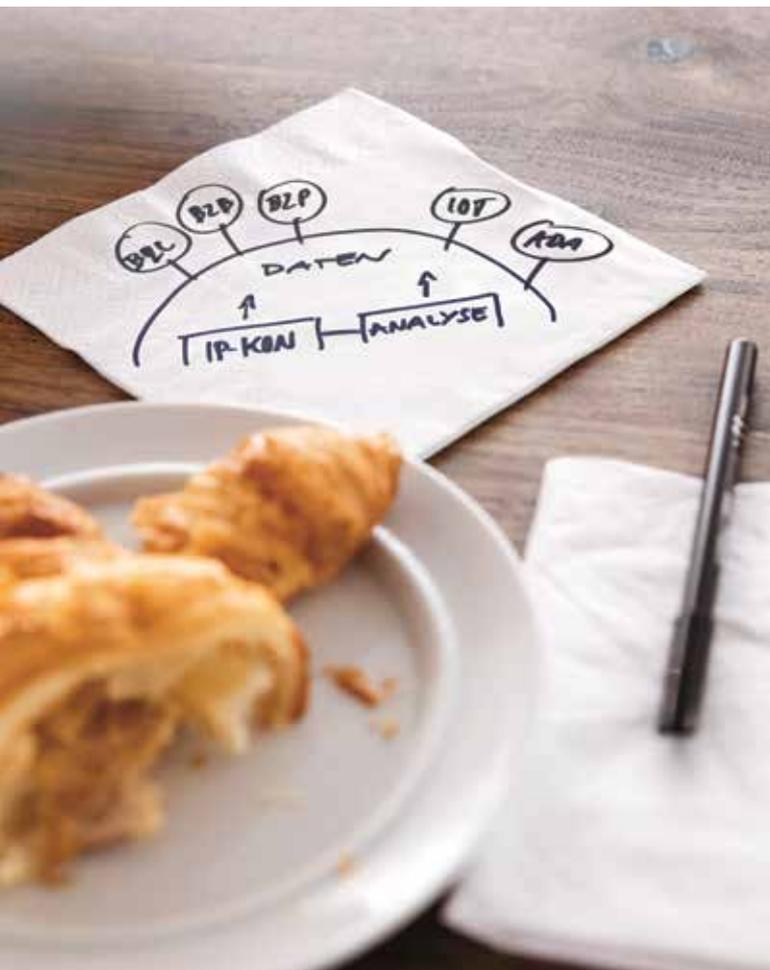
— Dirks: Yes, and rightly so. That is precisely the challenge we have to set ourselves. It is important to our customers that we make it transparent what data we use. It is crucial that we always give customers full control over the use of their data. We at Telefónica are taking a stand to ensure customers retain sovereignty over their data. This sets us apart from the competition. We are one of the first companies to have developed an anonymisation algorithm, which is already enabling us to fully anonymise large quantities of data via a three-step process. This is primarily data on people's movements, which is an important factor in urban planning, for example. We have filed a patent application for this innovative anonymisation procedure. We have encapsulated our promise of transparency and control over personal data in the motto: "We choose it all."

Germany is currently trailing behind in terms of digitalisation. Is that a disadvantage for us?

— Dirks: We shouldn't always just be sceptical in Germany. It is true that we here in Europe and in Germany did not win the first phase of digitalisation, which was primarily about services for consumers,

over the last three to five years. The major platforms from the USA and Asia came out on top here. But if the business customer segment is to become more important now, Germany with its large industrial basis should benefit in particular. Now it is about digitalising our leading industries, in which we are world leaders. We have major opportunities and ideal conditions here. People in the USA and China are already talking about "Industrie 4.0"; there is no English word for it. "Industrie 4.0" is becoming the new "Made in Germany". I am firmly convinced that we can shape the next phase of digitalisation from Germany and Europe. This is a big challenge, which we are taking on as Telefónica Deutschland, and we want to play a leading role in responding to it.

**» WE AT TELEFÓNICA ARE TAKING A STAND TO ENSURE CUSTOMERS RETAIN SOVEREIGNTY OVER THEIR DATA. «**



# WELL CONNECTED IN THE INTERNET OF THINGS\_

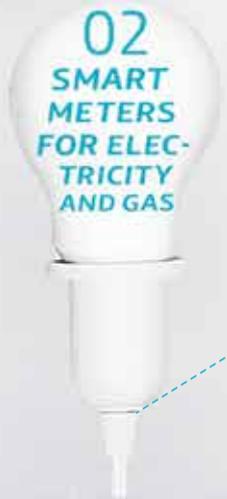
— The digital revolution is encompassing ever more areas of life at a great pace. While the first phase mainly involved digital applications and services for consumers, industrial applications are increasingly coming to the fore in the second phase that is just beginning. Devices, machines and vehicles are being interconnected and communicate with each other automatically. This is known as the “Internet of Things” and is altering value chains and enabling brand-new business models. Telefónica Deutschland is helping to drive this development forward across all industries and, together with partners, offers companies solutions for interconnection in the Internet of Things.

Telefónica Deutschland — 2015

01 MONITORING  
CHILDREN'S  
RIDES REMOTELY



02 SMART  
METERS  
FOR ELEC-  
TRICITY  
AND GAS



03 CONNECTED  
SHOES



04  
AUTOMATIC  
LOGBOOK FOR  
COMPANY CARS





05  
WORKS OF ART  
THAT PROTECT  
THEMSELVES

**01** For many children, a go on a flying carpet or in a Formula 1 car outside a store is a welcome diversion from the shopping trip. The company Kinderplanet operates more than 1,000 of these rides all over Germany. Previously, Kinderplanet only found out if a machine was defective or little-used if the trader informed them. Thanks to an interconnected solution from Telefónica, the company can now monitor the rides in real time.

**02** Interconnected gas, electricity and water meters not only save time and money because they do not have to be read every year, they also enable intelligent control of the energy and water supply. The municipal utility association Trianel has therefore developed a smart metering solution with Telefónica Deutschland that always uses the latest consumption data and guarantees safety against failure. Municipal utilities can thus ensure optimum supply.

**03** Interconnected shoes were previously only available for athletes to measure their distance and speed. The company GTX Corporation has now developed a special shoe insert for people with special needs who often lose their bearings. The inserts are fitted with the Global SIM from Telefónica Deutschland and regularly transmit geodata. In emergencies, carers and relatives can quickly locate the patient and come to their assistance.

**04** Keeping a logbook for a company car is a lot of effort, but often required by tax authorities. In order to make this much easier, Sixt Leasing AG, one of Germany's leading leasing providers, has developed an electronic logbook. The fully automated Sixt logbook is based on the innovative plug-and-play solution from Telefónica and its partner Geotab. Company car users can use an app to very simply document their routes and the reasons for their journeys with a smartphone.



06  
AN EMERGENCY CALL  
THAT SAVES LIVES

**05** Expensive paintings and artworks are usually sensitive and require a stable microclimate so as to not get damaged. To allow museums and owners to keep a constant eye on their collections, ArtGuardian has developed a globally deployable system for monitoring artworks as a Telefónica partner. A small sensor is attached to the artwork that records relevant factors such as temperature, humidity, light intensity and vibrations. In the event of deviation from the target values, an alarm is triggered via the mobile network.

**06** When elderly people are alone and suffer a fall, they are often unable to call for help themselves. This is a dangerous situation, as they are reliant on being found by chance. Until now, the only protection came from stationary home emergency call systems. Telefónica partner Libify has developed a solution called Geocare, which can make the potentially lifesaving emergency call from any location. Therefore, you can not only call for help at the touch of a button, but the system also automatically transmits the coordinates of your whereabouts.



07  
THE SMARTPHONE  
AS REMOTE CONTROL  
FOR YOUR CAR

**07** A new smartphone app lets you control your car's engine-independent heating conveniently from any location. What is special about it is that, unlike traditional remote controls, the solution developed by Telefónica partner digades works regardless of the distance from the vehicle. The driver sets the departure time and desired temperature using the app or via a website. Their car is then preheated at the right time.

# GLOBAL SIM

— Automatic communication between interconnected devices, machines and vehicles is a rapidly growing field. By 2020, there will be four times as many devices connected to the Internet of Things as there are people in the world. The volume of data thus generated and transmitted will advance in dimensions scarcely imaginable today. This is only possible with absolutely stable and efficient IP connectivity. Telefónica makes this reliable inter-connectivity available practically worldwide with the Global SIM.

## 159 COUNTRIES

With the Global SIM, Telefónica guarantees connectivity in nearly all countries of the Earth.

## 550 MOBILE NETWORKS

The Global SIM works in over 550 mobile networks. It automatically registers itself on the strongest available network and thus guarantees the best possible connection even in the most remote regions of the world.

-40° TO  
+105°



Impervious to temperature and humidity fluctuations and resistant to impacts: the Global SIM offers reliable connectivity even under extreme conditions.

10 YEARS



Even without a power supply, the Global SIM saves all data for up to a decade and thus preserves important information for a long-term service.

## STATE-OF-THE-ART ENCRYPTION

The Global SIM automatically encrypts data according to the latest standards and thus guarantees a high degree of security.

## 2 MILLION WRITE AND ERASE CYCLES

A Global SIM can be written to up to two million times. So it remains in working order in the long term.





# **GERMANY ON THE MOVE\_**

— Buses and trains adjust their schedules in real time. Street lights turn off at night when nobody is still out. Car traffic is controlled so intelligently that there are no more jams. What still sounds like a vision of the future today will soon be a reality in smart cities. Many of these innovative solutions require the flow of people's movements to be recorded precisely. Telefónica Deutschland has developed a technique for this, Mobility Insights, which meets the highest data protection standards.

Schildergasse in Cologne is one of the most popular shopping streets in Germany. On some days, more than 14,000 pedestrians stroll past the shops every hour. It is therefore one of the most expensive retail locations in Germany. So far, however, stores and retailers have relied on estimates and rough counts to know how many customers actually pass their window displays. Mobility Insights, a B2B product from Telefónica Deutschland, allows footfall in front of shops and in inner-city locations to be measured precisely. "Retailers can therefore value real estate much better and target advertising more precisely," says Pia von Houwald, Head of Business Development at Telefónica Deutschland.

People's movements are measured on the basis of the mobile signals of the more than 43 million Telefónica Deutschland customers. When a mobile phone moves from one place to the next, it automatically registers with the radio cells along the route. In this way, more than four billion data points are created every day. Before the data is aggregated and analysed, it goes through a sophisticated anonymisation procedure. "As a result, all the data we use is absolutely anonymous. Nothing can be traced back to individual users," von Houwald underlines. To ensure this, Telefónica Deutschland has developed and filed a patent application for its own anonymisation procedure in close coordination with the data protection authorities. In addition, Telefónica Deutschland gives every customer the opportunity to forbid the anonymous

**» AS A RESULT, ALL THE DATA WE USE IS ABSOLUTELY ANONYMOUS. NOTHING CAN BE TRACED BACK TO INDIVIDUAL USERS. «**

— Pia von Houwald,  
Head of Business  
Development at  
Telefónica Deutschland

use of their data or to consent to it again at [www.telefonica.de/dap](http://www.telefonica.de/dap).

On the basis of movement flows, a large number of new solutions and services will be created in the future, which will benefit a lot of people. Cities can use these analyses not only to plan

traffic more accurately, but also to better control pollutant levels at certain highly frequented locations. In public transport, buses and trains can adjust their schedules in real time.

Footfall is also relevant for the advertising industry. One application area is the measurement of advertising impact. For example, Mobility Insights allows a company to measure how many people of a certain age group pass by an advertising poster. With additional analysis methods, the company can also find out how many people of this age group visit the corresponding business. "Our information on people's movements is relevant to businesses from various industries as well as local authorities and public transport operators," says von Houwald. Mobility Insights is an example of how Telefónica Deutschland is tapping into new strategic business areas by making responsible use of the potential of intelligent data analysis with full transparency and freedom of choice for customers.



# WE CHOOSE IT ALL\_

Telefónica Deutschland — 2015

— Under the catchword “Big Data”, a debate of extremes has raged from the outset: while one side sees a golden age of knowledge and eternal youth drawing near, the other fears absolute surveillance by the state and businesses. But such polarisation gets us nowhere. In view of the upcoming challenges, we need to bring the discussion back down to earth and ask ourselves what advantages can be gained by analysing large volumes of data in the foreseeable future? And how can we ensure that people can retain sovereignty over their data and make confident decisions? An essay by Thorsten Dirks, CEO of Telefónica Deutschland, about free choice in a digital world.



**T**oday's world is a universe of information. If you wanted to express it mathematically, you would get a number with 21 zeros: there are currently over eight zettabytes of available information in the world. And we all make our own contribution to increasing this number every day. These days, more data is produced around the world in five days than in the previous 2,000 years of human history.

A realistic view of the potential of the new data economy requires a look at the considerable social and economic benefits that can be gained by collecting and analysing large volumes of data. Big Data is the person with a heart condition, who deliberately decides to have their body medically monitored around the clock, for that is the only way to ensure the best possible health care. Big Data is the use of networked technologies at home, which can reduce energy consumption and increase convenience. Not least, Big Data is intelligent city and traffic planning based on the current movement patterns of hundreds of thousands of people in a region. It results in fewer traffic jams, faster journeys for commuters and above all in lower consumption of resources

There are many other examples that bring major social and economic benefits. It is by no means the sheer volume of data that gives rise to such potential, but rather the abilities we have developed to combine data, analyse it in context and draw conclusions from the results. In technical jargon, this is known as data science. In medicine, for example, this entails insights of inestimable value. Knowledge about individual health indicators in conjunction with data on lifestyle habits results in a very reliable prediction of whether a person will contract diabetes in the future. On this basis, prevention programmes can be started in turn. Data, there can be no doubt, is the most important raw material of the 21st century. Its refinement creates extensive benefits.

Do we really want to forgo these benefits in the future? I am firmly convinced that this would be a big mistake. "Those who are too afraid will not take a share in much of the value created in the future," said German Chancellor Dr Angela Merkel recently with regard to Big Data. You can only agree with that. But it is not just about the economy; it is also about social benefits. Not even critics deny that the systematic analysis of large data volumes entails tremendous opportunities.

However, we should take sceptics' concerns seriously and provide answers. They are not only worried about giving up all privacy and individuality of any kind. Some also anticipate a consumer world controlled by global corporations through subtle manipulation.

My response to these concerns is simple: in a free society, every one of us should be able to decide at any time what happens with our data. In order to enable this free choice, companies must consent to grant individuals full transparency regarding their data and its use. And they must grant the right to deny the use of their data. This is the only way to inspire the acceptance needed to make use of the opportunities of Big Data for society and the economy. At the same time, we will protect and strengthen individual freedom.

This is the self-determination of the digital age and the heart of our philosophy. Telefónica Deutschland is using advanced data analytics to develop its own solutions for the analysis of large volumes of data and to make the findings available to the market. As the largest mobile communications provider in Germany with more than 43 million customers, we offer more than just data-based connectivity. We too want to use the raw material of data because we believe we can thus create added value for our customers and for society.

However, our approach is radically different to that of the large Internet platforms. Their business model is to offer their services supposedly for free. But the fact is all of us are secretly made to pay. The currency is our personal data. And we have no, or very limited, authority to make decisions about our data.

Telefónica Deutschland is deliberately taking a different path. For example, we have developed our own anonymisation procedure in close cooperation with the data protection authorities. When analysing large volumes of data, we thus ensure that nothing can be traced back to individual users. Above all, we ensure that our customers retain sovereignty over their data and let them decide whether, and to what extent, they consent to its use. They can weigh up their personal preferences with the benefit that their data creates for the economy and society. We therefore work to ensure that they remain the masters of their own digital lives.

"We choose it all." This is our motto for a reason. Everyone must be able to decide how much and what they will disclose about themselves. This is the only way to enable a self-determined digital life. Telefónica Deutschland stands for this free choice.

# DIGITAL MASTERMINDS

Telefónica Deutschland is not only shaping the digital transformation as a company, but is also leading the public debate about the future of the digital world and social coexistence. The Telefónica BASECAMP in the heart of Berlin is a central point for the debate on digitalisation. Week by week, events take place here that grap-

ple with various aspects of digitalisation. Digital multipliers, entrepreneurs, consumers, politicians and academics discuss the trends, opportunities and challenges of digitalisation. As part of the "Digital Masterminds" events series last year, we played host to renowned advocates, pioneers and critics of digitalisation.

»  
**DIGITAL  
TECHNOLOGY  
IS PART OF THE  
WORLD ITSELF.  
THERE IS NO  
PARALLEL WORLD.**  
«



**JARED COHEN**

Director of Google Ideas and co-author of the book *The New Digital Age*, a guest of Digital Masterminds on 10 November 2015

»  
**WE HAVE TO  
ASK OURSELVES  
"WHAT WORLD  
DO WE WANT?"  
I FEAR WE ARE  
SLEEPWALKING  
INTO A WORLD  
MOST PEOPLE  
DO NOT  
UNDERSTAND.**  
«



**ANDREW KEEN**

British-American author, speaker and entrepreneur, a guest of Digital Masterminds on 8 April 2015

»  
**ONLY OPEN  
SYSTEMS GIVE  
RISE TO TRULY  
INNOVATIVE  
IDEAS THAT ARE  
GOOD FOR  
THE MAJORITY  
OF PEOPLE.**  
«



**MITCHELL BAKER**

Executive Chairwoman of the Mozilla Foundation, a guest of Digital Masterminds on 13 July 2015

»  
**SWARM  
INTELLIGENCE  
FALLS DOWN  
WHEN PEOPLE  
LOSE THEIR  
INDIVIDUALITY.**  
«



**JARON LANIER**

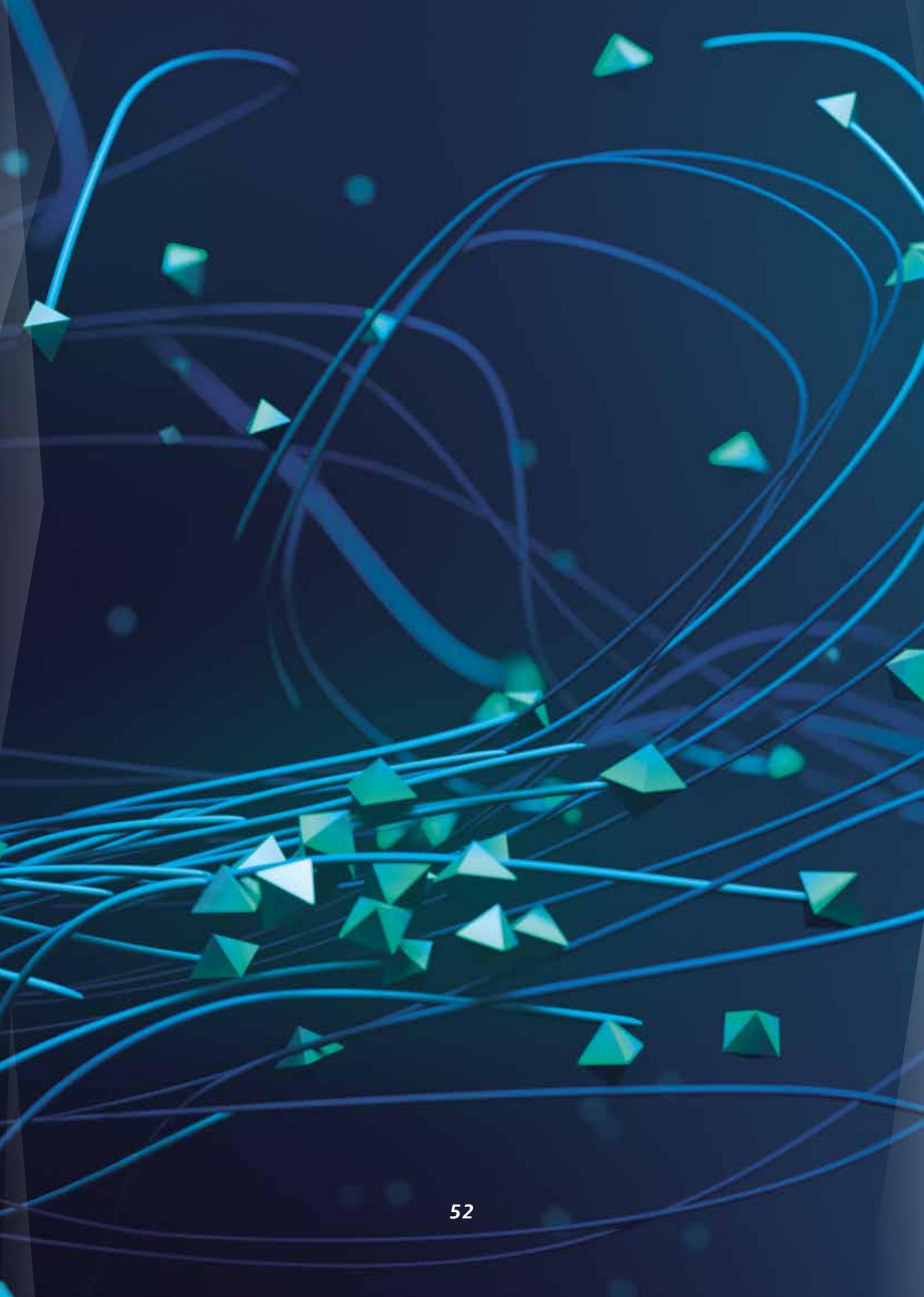
Internet pioneer, best-selling author and in 2014 holder of the Peace Prize of the German Book Trade, a guest of Digital Masterminds on 9 June 2015

# **ENHANCE ENABLE EMPOWER**

Telefónica Deutschland is well on its way to becoming the Leading Digital Telco in Germany. In the first integration year after the merger, we have already enhanced our business performance by means of a rational commercial strategy and the successful execution of important synergy milestones in the merger process. The introduction of UMTS national roaming and fast LTE deployment has helped us improve customer experience significantly and brought us a step closer to our goal of combining a state-of-the-art network with an attractive multi-brand product portfolio in all market segments.

At the same time, we continue to push ahead with the digital transformation of the company, so as to enable superior customer experience now and in the future. IP connectivity and data analytics stand at the core of our new business concept, as essential raw materials which form both the foundation and the framework for our customer relationships. IP connectivity is already equivalent to access in a connected world where data usage continues to grow exponentially. The arising Internet of Things and advanced data analytics will provide impulses which will empower us to capture the essence of customer and societal needs in the digital age.

As such, Telefónica Deutschland has a unique business model with a clear focus on creating a lean and efficient connectivity and data powerhouse, with the capabilities to react quickly to the demands of the ever-changing and continuously innovating telecommunications landscape. Not only will we thus optimally serve our customers, but we will also create added value for our shareholders. In the following pages we specifically address the interests of our shareholder community and explain the investment case of Telefónica Deutschland to all those who would like to actively partake in our future.





*OUR*  
**SHARE**

# DEAR SHAREHOLDERS OF TELEFÓNICA DEUTSCHLAND, LADIES AND GENTLEMEN,

With the first full financial year after the merger with E-Plus behind us, we have now fully embraced our new role as German mobile market leader. Our excellent operational and financial results reflect our focus on three strategic pillars: firstly momentum, which stands for our determination to drive our day-to-day business; secondly integration, or delivery on our synergy targets, and last but not least, transformation, i.e. the streamlining and digitalisation of our business operations.

**» WE HAVE NOW FULLY EMBRACED OUR NEW ROLE AS GERMAN MOBILE MARKET LEADER. «**

financial results reflect our focus on three strategic pillars: firstly momentum, which stands for our determination to drive our day-to-day business; secondly integration, or delivery on our synergy targets, and last but not least, transformation, i.e. the streamlining and digitalisation of our business operations.

We have taken major steps in the direction of accomplishing all three goals in 2015. They will continue to shape our business in 2016 and beyond, as

we are keeping a close eye on meeting customer needs in the digital age as well as generating attractive returns for our shareholders.

The mobile market was dynamic throughout the year; with our balanced yet active approach, we were able to maintain momentum both in the premium and non-premium segments. We have benefitted from strong dynamics in the partner business, in particular after the start of the MBA MVNO agreement with Drillisch in July 2015. Mobile service revenues (MSR) came in broadly stable year on year at +0.1%.

We have also made significant progress in terms of the integration of the two business entities. We achieved important milestones and were able to bring integration activities forward from 2016 into 2015. At the same time, we have started significant simplification processes. Together with our clear focus on optimising commercial costs this resulted in OIBDA<sup>1</sup> growth of 20.5% year on year in 2015.

**» WE HAVE ALSO MADE SIGNIFICANT PROGRESS IN TERMS OF THE INTEGRATION OF THE TWO BUSINESS ENTITIES. «**

Moreover, network quality improved dramatically for our customers over the course of 2015, as a result of 3G national roaming and the ongoing LTE network roll-out; the successful conclusion of the multi-band spectrum auction in June 2015 also helped secure our spectrum set-up for the future. Despite the ongoing network investments, we were able to reduce CapEx<sup>2</sup> by 11.1%.



— Thorsten Dirks, CEO,  
Telefónica Deutschland

— Rachel Empey, CFO,  
Telefónica Deutschland

— Markus Haas, COO,  
Telefónica Deutschland

**» WE ARE CLEARLY ON TRACK TO BECOMING GERMANY'S LEADING DIGITAL TELCO. «**

On behalf of the entire management team we would like to thank all our employees for their hard work and dedication throughout the year, which has been instrumental in achieving the above.

As a result, we are clearly on track to becoming Germany's Leading Digital Telco. We are going to build on the strong foundation that we laid in 2015. The future starts now! And it is all about digitalisation. Our lives and work habits are changing fast as a result of digitalisation; thus the volume of data transported across our network every day is ever-increasing.

Telefónica Deutschland is well positioned to partake in, and benefit from, this development because we own the raw materials: IP connectivity and data analytics. They will be at the heart of our future business both in terms of ensuring access for our customers and in terms of generating new ideas and solutions to complement existing consumer, business and partner operations.

Finally, we would like to thank our shareholders for the trust they have placed in us. We remain committed to our strategic and financial goals. As such, our decision to propose a stable dividend of EUR 0.24/share in the first integration year, while at the same time ensuring financial flexibility, is a reflection of our commitment to shareholder remuneration.

Yours sincerely,



—  
Thorsten Dirks



—  
Rachel Empey



—  
Markus Haas

1 OIBDA after group fees but before exceptionals.

2 Excluding investments for licenses in mobile phone frequency usage rights.

# GOOD REASONS TO INVEST IN TELEFÓNICA DEUTSCHLAND\_

1.

## GERMANY:

An attractive and dynamic  
telecoms market

2.

## FROM CHALLENGER TO ESTABLISHED PLAYER:

Shaping the digital transformation for an  
exceptional customer experience

3.

## UNIQUE BUSINESS MODEL:

Lean and efficient operations  
to drive growth in profitability and  
free cash flow

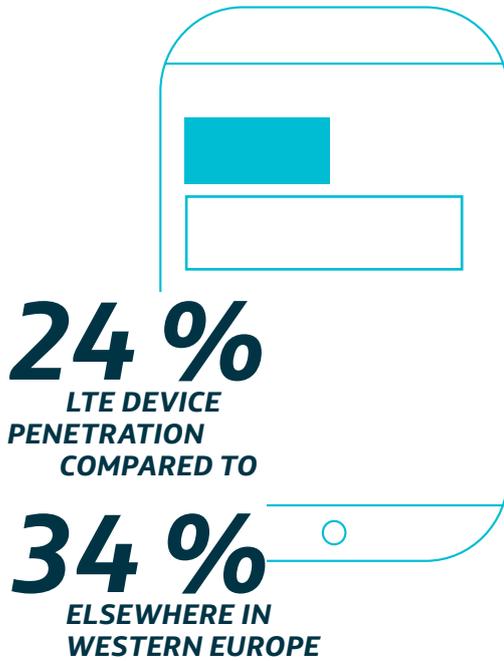
4.

## VALUE PROPOSITION:

Attractive shareholder return and  
financial flexibility  
on strong fundamentals

# 1.

## **GERMANY: AN ATTRACTIVE AND DYNAMIC TELECOMS MARKET**



Since the market consolidation from four to three mobile network operators in 2014, the German market has become one of the most attractive markets in Europe, with relatively stable pricing and a gradual easing of promotional activity. Mobile network operators have generally focused on creating rational, segmented tariff and device portfolios to monetise growing data usage. In terms of its potential for data growth, the German market is still a European laggard, with only 24% LTE device penetration compared to 34% elsewhere in Western Europe. As a result, we believe that it is likely to outperform in the coming years in terms of its data growth trajectory, thus providing a significant opportunity for data monetisation in the German telecoms space.

While dynamics in the premium segment continue to be benign, the non-premium end of the market has seen increased competition in the latter half of 2015 especially among mobile virtual network operators, partially as a result of the remedies. This shift towards wholesale is currently weighing on the mobile service revenues of the established operators. However, with average data usage on smart devices already surpassing 1 GB in 2015, we expect the growing data demand of the German consumer to drive a return to mobile service revenue growth in the mid-term.

In terms of the fixed-line environment, the German market remains a “soft” convergent market with only moderate discounts for customers who choose fixed and mobile products from one operator. This positively differentiates it from other European markets where convergent discounting has eroded value over time.

# 2.

## **FROM CHALLENGER TO ESTABLISHED PLAYER: SHAPING THE DIGITAL TRANS- FORMATION FOR AN EXCEPTIONAL CUSTOMER EXPERIENCE**

Having become the largest German mobile telco player in terms of subscriber base as a result of the acquisition of E-Plus, Telefónica Deutschland intends to lead the market in terms of a rational commercial approach with a focus on customer retention and the further development of our customer base. While we depend on the market environment for the continued viability of this strategy, the significant increase in our profitability this year stands testament to the appropriateness of such a strategy in a saturated market.

We will also continue to position ourselves as a multi-brand player for premium and non-premium customers into the future. On the premium side, we will develop our premium brand O<sub>2</sub> into a lifetime proposition with a focus on excellent network and customer service quality and an outstanding multi-channel experience for our customers. At the same time, we will continue to leverage our strong partnerships and multiple distribution channels at the non-premium end of the market.

Across all segments we intend to capture the mobile data opportunity through up- and cross-selling mechanisms and a focus on digitalising customer relationships. This will, for example, include a shift from indirect to direct channels with new experience stores and a new customer service concept so as to improve customer experience and, at the same time, significantly reduce customer service costs. We also intend to employ superior data analytics for smart network deployment and targeted marketing especially via our online channels. In this way, we will redeploy the best of our legacy in combination with cutting-edge digital

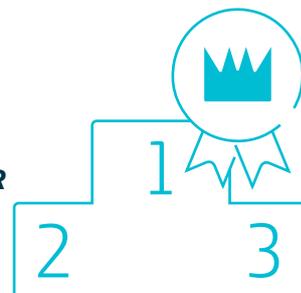
insights to improve customer experience and streamline our operations.

Parallel to this, we will continue to actively monitor and participate in opportunities in the OTT space as well as in TV and fixed broadband via key partnerships. Our current cooperation with Napster, Sixt, Apple and Amazon for music streaming, M2M, e-billing and distribution are cases in point.

Besides our core retail and partner business, we also intend to further develop our offering in the business and SME space, where we now have the scale to compete more effectively with an enlarged sales force and our competitive and unique product O<sub>2</sub> Unite.

In terms of our fixed-line offering, we will continue to leverage our wholesale partnership with Deutsche Telekom to offer converged services.

**NO. 1**  
**MOBILE**  
**TELCO PLAYER**  
**IN TERMS OF**  
**SUBSCRIBER**  
**BASE**



# 3.

## **UNIQUE BUSINESS MODEL: OPERATIONS TO DRIVE GROWTH IN PROFITABILITY AND FREE CASH FLOW**

**75 %** **LTE**  
**LTE COVERAGE  
IN GERMANY**



The integration of the Telefónica Deutschland Group and the E-Plus Group presents a unique opportunity to transform the company into the Leading Digital Telco in Germany – both in terms of its commercial positioning and its operational efficiency. By year five, we expect to generate EUR 800 million in operating cash flow synergies, 35 % of which were already achieved in 2015. Successful initiatives included the first wave of the leaver programme, the optimisation of the shop footprint, facilities and external staff as well as simplification projects and the elimination of duplications in various business areas.

In terms of network, the legacy infrastructure of Telefónica Deutschland and E-Plus as well as the spectrum acquired in the multiband auction in June 2015 provide a powerful framework. The availability of 3G national roaming as of April 2015 has already resulted in a significant improvement in customer network perception as well as increased data usage, which is particularly relevant given that around two-thirds of traffic in Germany is still carried over 3G. However, we also continue to push ahead with the LTE roll-out, with coverage reaching 75 % at year-end 2015. Over the five years of the integration

process, we target the reduction of 14,000 network sites to achieve a “golden grid”, which will enable us to compete with our competition on an equal footing in terms of coverage, capacity and efficiency.

The year 2016 will be a transformative year not only in terms of network but also with regard to other operational milestones, such as the optimisation of our brand portfolio and related customer migration, which require the rethinking of our IT systems landscape. We view this phase with a challenger mentality, which enables us to review each process in turn. As in 2015 we will focus on maintaining market momentum, while at the same time using this opportunity to rationalise and digitalise our operating model end to end.

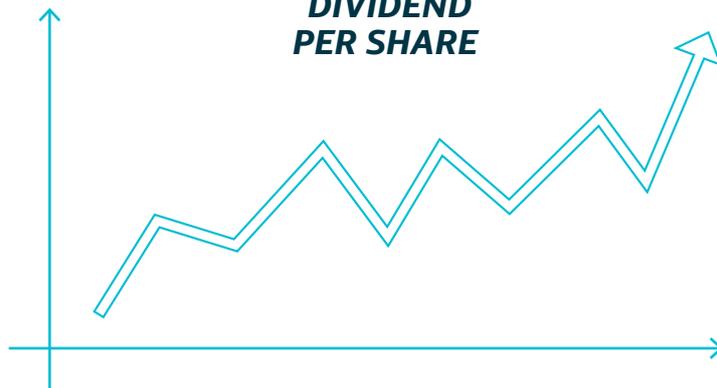
In this process, we view IP connectivity and data analytics as the commodities of our core business, which we must leverage in order to generate value and partake in new strategic opportunities offered by, for example, the rise of data analytics and the Internet of Things. In the coming years, Telefónica Deutschland will invest significant time and effort into building up our capacities in the areas of connectivity and data, in order to drive our positioning in the digital ecosystems of the future, while at the same time protecting customer privacy and ensuring that customers retain ownership of their data.

# 4.

## **VALUE PROPOSITION: ATTRACTIVE SHAREHOLDER RETURN AND FINANCIAL FLEXIBILITY ON STRONG FUNDAMENTALS**

**€ 0.24**

**DIVIDEND  
PER SHARE**



Telefónica Deutschland offers its shareholders a unique combination of attributes. As a mobile-centric operator and the only German pure-play, we are also the obvious beneficiary from the German 4:3 consolidation. We have a strong multi-brand proposition across post-paid and prepaid, with a strong presence in the growing wholesale segment of the market. Over the five-year synergy process, the company also offers a clear path to profitability and free cash flow generation, with market expectations indicating the potential for a five-fold increase in operating cash flow (OIBDA minus CapEx) during that period.

In terms of dividend policy, the company is committed to a high payout ratio in relation to free cash flow, taking into account future cash flows from synergies when making dividend decisions during the integration process. For 2015, management intends to propose a stable dividend of EUR 0.24/share to the next Annual General Meeting on 19 May 2016. This policy is intended to ensure financial flexibility and a strong equity-debt balance, while at the same time supporting a compelling total shareholder return.

# HIGHLIGHTS FINANCIAL YEAR 2015

At the end of December 2015, Telefónica Deutschland had 48.4 million customer access, up 1.5% year on year on the back of the strong growth (+2.2%) of mobile accesses both in pre-paid and in post-paid.

As expected, mobile service revenues remained broadly stable year on year at +0.1%. This is a reflection of our continued focus on customer retention and customer base development as well as a strong performance of the partner business.

The significant increase of OIBDA<sup>2</sup> in 2015 is mainly the result of the accelerated capture of synergies, as we were able to bring forward major integration initiatives from 2016 into 2015. These resulted in operating cash flow (OIBDA minus CapEx) savings of EUR 280 million. In addition, the development of commercial costs benefitted from our focus on customer base development.

## MOBILE SERVICE REVENUES

(euros in millions)

+0.1 %



## OIBDA/OIBDA MARGIN<sup>2</sup>

(euros in millions)

+20.5 %



## MOBILE ACCESSES

(in thousand)

+2.2 %



## SUMMARY: FINANCIAL OUTLOOK 2016

| Baseline 2015   | Outlook 2016 (year-on-year)  |
|---|--|
| MSR:<br><b>€ 5,532 Mill.</b>                              | MSR:<br><b>Slightly negative to broadly stable</b>                           |
| OIBDA before exceptional effects:<br><b>€ 1,760 Mill.</b> | OIBDA before exceptional effects:<br><b>Low to mid-single-digit % growth</b> |
| CapEx excluding spectrum:<br><b>€ 1,032 Mill.</b>         | CapEx excluding spectrum:<br><b>% growth in the low tens</b>                 |

- 1 Combined figures for 2014 are approximate and the result of the aggregation and then consolidation of Telefónica Deutschland and E-Plus Group financials according to Telefónica Deutschland Group accounting policies. The combined figures are further adjusted by exceptional effects, such as capital gains or restructuring costs based on estimates made by Telefónica Deutschland management and resulting in combined figures we believe are more meaningful as a comparable basis.
- 2 Before exceptional effects.



# INVESTOR RELATIONS

The year 2015 was the first full financial year after the closure of the acquisition of the E-Plus Group by the Telefónica Deutschland Group. We successfully completed a number of significant integration milestones and delivered on our financial and strategic targets for the full year 2015. As of year-end, we are well positioned and on track to become the Leading Digital Telco in the German market.

As Investor Relations, we endeavour to provide fast, effective and consistent communication between the company, the financial community and other stakeholders, in order to allow interested parties to follow our progress. Our primary operating objective is to proactively inform and communicate with investors and to thus enable them to make realistic assumptions about the fair relative valuation of the company.

## 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  | Telecommunications             |

## ECONOMIC AND CAPITAL MARKET ENVIRONMENT

In a difficult global economic environment the German economy proved resilient and showed robust GDP growth of +1.7%, driven by strong domestic demand and continued high consumer confidence.

Capital markets rose until April when the Greek debt crisis and a potential "Grexit" renewed investor uncertainty and resulted in a period of prolonged volatility. A short rally after the conclusion of a bailout agreement in early July was ended by the stock market crash in China and growing concerns about an impending interest rate hike in the US. The ensuing global market slump lasted until the end of September. Thereafter, European shares returned to strength supported by the expectation of ECB stimulus coupled with optimism that the global economy could withstand higher US interest rates. In early December, markets took another turn for the worse when the ECB announced stimulus measures that fell short of market expectations while the Fed decided to increase interest rates for the first time in a decade. The Stoxx 600 closed the year up 6.8% compared to the DAX at +9.6%, as the latter was negatively affected by the emerging market exposure of German exporters throughout the year.

### CLOSING PRICE

|  | 2014               | 2015                        |
|--|--------------------|-----------------------------|
| <b>XETRA closing prices</b>              |                    |                             |
| 31 December                              | EUR 4.414          | EUR 4.891                   |
| Performance                              | -6.98%             | +10.81%                     |
| Year high                                | EUR 5.037          | EUR 5.856                   |
| Year low                                 | EUR 3.577          | EUR 4.352                   |
| <b>Trading volumes</b>                   |                    |                             |
| Average daily trading                    | 2,057,757          | 2,135,501                   |
| Number of shares outstanding 31 December | 2,974,554,993      | 2,974,554,993               |
| Market cap at 31 December                | 12,129,685,739     | 14,548,548,471              |
| Weight on TecDAX                         | 6.75%              | 7.79%                       |
| <b>Dividend</b>                          | EUR 0.24 per share | EUR 0.24 per share proposed |

### SHARE PRICE PERFORMANCE 2015

1 January to 31 December, rebased



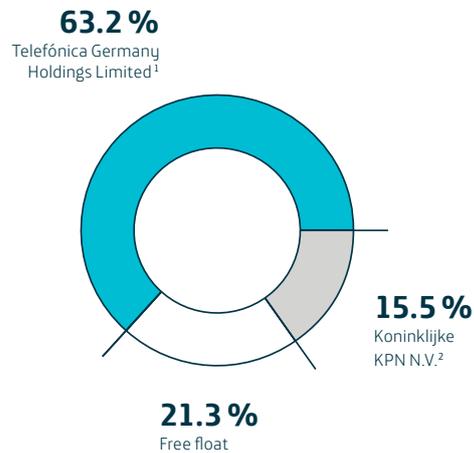
The telecommunications sector performed well until the end of August amidst improved earnings momentum and M&A speculation, when it pulled back together with wider markets. It never quite recovered to summer highs in the latter half of the year, but still closed 2015 ahead with +8.5%.

The Telefónica Deutschland share started 2015 with an intra-day low of EUR 4.303 and reached an intra-day high of EUR 5.994 at the end of October. By and large, the share performed in line with the wider market and the sector in the first half of the year, but showed resilience to the slump in September and outperformed into Q3 preliminary results, which were released on 5 November 2015.

On 8 November 2015, KPN went to market with a quarter of its total stake of 20.5% in Telefónica Deutschland in an accelerated book-building process, selling 150 million shares at a price of EUR 5.37 per share. The transaction increased the free float of Telefónica Deutschland to 21.3%, thus improving the liquidity of the share and increasing its weight in the TecDAX from 6.75% to 7.79%.

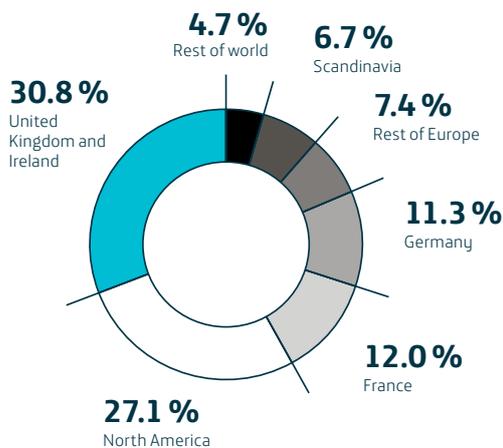
In line with markets O2D reversed parts of its earlier gains towards the end of the year. The share ended the year up 10.81% at EUR 4.891, thereby outperforming the wider market, the DAX and the sector.

## SHAREHOLDER STRUCTURE



- 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 these shares directly.

## GEOGRAPHICAL DISTRIBUTION OF FREE FLOAT



## SHAREHOLDER REMUNERATION

Telefónica Deutschland aims to 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, the company places great emphasis on financial flexibility and a conservative financing policy. Currently, this policy includes a target leverage ratio of at or below 1.0x.

On 5 November 2015, the Management Board of Telefónica Deutschland announced its intention to propose a cash dividend of EUR 0.24 per share to the next Annual General Meeting, which is scheduled for 19 May 2016.

## INVESTOR RELATIONS ACTIVITIES

Telefónica Deutschland Investor Relations activities are aimed at facilitating a close dialogue between the company and the financial community, including retail and institutional investors as well as financial analysts. In 2015, the Management Board and IR team represented Telefónica Deutschland at more than 450 individual and group meetings, including results conference calls, roadshows and conferences in Europe and North America. Altogether, the team spent nine weeks of the year on the road.

Investor Relations Director Victor Garcia-Aranda returned to Spain and handed over the lead to Veronika Bunk-Sanderson, who joined Telefónica Deutschland from Telekom Austria Group in Vienna in September 2015.

For further information related with the company or the Telefónica Deutschland share, please see our contact information on page 68.



—Thorsten Dirks, CEO of Telefónica Deutschland, at the Annual General Meeting 2015

1 Net debt/OIBDA after group fees but before exceptionals.

### TELEFÓNICA DEUTSCHLAND GROUP 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 |

Telefónica Deutschland has a long-term issuer credit rating by rating agency Fitch, which is subject to regular evaluation. On 21 December 2015, the agency confirmed the BBB rating with a stable outlook.



# **FINANCIAL CALENDAR**

## **2016**

(All dates preliminary and subject to change.)

**25 February**

Q4 2015 – Preliminary results

**28 April**

Q1 2016 – Preliminary results

**19 May**

Annual General Meeting

**28 July**

Q2 2016 – Preliminary results

**27 October**

Q3 2016 – Preliminary results



# **CONTACT**

**TELEFÓNICA DEUTSCHLAND GROUP**  
**INVESTOR RELATIONS**

**Telephone**

+49 (0)89 2442 1010

**E-mail**

Institutional investors: [ir-deutschland@telefonica.com](mailto:ir-deutschland@telefonica.com)  
Private investors: [shareholder-deutschland@telefonica.com](mailto:shareholder-deutschland@telefonica.com)

**Web**

[www.telefonica.de/investor-relations](http://www.telefonica.de/investor-relations)

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Georg-Brauchle-Ring 23–25  
80992 Munich  
Tel. +49 89 2442 0  
www.telefonica.de

#### **RESPONSIBLE FOR CONTENT**

Peter Mentner,  
Director Communications & Public Relations

#### **PROJECT MANAGEMENT**

Tina Hoffmann, Head of Group  
Communications Strategy & Management  
Stefanie Seidlitz, Project Manager Communications

#### **CONCEPT AND DESIGN**

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Telefónica Deutschland Holding AG  
Georg-Brauchle-Ring 23–25  
80992 Munich, Germany  
Tel. +49 89 2442 0  
[www.telefonica.de](http://www.telefonica.de)

Telefónica Deutschland  
Annual Report

2 0 1 5



**SHAPING  
THE LEADING  
DIGITAL  
TELCO**

*Telefónica*

Deutschland

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Combined  
Management  
Report\_

for the financial year 2015

# A

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# Basic Information on the Group

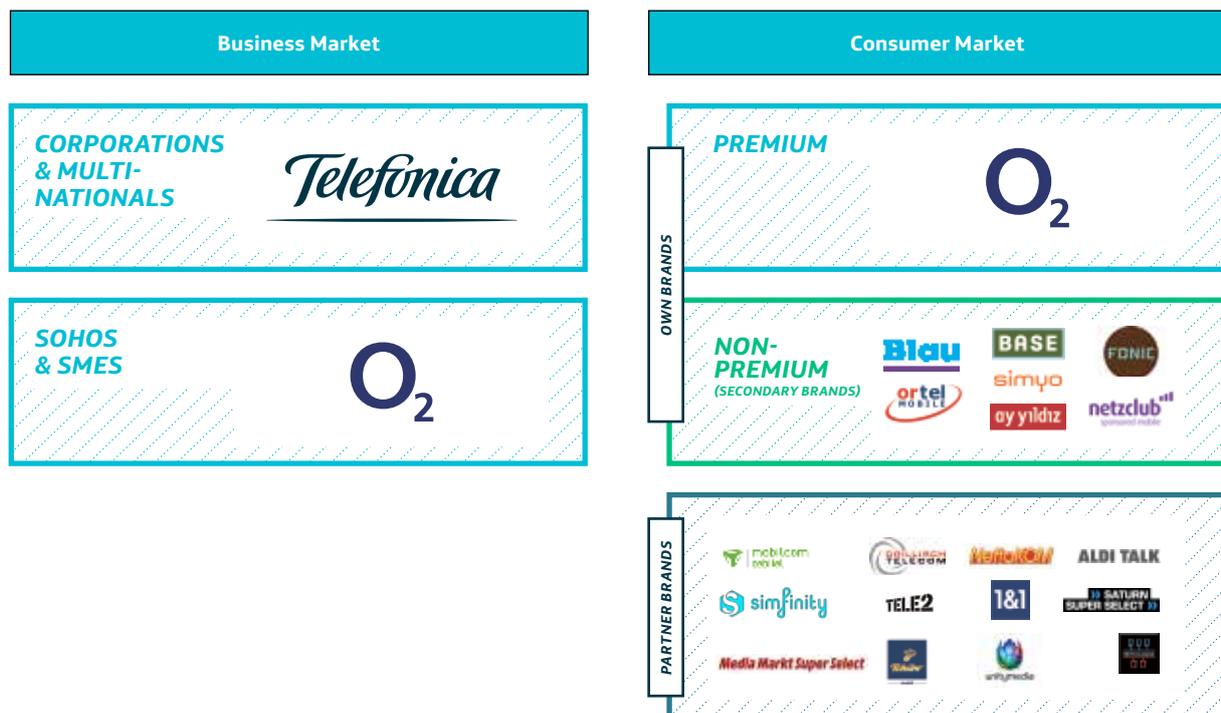
## Business activity

*Telefónica Deutschland Group is one of the leading integrated operator in Germany./We successfully approach all market areas with a multi-brand strategy./Telefónica Deutschland 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.*

With more than 48 million customer accesses as of 31 December 2015, 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 43 million mobile customer accesses as of 31 December 2015. We are a part of Telefónica, S.A. Group, one of the biggest telecommunications companies in the world.

## Our brands: covering all market areas & needs

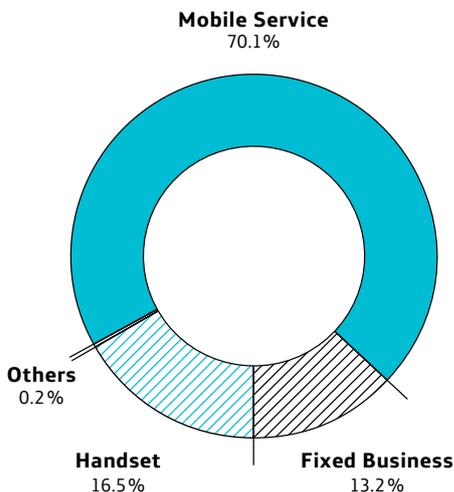
### G01 — Our brands



Our marketing and sales approach follows a consequent and focused multi-brand strategy in order to address a broad range of customer types with our products and services. We offer the majority of our mobile communications products in the postpaid customer market via our brands O<sub>2</sub> and BASE. Fixed communication products and bundles are offered via our premium brand O<sub>2</sub>. We continually strive for an improvement of the market positioning of our premium brand, particularly in order to gain high value customers in the consumer and the business market areas. Large international businesses are addressed through the Telefónica brand.

With our secondary and partner brands and through our wholesale channels, we reach further groups of customers that we do not target with our O<sub>2</sub> brand. Our secondary brands include Blau, BASE, simyo, Fonic, netzclub, AY YILDIZ and Ortel Mobile. We also count on brands from joint operations and strategic partnerships such as TCHIBO mobil. Our multi-brand approach enables us to address a broad spectrum of customers and to maximise and also efficiently control our sales range with customised product offerings, sales and marketing.

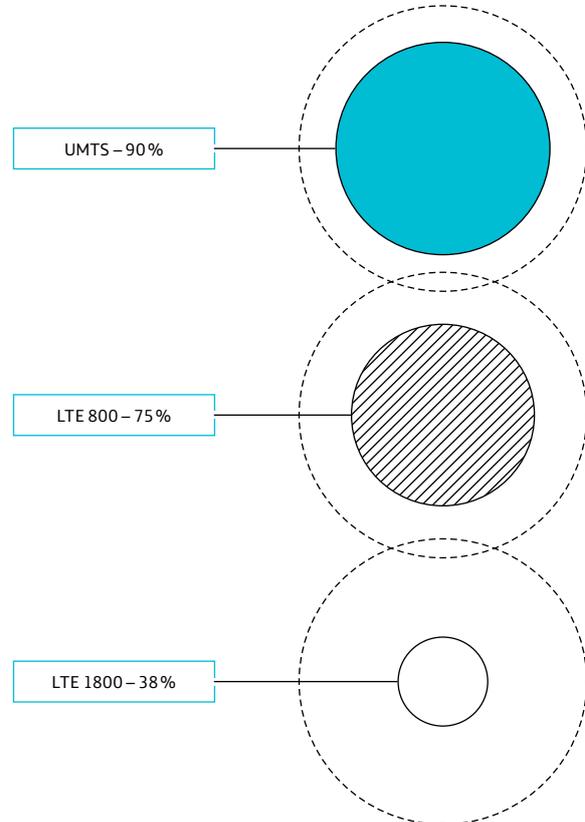
## G02 — Revenue Structure FY 2015



### Mobile Business 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 in urban and suburban areas thanks to, among other things, the densest UMTS network in Germany. We are rapidly improving in rural areas especially driven by the deployment of our LTE network. In 2015, the mobile business has been the main revenue stream for Telefónica Deutschland Group with EUR 5,532 million (70.1% over total).

## G03 — Network Coverage



The combined UMTS network infrastructure now reaches around 90% of the population in Germany. Our customers benefit from the combined strength of the O<sub>2</sub> and E-Plus network and can make use of even better mobile data applications.

In order to improve the network experience beyond using mobile data on UMTS, Telefónica Deutschland Group is also constantly driving forward the expansion of its LTE network. By the end of 2015, the company achieved a nationwide LTE coverage rate of approximately 75%.

### Fixed Business: Future proof infrastructure & full service offers

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 fixed infrastructure, currently covering over 22 million households with high-speed VDSL internet access.

In addition, Telefónica Deutschland Group benefits from all future network improvements such as an increase in VDSL coverage and higher speeds based on 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<sub>2</sub> 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 twelve 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, which represent 78 % of mobile phones sold to our O<sub>2</sub> postpaid consumer customers during 2015. This share is constantly increasing. 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.

To complete our propositions around smartphones, we have increased our portfolio with additional services and products such as smartphone insurance services, antivirus protection or state-of-the-art complements such as the latest digital lifestyle devices (e.g. smartwatches or TV extenders), protection cases or selfie sticks.

#### **Our Market Areas**

We continually strive for an improvement of the market positioning of our premium brand, 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 platform. This includes direct sales channels such as our own shops, a nationwide network of independently operated franchise and premium partner shops, online and telesales plus indirect sales channels such as partnerships and cooperations with retailers (physical or online channels).

#### **Value Management & Sustain Leadership in Consumer Retail**

The O<sub>2</sub> brand is market leader in the consumer postpaid market according to accesses in Germany. As a forerunner in

the German market, our strategic focus has been on the sale of data-centric mobile telecommunications contracts to smartphone users. On the back of their use of mobile data services, together with an increasing interest in the new mobile communications standard LTE, 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. As such, we also offer special prepaid tariffs for smartphone users.

A relevant market trend are digital applications that make our customers' lives easier and more secure in many areas. We enable our customers to handle important elements of every day life via their mobile phones, such as mobile paying, music and video streaming, playing games, monitoring the condition and location of their cars or controlling power usage in their homes.

#### **Business Customer: Focus on small and medium-sized enterprises (SMEs)**

We address SMEs as well as small office/home office (SoHo) through our premium brand O<sub>2</sub>, for example with our innovative product “O<sub>2</sub> Unite”. “O<sub>2</sub> Unite” offers our customers a drastic cost reduction by pooling SMS, minutes and data for all employees of a company.

Another example meeting 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 (low infrastructure requirements, flat rates 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 2015, we have optimized our product portfolio and organisation accordingly. As a result, in the last quarter of the financial year 2015 we have experienced slight revenue growth in the business market area compared to the same period of the previous year (the first quarter after the merger with the E-Plus Group).

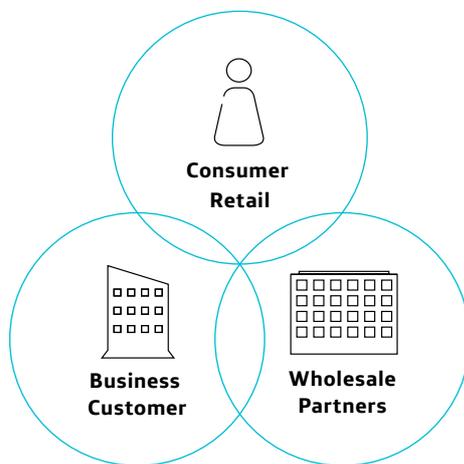
#### **Wholesale Partners: Maintain Leadership**

As part of the wholesale business, we offer mobile services for customers such as MEDIONmobile (ALDI TALK), United Internet (1&1), mobilcom/debitel, MTV, WhatsApp and cable providers. In addition, we have committed to selling 20 % of our future 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.

Furthermore, we offer value added services such as billing services or the management of telephone numbers and SIP accounts. This comprehensive portfolio enables our wholesale partners to independently serve their consumers and, at the same time, gives us the opportunity to increase our range and leverage economies of scale. However, we will phase out this model by 2019, as part of the transition to the next generation network of Telekom Deutschland GmbH.

#### G04 — Main Market Areas



## Goals and Strategies

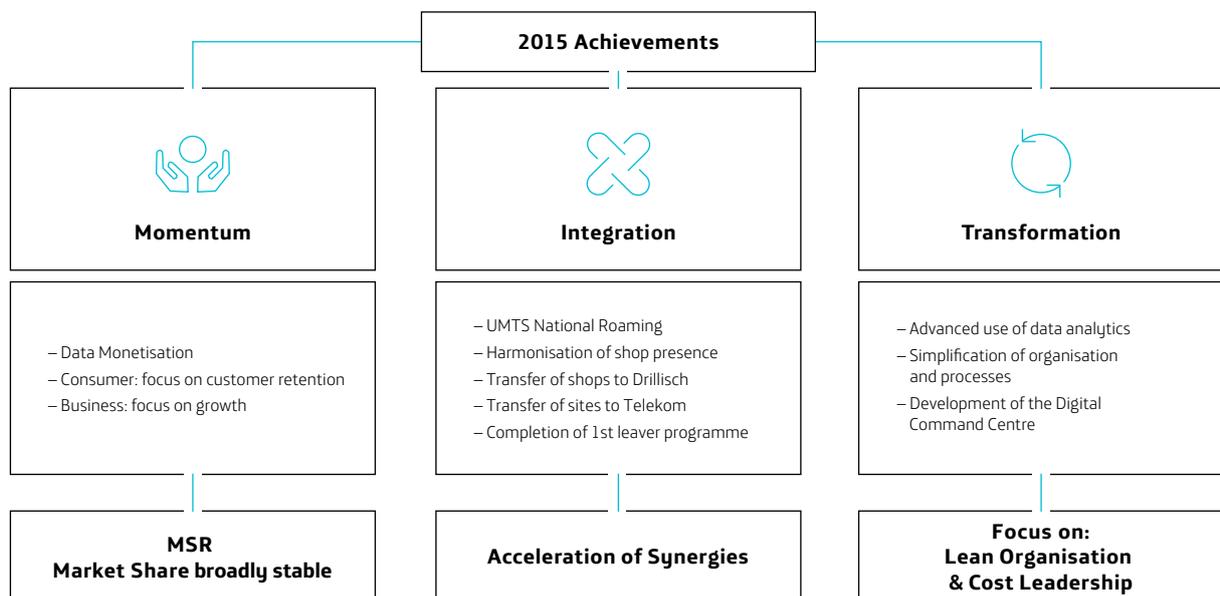
*We want to further improve our leading position in the German mobile market./We strive for the best customer and network experiences and the best price-performance ratio./We focus on the monetisation of data usage and cost leadership./Our vision is to become the leading digital telecommunications company in Germany./To achieve this, we have three main strategic priorities: Keep the Momentum, Integrate quickly and Transform effectively.*

During 2015, we have been building the solid foundation for the leading digital telco in Germany. We made that possible with our multiple and ambitious actions around our strategic priorities: Momentum, Integration and Transformation (MIT). As a leading digital telco, we strive for the best network experience, the best customer experience and most attractive offers thanks to our focus on cost leadership (efficient processes and organisational structure, leverage economies of scale).

#### Momentum: We drive the German market

Telefónica Deutschland Group is driving the German mobile market through excellent customer experience, first-class connectivity and good value for money. Thanks to the focus on customer retention rather than acquisition for the consumer market area, Telefónica Deutschland Group remained the market leader by customer base while our share of mobile

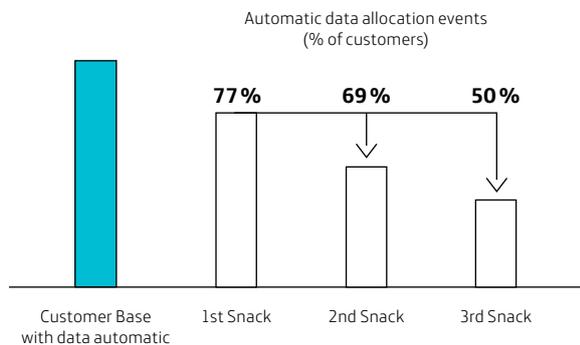
#### G05 — 2015 Achievements



service revenue remained broadly stable. In the business market area, we have successfully approached the market with innovative products and we have increased our focus on SMEs and SoHos.

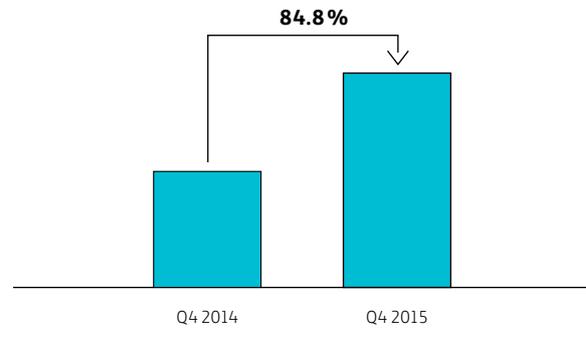
Data monetisation has been at the centre of our strategic priorities. Thanks to the use of data as a product differentiator in a context of growing data demand, revenues have remained broadly stable compared to 2014 (RESULTS OF OPERATIONS, PAGE 28). Example of data monetisation measures which we have successfully implemented are our data automatic and data upselling mechanisms. The data automatic mechanism offers our customers an automatic increase in their data allowance ("data snack") if the latter has been exhausted without having to experience the effects of throttling (GRAPH 06: O<sub>2</sub> BLUE ALL-IN PORTFOLIO). Data upselling mechanisms give the customers the option to increase their regular monthly data allowance upon request.

#### G06—O<sub>2</sub> Blue All-in Portfolio (dynamics within data automatic)



The result of these innovative customer propositions is a continued and significant increase in data usage and the improvement of our ability to monetise this data usage. During 2015, the average LTE data usage of O<sub>2</sub> postpaid consumer LTE customers increased by 84.8%. All in all, a clear example of Telefónica Deutschland Group supporting the digital lifestyle of consumers.

#### G07—Average Data Usage for O<sub>2</sub> Postpaid consumer LTE customer



The above is complemented by our leadership position in the wholesale market, as the partner of choice for most relevant MVNO players. With the coverage of the three areas consumer, business and partners, Telefónica Deutschland Group approaches the market with a competitive and integrated portfolio. Our convergent offer, for instance, mobile/fixed gives customers the option to combine mobile and fixed services from one provider at a promotional price ("Kombivorteil"). This contributed to the slight reduction in the consumer postpaid churn rate in 2015.

All the above is supported by our multi-brand strategy. This enables us to cover all market areas and to address the different needs of the customer. Within our portfolio the O<sub>2</sub> brand is positioned as the flagship brand for Telefónica Deutschland Group (BUSINESS ACTIVITY, PAGE 6).

#### Integration: Within the synergy plan

Our strategy is to integrate quickly and we have closed 2015 as planned. This is reflected in the synergy generation reaching around EUR 280 million in in-year Operating Cash Flow (OIBDA minus CapEx) savings, which already represents approximately 35% of total Operating Cash Flow synergies of EUR 800 million targeted for 2019. We have been able to accelerate and bring projects forward from 2016 into 2015, while the overall synergy case remains unchanged.

We achieved key milestones to make this possible. Firstly, we started the network optimisation. Telefónica Deutschland Group is selecting the best locations from the two networks so that the joint network reaches approximately 25,000 sites once the integration is completed. This will ensure improved coverage, service quality and operational efficiency. Part of the site reduction has been achieved by means of the agreement with Deutsche Telekom for the transfer of around 7,700 sites that entered into force in October 2015 (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26). Telefónica Deutschland Group has access to 357.5 MHz of spectrum including 60 MHz (2x10 MHz at 700 MHz, 900 MHz and 1800 MHz of paired spectrum) obtained during the last spec-

trum auction that finalised in June 2015 (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26).

Among the frequencies obtained, the spectrum at 700 MHz and 1.8 GHz will lead to a larger and denser LTE network both in major cities and in the countryside and enables us to offer our customers all over Germany outstanding connectivity to use mobile data services. The spectrum at 700 MHz will complement the frequencies at 800 MHz already obtained in 2010, thus favouring the extension of LTE coverage in suburban and rural areas.

The auctioned blocks in the 1.8 GHz range also allow us to establish an even stronger high-performance network with more capacity in the cities. Our customers will thus benefit significantly from higher LTE speeds. The blocks in the 900 MHz range will also ensure the high quality of the nationwide GSM network for voice, SMS and narrowband internet connections in the future.

With its existing and newly acquired frequencies, Telefónica Deutschland Group holds a balanced share in the frequencies below 1 GHz (area coverage) and a leading position in 1.8 GHz frequencies and above (capacity coverage). The investment of EUR 1.2 billion (23.5 % of total auction costs in 2015) in this valuable frequency package is therefore an important building block for further network expansion

and focused data business. We want to point out our efficient capital allocation which ensures our leadership position in the high-frequency spectrum while, at the same time, investing the least among the German network operators during the auction.

Secondly, we have activated national roaming between the UMTS networks of the former Telefónica Deutschland Group (O<sub>2</sub>) and the E-Plus Group (E-Plus) in the first half of 2015, combining for the first time the strength of both our networks. This milestone supports a positive network experience for our customers. As a result, we offer the customers of all our brands and partner brands the densest UMTS network infrastructure in urban and suburban areas and considerably expanded coverage in rural areas. This step improves the user experience for mobile data services even in areas where our customers do not yet have LTE, and thus it demonstrably improves customer experience and satisfaction.

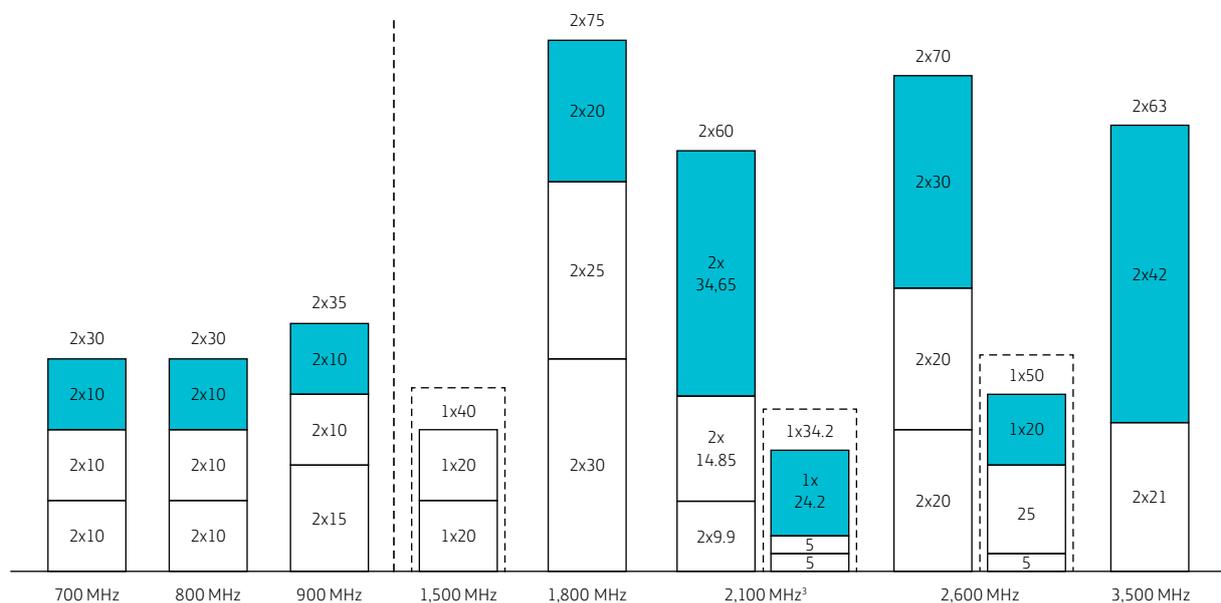
Thirdly, we have advanced in the optimisation of our retail distribution network, one of the biggest strengths of Telefónica Deutschland Group, to keep momentum and achieve our strategic goals. We have harmonised the branding of our shops. Since the end of the year 2015, almost all shops operate under the O<sub>2</sub> brand. The shop network has been analysed based on the criteria of location and perfor-

## G08 — Results of the Spectrum Auction in 2015

- Telefónica Deutschland Group
- Competitors
- FDD<sup>1</sup> spectrum
- - TDD<sup>2</sup> spectrum

Frequencies for coverage: a level playing field

Frequencies for high capacity: Telefónica Deutschland Group keeps spectrum leadership

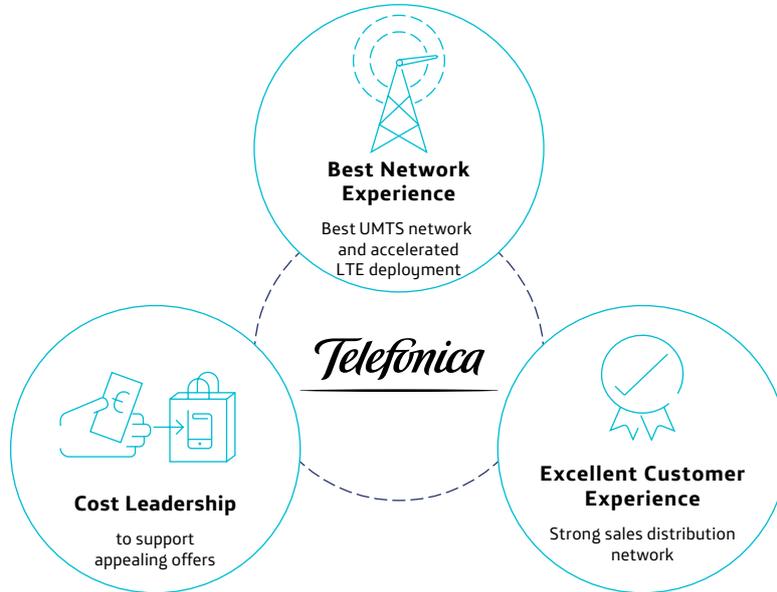


<sup>1</sup> FDD = Frequency Division Duplex

<sup>2</sup> TDD = Time Division Duplex

<sup>3</sup> So called "UMTS core band" also referred as 2 GHz band by the Federal Network Agency

## G09—Our Focus



mance. The integration has been accompanied by a reduction of around 400 stores in order to approach the reduction goal of one third of shops until 2018. This means from approximately 1,800 shops in the beginning of 2015 to approximately 1,300. In this context, we have agreed to transfer shops to Drillisch as part of the agreement in the summer of 2014. Drillisch acquired 301 shops and partner shops, of which most have already been transferred in 2015 (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26).

Telefónica Germany has significantly advanced in the integration and its transformation by completing the first wave of the leaver programme. This has been agreed with the workers council. As a result, around 800 FTEs (50% of targeted reduction until 2018) have thus been restructured (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26). This supports our focus on cost leadership and transformation.

### Transformation: Shaping the leading digital telco

The third strategic priority has been an effective transformation of the whole company with the target of becoming the leading digital telco in Germany.

In order to achieve this we have focussed on initiatives to simplify, digitalise and amend the business models and day-to-day business activities. Simplification and digitalisation are core levers to increase customer loyalty and satisfaction while sustaining our focus on cost leadership.

One important enabler for our transformation in the context of digitalisation is applying Advanced Data Analytics across our customer data to increase the efficiency of our internal processes. A prerequisite for the use of our customer data is ensuring data privacy and security, which is a core

believe of our company. We ensure data security and privacy by different means such as our newly developed and patented Anonymization Platform. Furthermore, we let our customers choose what data to share and ensure the highest possible transparency for the use of our customer data. Customers can choose whether to participate in the O<sub>2</sub> More Local service, for example, by which they receive special offers based on their location.

Advanced 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 a 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.

Ensuring a seamless digital experience for our customers is also part of the transformation process. We are proactively increasing the share of digital customer contacts by improving our digital channels. As a result, we plan to significantly reduce our customer services cost over the next years.

The digital channels are complemented by a large variety of alternative contact possibilities, and 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 collect it from the store. New types of concept stores will increase customer loyalty to the O<sub>2</sub> brand. By the end of 2015 we opened 16 new concept stores.

A key achievement on the management of Advanced Data Analytics in conjunction with digital and offline channels has been the development and the building of our Digital Command Centre. This will provide real-time information for faster decision making and for the anticipation to our customer needs. As a consequence, we will improve our customer experience. The system will cover all aspects of our interaction with the customer, from the first contact to customer care and retention. This will help to improve our offers and the way we communicate with our customers.

As part of the Telefónica, S.A. Group, leading in R&D investments among European communications providers, innovation is at the heart of our core values. Both former companies merged in the new Telefónica Deutschland Group were known for innovations 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, as we have already shown with the launch of Voice over LTE (VoLTE) in 2015 as the first operator in Germany. This new technology strongly improves the quality of the voice service with the reduction of call set-up times, better speech quality and longer handset battery duration.

### Our ambitions in 2016

The Telefónica Deutschland Group will continue to drive the German market, advance its integration and complete some major projects in this context. Moreover, the company focusses on the digital transformation and aims to shape the leading digital telco and become the Onlife Telco by 2020. This is a digital telco that goes beyond the provision of connectivity and instead plays a central role in the digital life of its customers.

We have already begun moving in that direction in 2015, as shown by the above-mentioned achievements, and will continue to focus on our ambitions accordingly in 2016.

To accomplish our ambitions we will continue to develop intensively our network towards outstanding connectivity. This is shown in our coverage goals for 2016 › GRAPH 10: OUR AMBITIONS IN 2016, PAGE 14. In parallel, we continue to work on the full integration of networks which includes the termina-

tion of around 5,000 sites in 2016. The continuous improvement of our network is without doubt a key strength of our company and of our value propositions to the customers.

The use of Advanced Data Analytics in innovative ways thanks to the completion of our Digital Command Centre will significantly increase in 2016. Furthermore, we will continue to expand digital lifestyle propositions for our customers such as smart home services or the WLAN calling application as part of our integrated offerings.

As a complement to a state-of-the-art telecommunications infrastructure and digital lifestyle propositions, our ambitious plans also include the expansion of new concept stores during 2016. This, supported with enhancements of the online channels will ensure an improvement in customer experience and their digital lifestyle.

During 2016, we will notably increase our focus on the Internet of Things (IoT), the evolution of our M2M business. This market is expected to grow at double-digit rates until 2024 from around 6 billion connections worldwide to 27 billion<sup>1</sup>. Telefónica, S.A. Group is among the global leaders in the provision of M2M services, a core element in IoT ecosystem. These will serve as a base for the development of end-to-end solutions for selected use cases like fleet management. We have already successfully gained expertise and major clients such as Sixt Leasing for smart mobility services. Telefónica Germany Group benefits from the global capabilities of the Telefónica, S.A. Group like the Global SIM IoT platform. This platform provides worldwide coverage for any cellular IoT devices in secured ways thanks to the scale of Telefónica, S.A. Group and its extensive network of data centres and roaming partners.

The central role of IoT and Advanced Data Analytics in our strategy will be also reflected in our intention to create specific market units dedicated to those activities and supported by a central unit, the Factory, responsible for the technological developments.

We will thus continue to accelerate our transformation towards the Onlife Telco by means of increased efficiencies driven by digitalisation efforts which result in simplified structures, better capital allocation and new revenue streams across all market areas.

<sup>1</sup> Source: Ranken, Margaret (Machina Research). M2M Global Forecast & Analysis 2014–2024. June 2015.

## G 10—Our Ambitions in 2016

|   |  |   |
|---|--|---|
| <b>Outstanding Connectivity</b>                                       | <b>Advanced Data Analytics &amp; Innovation</b>              | <b>Integrated Offerings</b>   |
| <p>Expected Coverage in 2016 at eye level with the competition</p>    | <p>Completion and leverage of the Digital Command Centre</p> | <p>Expanding our portfolio of digital lifestyle propositions</p>                            |
| <b>Values &amp; Customer Experience</b>                               | <b>End-to-End Digitalisation</b>                             | <b>Capital Allocation &amp; Simplification</b>  |
| <p>Significantly increase number of Concept Stores by end of year</p> | <p>Double digit growth in gross adds online channels</p>     | <p>Integration of networks &amp; distribution channels<br/>2nd wave of Leaver Programme</p> |

## Product Development and Innovation Management

*Innovative products are essential for sustainable revenue and earnings growth./We launched some highly innovative new products and services in the year under review./Trends are identified at an early stage and implemented in the form of new products./We work in close cooperation with internal and external stakeholders in the area of innovation management.*

### Product development is vital for long-term business success

Innovative and customer-oriented products form the basis for sustainable business success and growth of results. Accordingly, we are continually expanding and improving our product portfolio. The permanent analysis of our customer groups delivered an important insight that allowed us to precisely tailor our product and services offering to the needs of the relevant target groups as part of our focused multi-brand strategy.

For example, the O<sub>2</sub> Blue tariffs now offer higher data volumes and LTE access for all customers who use LTE-capable devices. The new dynamic data allocation enables unlimited surfing at a constant speed. If the data volume included in the tariff is not enough, contract customers automatically get extra capacity for a small fee. If the customer is not interested the automated data service can be deactivated.

Business customers can now enjoy greater flexibility – users of O<sub>2</sub> on Business S, M or L can increase their monthly data volume temporarily if they require more capacity in a particular quarter.

Meanwhile, new technology is making the calling experience even more comfortable. The launch of HD Voice on the O<sub>2</sub> network means considerably better voice quality with clear transmission and a natural sound pattern as in face-to-face conversation. At the same time, the technology suppresses disruptive background noise, ensuring excellent acoustic quality even in loud environments. In this way, HD Voice ensures better audibility and greater clarity, whether in the car or in teleconferences with multiple participants.

Voice over LTE (VoLTE) means that O<sub>2</sub> customers also benefit from shorter call set-up times and improved voice connection. At the same time, VoLTE means less of a drain on the device battery as telephony and data transmission are now both processed on the LTE network, which requires considerably less network searching.

With the free O<sub>2</sub> Message+Call app, O<sub>2</sub> is the first mobile communications provider on the German market to offer its customers the possibility of making telephone calls on their smartphones via WLAN. In addition, customers can use further digital features such as video calling, chat and file sharing. The O<sub>2</sub> Message+Call app is initially available as a beta version and will be continuously developed and optimised on the basis of customer experiences.

When it comes to mobile devices, we are permanently pursuing new approaches and expanding the range of options

available to our customers in order to allow them to find the ideal handset for their needs. For example, we are the first German network operator to launch a smartphone from the extremely popular Spanish brand BQ on the German market. With this move, the Telefónica, S.A. Group also introduced Europe's first mobile device with Cyanogen OS, an Android-based operating system that offers an interface with more extensive customisation options and increased privacy and security.

We want that our customers can use the various possibilities of digitization at its best. This includes simple, comfortable and mobile payment solutions for apps and services. All O<sub>2</sub> customers can now pay for purchases on Apple Music, iTunes, the App Store and the iBook Store via their mobile bill, making us a pioneer among network operators globally.

The mobile device itself is also becoming a secure payment instrument thanks to near field communication (NFC). With innovative products for mobile payment and associated services we are well positioned in this growth market. As of this year, we have been supporting the NFC-City Berlin project initiated by GS1 Germany, which has also been joined by the other network operators and various major retailers. Consumers in the German capital can now make contactless payments in hundreds of stores using their smartphones.

### **Innovation management converts trends into new products**

For our future growth, it is critical that we recognise trends and new technological developments at an early stage, transform them into customer-oriented products and bring them onto the market quickly. To achieve this, we use the worldwide innovation network of the Telefónica, S.A. Group and optimise the relevant global products. We also develop targeted products and services that are of strategic significance for the German market.

Our development work is laying the foundations for the business areas of the future. They include Advanced Data Analytics, which is one of our strategic priorities for 2016 (GOALS AND STRATEGIES, PAGE 9). The results can be used to improve road traffic capacity planning, optimise inner-city infrastructures or expand rural mobile networks to reflect demand, for example. People's personal information must be given special protection. With this in mind, we have developed a procedure for data anonymisation for which a patent application has been submitted. This ensures that the statistics generated cannot be traced back to any of the personal information provided.

The basis for these developments is our innovation management, which follows the principle of open innovation. Accordingly, we include employees as well as customers, start-up enterprises, business partners and other innovation assistants in our innovation activities.

It is very important for us to involve our customers in product development to a greater degree in order to better respond to their needs and to speed up the time to market. On our redesigned internet forum, the O<sub>2</sub> Community, a community expert programme is bringing together the most active and motivated customers. These technically adept users provide targeted feedback on products and services. Since 2011, we have also been operating the O<sub>2</sub> Ideas Laboratory, where we introduce new concepts and products to our customers at an early stage of development and receive direct user feedback. By implementing selected ideas from the O<sub>2</sub> Ideas Laboratory, we not only improve our products, but also deliver credible proof of our pronounced customer orientation.

The Telefónica, S.A. Group is supporting young technology businesses through the global start-up initiative Wayra, thereby securing access to new business models. In addition, since 2012 we have been operating the Wayra Academy in Munich, where start-ups can further develop their business models and bring them to market maturity. The Wayra start-up Volo, which offers an efficient delivery service for restaurants, was sold successfully to a subsidiary of Rocket Internet in 2015. Other start-ups originating at the Munich-based academy, including Parkpocket, NFWare, Neokami and Meet'n'Learn, obtained additional funding from external investors in 2015.

In addition to Wayra, we use the venture capital company Shortcut Ventures to support start-up companies. Shortcut Ventures invests in young entrepreneurs with new ideas and visions for the market of tomorrow. They are provided with risk capital and direct and personal access to start-up expertise and the experience of an expert team right from the start. Examples of Shortcut Ventures' investments include So1 GmbH, Berlin, and Tado GmbH, Munich. So1 GmbH provides data analytics for the optimisation of their price promotions, while Tado offers innovative solutions for controlling efficient energy consumption in the home.

As part of our contribution to shaping the digital transformation, we are also encouraging the social debate on its rules and objectives. Our new representative office in Berlin and the BASECAMP serve as an interface with digital masterminds, from artists and entrepreneurs through to research institutions. We also regularly attend technical conferences and panel discussions like the DLD (Digital-Life-Design) conference and Medientage München, which brings together pioneers from the IT and telecommunications branches.

## Structure of the Telefónica Deutschland Group

Telefónica Deutschland Holding AG (hereinafter also "Telefónica Deutschland") is a public stock corporation (AG) 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 entered in the commercial register of the Munich Local Court under 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](http://www.telefonica.de)). Telefónica Deutschland Holding AG is 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 International Securities Identification Number (ISIN) is DE000A1J5RX9.

### Share capital

The share capital of the company is EUR 2,974,554,993 and is divided into the same number of no-par value registered shares.

As a matter of principle, each no-par value share grants one vote at the Annual General Meeting.

### Authorised capital

Telefónica Deutschland Holding AG had authorised capital 2012/1 in the amount of EUR 292,808,507 as of 31 December 2015.

### Contingent capital

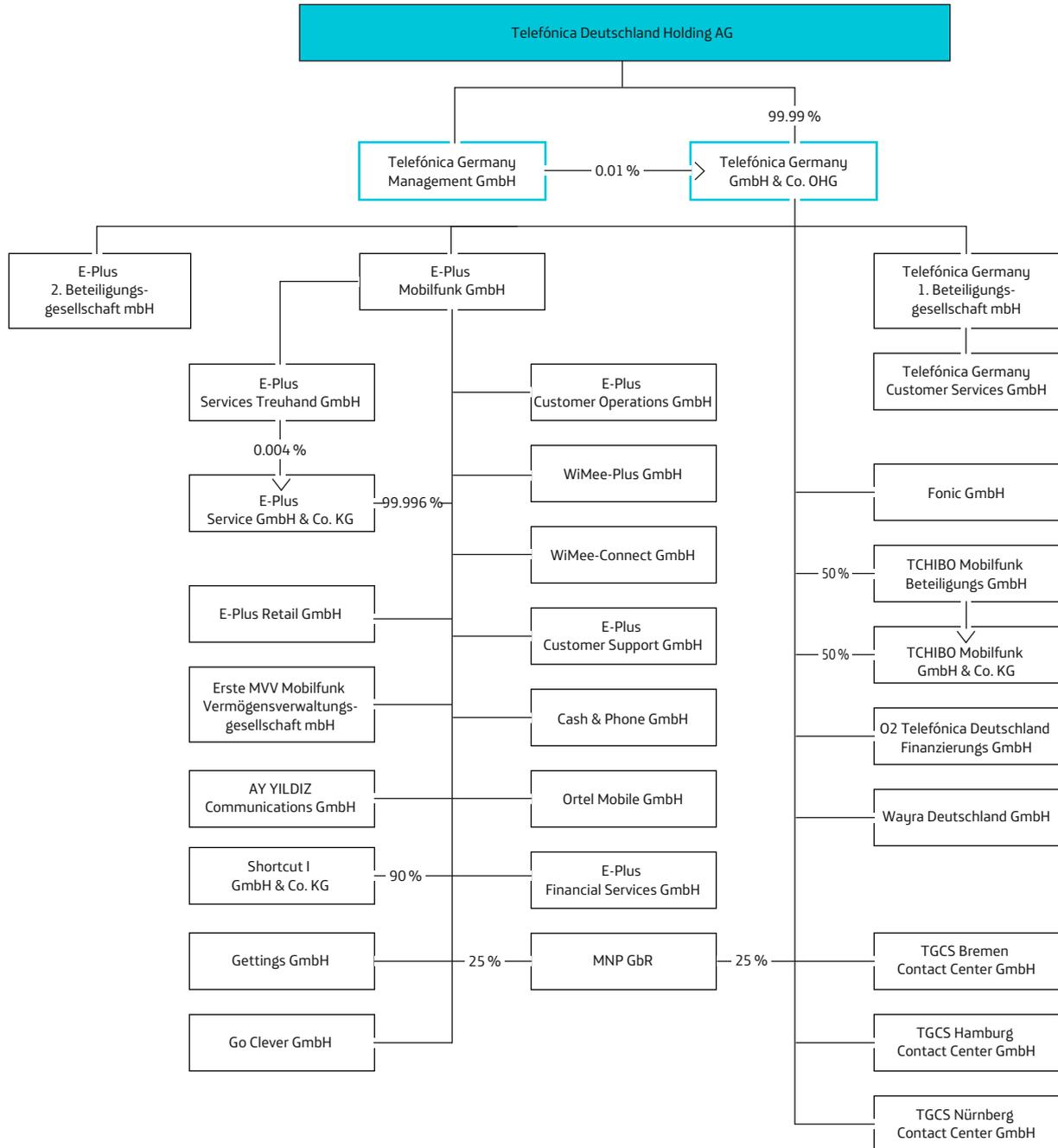
Telefónica Deutschland Holding AG had contingent capital 2014/1 of EUR 558,472,700 as of 31 December 2015.

### Structure of the Telefónica Deutschland 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 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.

As of 31 December 2015, the companies included in the Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart:

**G11 — Telefónica Deutschland Group Companies**



Unless otherwise stated, the holding quotes amount 100 %.

The sale of yourfone GmbH to Drillisch was completed on 2 January 2015 (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26).

In the financial year 2015, simyo GmbH, E-Plus 1. Beteiligungsgesellschaft mbH and BLAU Mobilfunk GmbH were merged with Telefónica Germany GmbH & Co. OHG with effect from 30 June 2015. Blau Service GmbH had been merged with BLAU Mobilfunk GmbH prior to this date.

### Management and governing bodies

The company's executive bodies are the Management Board, the Supervisory Board and the Annual General Meeting. The powers of these bodies are established by the Aktiengesetz (AktG – German Stock Corporation Act), the articles of association of the company and the by-laws of the Management Board and the Supervisory Board.

### Management Board

The members of the Management Board are appointed by the Supervisory Board for a period of no more than five years and can be reappointed without limitation, in each case for no more than five years. The Supervisory Board may recall a Management Board member before the end of his term in office for good cause, such as a gross violation of duty or in the event of a vote of no confidence at the Annual General Meeting. Other reasons for termination, such as a mutual termination agreement, are also possible. The Supervisory Board may nominate one Management Board member as the Chair of the Management Board and another Management Board member as the Deputy Chair. On 31 December 2015, the Management Board of the company comprised three members:

- Thorsten Dirks, CEO (Chief Executive Officer)
- Rachel Empey, CFO (Chief Financial Officer)
- Markus Haas, COO (Chief Operating Officer)

### Supervisory Board

In accordance with section 11 para. 1 of the articles of association of the company, sections 95 and 96 of the AktG and section 7 of the Mitbestimmungsgesetz (MitbestG – German Co-Determination Act), the Supervisory Board comprises sixteen members, eight of whom are shareholder representatives and eight of whom are employee representatives.

All current shareholder representatives on the Supervisory Board were appointed for the period until the end of the Annual General Meeting resolving on the approval of the actions of the Supervisory Board for the financial year ending 31 December 2016.

## 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 fundamentals 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 organisation

### Strategic objectives are reviewed and redefined annually

As part of the annual planning process, the corporate strategy is reviewed by the Management Board of Telefónica Deutschland. Long-term strategic goals for the positioning of the company on the German market as well as a business plan with a typical horizon of three years are developed as part of this process. Decisions are based on current market and competition analysis as well as market forecasts, which are compared with the corporate vision and the long-term strategic goals.

Within this systematic approach, chances and opportunities for growth are determined and investment decisions are made.

In close cooperation with the individual business units, 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 and 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 for the realisation of the 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:

#### Mobile service revenue

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 effects

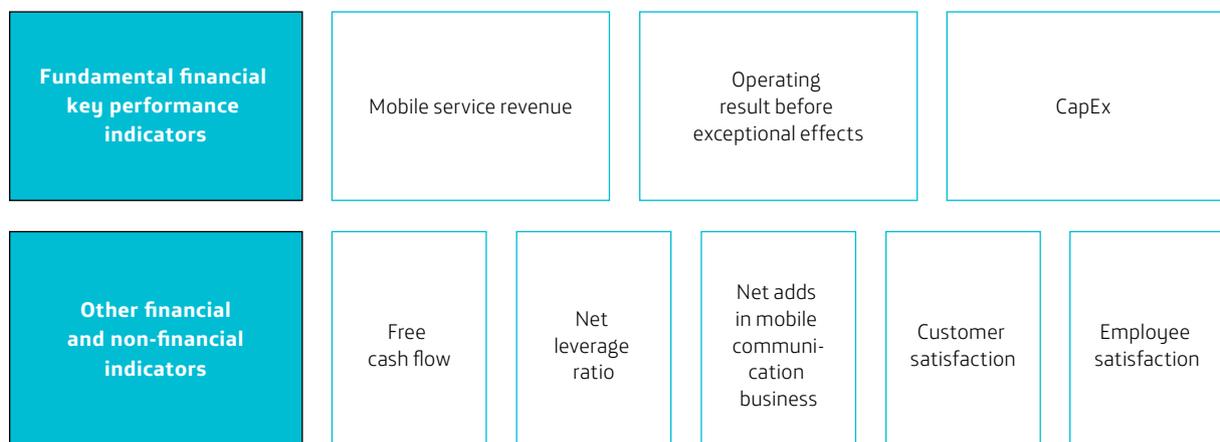
We measure the profitability of our operating business on the basis of OIBDA before exceptional effects, i.e. the operating result before depreciation of property, plant and equipment and amortisation of intangible assets and before exceptional effects. OIBDA before exceptional effects as a fundamental 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 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 example, restructuring expenses). 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 for the expansion of the coverage and capacity of our network (particularly for LTE and UMTS) as well as product development. CapEx does not include investments in licences for 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 revenue, OIBDA before exceptional effects and CapEx, other financial and non-financial indicators are observed.

### G12 — Performance Indicators



### 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<sup>2</sup> is defined as the quotient of the net financial debt and the operating result before depreciation and amortisation (OIBDA) before exceptional 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 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, the Telefónica Deutschland Group 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 digital leading 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. 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.

<sup>2</sup> The leverage ratio is defined as the net financial debt divided by adjusted LTM (Last Twelve Months) OIBDA. A combined OIBDA is applied solely for the purpose of calculating the leverage for any twelve-month period which includes historical periods prior to the closing of the merger with E-Plus. This combined OIBDA includes the OIBDA of the E-Plus Group under Telefónica Deutschland Group accounting policies for the entire twelve-month period as if the closing of the transaction had occurred at the beginning of such twelve-month period.

# Economic Report of the Group\_

## Overall economic and industry conditions

*The German economy grew by 1.7% in 2015./Rising demand for bandwidth represents growth opportunity./The German mobile telecommunications market is the EU's largest in terms of customer numbers./Our markets continue to be characterised by intense competition./The Telefónica Deutschland Group is exposed to various regulatory factors.*

### Economic environment

#### Solid macroeconomic development in Germany

The German economy performed well in 2015 against the backdrop of a difficult global environment. As reported by the German Federal Statistical Office, gross domestic product (GDP) rose by 1.7% year on year in 2015. This development was primarily driven by domestic factors. Foremost among these was private consumption, which benefited from the positive employment trend in particular. The number of people in employment increased once again thanks to migration and a slight reduction in unemployment. Private consumption was also boosted by the increased purchasing power enjoyed by consumers. This was reinforced by the substantial reduction in energy prices compared with the previous year, while collective wage increases well ahead of inflation also served to improve real consumer purchasing power.

The consumer climate remained at a high level in 2015, although it weakened several times in the second half of 2015. In the last month of the year, consumer mood further improved again.

#### Trends on the German telecommunications market offer growth potential

Various trends can be observed in the German telecommunications sector alongside continuing customer demand for more bandwidth.

The strong demand for mobile data usage and increasing smartphone and tablet penetration are opening up further growth opportunities for mobile network operators, and this trend will continue in future. Smartphones and tablets are

trailblazers for the digital revolution in Germany. At the same time, the monetisation of mobile data business will remain a strong focus for mobile telecommunications providers.

According to the industry association Bitkom, the increasing availability of cloud services is responsible for a profound change in information technology. In cloud computing, IT services are employed as needed via decentralised rather than local computers, which are connected through data networks (in the "cloud").

A further trend is the growing market for machine-to-machine interconnection/communication (M2M), with countless potential applications.

#### Market development driven by demand for mobile data services

With 113.4 million customers (SIM cards) at the end of September 2015, the German mobile telecommunications market is the largest in the EU. The notional mobile penetration rate was 141%, i.e. each German citizen has an average of 1.4 mobile SIM cards. Customer growth in the period from January to September 2015 was primarily attributable to the higher-value postpaid sector. All in all, postpaid customers accounted for 52.0% of total connections at the end of September 2015 compared with 50.5% at the end of December 2014.

The mobile telecommunications market saw dynamic development in 2015 and was characterised by intense competition, primarily driven by the strong demand for smartphones and the growing number of attractive smartphone tariffs. According to a survey by the industry association Bitkom, around two thirds of Germans used a smartphone in 2015. A year previously, the figure was just 55%. The use of tablet PCs in Germany has also risen from 28% in 2014 to 40% in 2015. Bitkom expected 7.7 million tablet PCs to be sold in Germany in 2015. Mobile media use is resulting in growing mobile data use and rising sales volumes and revenues, particularly for smartphones and tablet PCs. According to Dialog Consult, 510 million GB of data was transferred via mobile networks in 2015, an increase of 29% on 2014 (395 million GB).

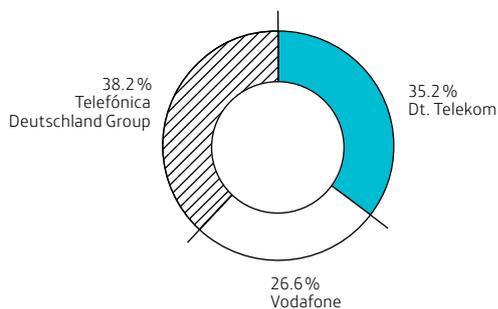
The growing penetration of mobile end-devices with internet capability, such as smartphones or tablets, and the increasing use of mobile data services is also evident in the strong increase in revenues from mobile data on the German

market. According to estimates by Analysys Mason, mobile data revenues increased by around 14 % in 2015 compared with the previous year. By contrast, revenues from mobile telephony and SMS have fallen, driven by declining prices, regulatory effects and changes in customer behaviour.

### The German mobile telecommunications market is an established market

Following the merger of the Telefónica Deutschland Group with the E-Plus Group, it consists of three network operators and several service providers and MVNOs. As of the end of September 2015, the Telefónica Deutschland Group had a market share of 38.2 % with around 43 million connections in total, making it the largest German mobile telecommunications network operator in terms of customer connections.

#### G13 — Market Share in the Mobile Telecommunications Market per Customer (in %) by the End of September 2015



Source: Company data, Bitkom, Analysys Mason, Dialog-Consult/VATM analyses and forecasts, GfK, German Federal Statistical Office

### German fixed line market characterised by strong competition

Intense competition also still prevails on the German market for fixed broadband services. The number of subscriber lines rose by around 5 % year on year, while the customer base increased to approximately 30.4 million by the end of September 2015. The share of DSL connections is almost 80 %. The relevance of VDSL continued to grow in 2015. According to analyst estimates, more than 20 % of DSL customers used VDSL technology as of year-end 2015. Rising customer demand for increased bandwidth is also reflected in the data volume generated per broadband connection per month. According to Dialog-Consult, this increased by almost 20 % year on year to 31.8 GB per connection.

Source: Analysys Mason, Dialog-Consult/VATM analyses and forecasts

The largest DSL provider in Germany is Deutsche Telekom AG, Bonn. The Telefónica Deutschland Group and other significant players on the broadband internet market rent the unbundled subscriber lines (unbundled local loop, ULL) from Deutsche Telekom AG.

## 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 financial year under review are discussed below:

### The Telefónica Deutschland Group has acquired frequencies for mobile broadband use and existing GSM use with effect from 1 January 2017

Operating a mobile telecommunications network requires mobile telecommunications frequencies. As a matter of principle, any and all use of frequencies requires prior frequency allocation by the BNetzA.

The frequencies currently allocated by the BNetzA in the 900 MHz range and, to a large extent, in the 1800 MHz range are limited to the end of 2016. In addition to the expiration of these frequencies, additional frequency ranges (700 MHz and 1.5 GHz) have become available for mobile telecommunications use for the first time. In 2015, the expiring and new frequencies were awarded as part of an awarding procedure initiated by the BNetzA. The BNetzA granted the Telefónica Deutschland Group admission to the auction by way of a notification dated 22 April 2015. The auction began on 27 May 2015 and ended on 19 June 2015. The Telefónica Deutschland Group acquired two paired frequency blocks in the 700 MHz range, two paired blocks in the 900 MHz range and two paired blocks in the 1.8 GHz range with a term until the end of 2033 for a total of around EUR 1,198 million. The first instalment of the frequency fees of around EUR 976 million was paid on 26 June 2015. The two outstanding instalments of approximately EUR 111 million each for the spectrum in the 700 MHz range are due on 1 July 2016 and 2017.

The paired (2 x ...) and unpaired (1 x ...) frequencies available to the Telefónica Deutschland Group from 1 January 2017 (in MHz) are shown in the > GRAPH 08: RESULTS OF THE SPECTRUM AUCTION IN 2015, PAGE 11.

### **BNetzA and Telefónica Deutschland Group compromised on the return of frequencies in the 1800 MHz range ahead of schedule**

In connection with the planned merger of the Telefónica Deutschland Group and the E-Plus Group, the BNetzA bound Telefónica Deutschland Holding AG and E-Plus Mobilfunk GmbH with decisions on 4 July 2014 and 7 October 2014 to return all frequencies in the 900 MHz and 1800 MHz ranges that had not been allocated to them beyond 2016 ahead of schedule on 31 December 2015. The original term of the frequencies in the 900 MHz and 1800 MHz ranges ended on 31 December 2016, meaning that the decisions involved a one-year reduction.

The Telefónica Deutschland Group sought judicial protection against the decisions at the Administrative Court of Cologne successfully and ultimately obtained the reversal of the BNetzA's decisions. In July 2015, the BNetzA filed appeals against these verdicts, which therefore did not become legally binding. At the same time, the BNetzA again called on the Telefónica Deutschland Group to return frequencies ahead of schedule.

As a result, the Telefónica Deutschland Group sought to obtain planning and legal certainty with regard to the imminent network consolidation. In response to a corresponding request by the Telefónica Deutschland Group on 7 September 2015, the BNetzA granted Telefónica Germany GmbH & Co. OHG and E-Plus Mobilfunk GmbH permission for mutual use of the frequencies available within the Telefónica Deutschland Group by way of a definitive decision dated 25 September 2015, making this permission subject to the condition precedent that both companies prematurely waive the use of certain frequencies in the 1800 MHz range, firstly in certain regions by the end of 31 December 2015 and then nationwide by the end of 30 June 2016. The regional vacation of the frequencies with effect from 31 December 2015 has already taken place as scheduled. The Telefónica Deutschland Group and the BNetzA terminated the attached legal proceedings by mutual consent.

### **Telefónica Deutschland Group obtains final decisions on MTR**

By way of a decision dated 24 April 2015, the BNetzA finally approved the mobile termination rates (MTR) of 1.72 cents per minute for the period from 1 December 2014 to 30 November 2015 and 1.66 cents per minute for the period from 1 December 2015 to 30 November 2016, thereby confirming the preliminary decision from 2014 following the MTR consultation with the European Commission that has taken place in the meantime. The rates were set at the same level for all German mobile network operators.

### **Telefónica Deutschland Group obtains final decision on FTR**

On 28 November 2014, the BNetzA issued a provisional decision for alternative local exchange carriers, and hence also for the Telefónica Deutschland Group, with regard to the applicable local FTR from 1 December 2014. The amount was set at 0.24 cents per minute with a term until 31 December 2016. The BNetzA notified the European Commission of its preliminary decision on 18 January 2015. In response, the European Commission expressed serious doubts concerning the rate method and the rate level. The BNetzA made its final decisions in August 2015, confirming the preliminary decisions from 28 November 2014 in the original amount in spite of the criticism from the European Commission.

### **Telefónica Deutschland Group terminates legal proceedings with Telekom Deutschland GmbH on MTR, FTR and local loop rates**

Since 1999, the Telefónica Deutschland Group and Telekom Deutschland GmbH and its legal predecessors had been involved in legal actions against one another on various approvals concerning MTR, FTR and monthly local loop rates. In 2015, the two parties agreed an amicable settlement of the actions, with corresponding agreements signed in September 2015. With various regulatory approvals and withdrawal of actions carried out the Telefónica Deutschland Group received compensation of EUR 7 million.

### **BNetzA publishes draft decision on local loop access for local vectoring**

On 23 November 2015, the BNetzA published its draft decision on the conditions under which competitors can obtain access to the local loop of Telekom Deutschland GmbH in the coming years. In particular, the draft addresses the question of access in connection with the introduction of vectoring technology in street cabinets in the local loop. To ensure the smooth roll-out of vectoring in the main distribution frame and street cabinets, responsibility for technical implementation must be placed with a single operator. In February 2015, Telekom submitted an application to the BNetzA with the aim of being granted exclusive, Germany-wide responsibility for vectoring operations in street cabinets in the local loop.

In its draft decision dated 23 November 2015, the BNetzA ruled against granting exclusivity to Telekom. Instead, the draft set out a complex distribution mechanism that theoretically gives alternative providers the option of performing vectoring operations in certain street cabinets in the local loop. The fixed line cooperation with Telekom means that the Telefónica Deutschland Group has direct access to Telekom's street cabinets, meaning that it would benefit from the content of the draft decision.

Interested parties had the opportunity to submit written opinions on the draft until 18 January 2016. The Telefónica Deutschland Group participates in the consultation process. The draft of the BNetzA will possibly be revised and submitted to the European Commission. The final decision by the BNetzA is expected in the first quarter of 2016.

#### **BNetzA to issue transparency regulation**

To strengthen the position of consumers, the BNetzA will issue a regulation containing measures aimed at increasing the transparency of mobile and fixed line telephone and internet services. Among other things, the near-final draft of 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. Before being issued, the regulation still requires the consent of several federal ministries and of the German Federal Parliament (Bundestag). The regulation is expected to enter into force in the first quarter of 2016. However, parts of the regulation will not take effect until the second half of 2016 or, in some cases, in 2017 owing to extended implementation periods.

#### **Bundestag approves removal of router requirement**

In November 2015, the German Federal Parliament (Bundestag) approved an amendment to the Gesetz über Funkanlagen und Telekommunikationseinrichtungen (FTEG – German Radio Equipment and Telecommunications Terminal Equipment Act). This will give consumers freedom of choice with regard to their telecommunications terminal equipment (router). This means that providers of stationary broadband connections like the Telefónica Deutschland Group would no longer be able to require that customers use certain hardware to access their network. Certain access data should be sent to the customer. The amendment to the law has been published on 29 January 2016 in the Federal Law Gazette (Bundesgesetzblatt) and the formal legislative process has been concluded thereby. Due to the implementation period the legislation will come into force on 1 August 2016.

#### **European Commission issues new regulations on roaming and net neutrality and continues its Digital Single Market initiative**

In 2013, the European Commission published the draft Digital Single Market Regulation. Following the elections to the European Parliament and the constitution of a new European Commission in 2014, the legislative project was divided into two parts.

One part concerns the regulation of the telecommunications market, the Telecom Single Market Package. It contains plans for the consistent regulation of net neutrality and roaming throughout Europe. A corresponding regulation came into force following publication in the official journal of the European Commission on 29 November 2015. The new roaming regulations provide for an end to roaming charges for consumers from 15 June 2017, while enabling fair use restrictions in order to prevent the permanent and not merely temporary use of roaming services abroad. From April 2016, current roaming charges will then to be capped at 5 Euro cents net per call minute, 2 Euro cents net per sent SMS and 5 Euro cents net per MB for data connections. Wholesale roaming charges are to be reviewed in the coming months. The compromise also includes regulations for an open internet guaranteeing equal and non-discriminatory access to the internet (net neutrality) while making it possible to offer special services.

The other part focuses on more detailed regulatory issues concerning the European information and telecommunications market. The European Commission presented its five key points for this package of laws, again called the Digital Single Market Package, in June 2015. The regulations on the standardisation of the market, the harmonisation of spectrum management, the incentives for network investment, the regulation of new digital services and the regulatory authorities are to undergo closer examination. To this end, in September 2015 the European Commission initiated a public consultation to run until 7 December 2015 in which the Telefónica Deutschland Group participated in a timely manner. The European Commission will continue its investigations based on the results of the consultation.

## Overview of the Financial Year 2015

*The year 2015 was characterised by the integration of the E-Plus Group./Synergies are within the plan./We have raised our outlook during the year./Together with the workers council a framework redundancy plan was agreed./The company acquired a valuable spectrum in the mobile phone frequency auction.*

The acquisition of the E-Plus Group as of 1 October 2014 has changed the scope of operations of the Telefónica Deutschland Group significantly. As the integration of the E-Plus Group is progressing rapidly, we do not consider the separate reporting of the results of operations of the former E-Plus Group appropriate.

To allow for a better comparison, selected indicators are presented in this section exclusively on a combined basis<sup>3</sup>.

In the financial year 2015, the Telefónica Deutschland Group successfully pursued the priorities of maintaining market momentum while driving the integration and transforming the company to becoming the leading digital telecommunication company in Germany. With a number of important integration milestones already achieved, the financial and operational performance reflects the contribution of synergy-driven savings plus optimisation of commercial costs from the continued focus on the development of the customer base. The German mobile market remained dynamic with a largely stable pricing environment, in particular in the premium segment.

Mobile service revenue was broadly stable at +0.1 % year on year for the financial year 2015, reaching EUR 5,532 million. This was mainly the result of the company strategy and the strong contribution of the partner business. We continue to see increasing data usage from our customers, leveraging the demand for LTE. Other effects, such as the lower usage of traditional text messaging and the renewal of expired long-term contracts for lower prices within the premium brand customer base continue to have a less dilutive impact. As such, mobile service revenue for the twelve months of 2015 are in line with our expectation for 2015.

Operating Income before Depreciation and Amortisation (OIBDA) for the financial year 2015 amounted to EUR 1,804 million. Excluding the exceptional effects of the period (a EUR 15 million gain from the sale of yourfone GmbH, restructuring costs of EUR 73 million and net income of the purchase price adjustment from the acquisition of the E-Plus Group in an amount of EUR 102 million) OIBDA for the twelve months period 2015 was EUR 1,760 million, which represents

a growth of 20.5 % year on year on a combined basis<sup>3</sup>. The substantial OIBDA growth in the twelve-month period 2015 was the result of our focused commercial approach and related optimisation of costs plus the early capture of integration synergies. The evolution for the period until September 2015 already slightly exceeded our expectations as we could bring forward significant integration activities from 2016 into 2015, while the overall synergy case remains unchanged. On the back of this outperformance we updated our outlook for OIBDA before exceptional effects for the full year 2015 in the Condensed Interim Group Management Report for the period 1 January to 30 September 2015 to be higher year on year by 15 % to 20 % (previously more than 10 %). As such, the actual performance is in line with expectations.

Capital expenditures (CapEx), in the twelve-month period 2015 amounted to EUR 1,032 million, a decline of 11.1 % year on year on a combined basis<sup>3</sup>. The decline in the first nine months 2015 was slightly better than expected, mainly driven by phasing and the realisation of CapEx synergies which outweigh investments for the LTE rollout and network integration costs. As such, we updated our full-year outlook for CapEx in the Condensed Interim Group Management Report for the period 1 January to 30 September 2015 to a low double-digit decline (from a high single-digit decline) year on year. Telefónica Deutschland Group maintained a clear focus on the accelerated deployment of the LTE network, giving priority to urban areas while customers have already started to experience the first tangible results from the combination of the two networks. CapEx for the full year 2015 is in line with our expectation and the updated outlook.

The business development is further detailed in the following sections.

<sup>3</sup> Combined figures for 2014 are based on estimates and are the result of the aggregation and subsequent consolidation of the Telefónica Deutschland Group and the E-Plus Group financials according to Telefónica Deutschland Group accounting policies. The combined figures are further adjusted by material exceptional effects, such as capital gains or restructuring costs based on estimates made by Telefónica Deutschland management, resulting in combined figures that we believe are more meaningful as a comparable basis. The combined financials are not necessarily indicative of results that would have occurred if the business had been a separate stand-alone entity during the year presented or of future results of the business. The presentation of the combined financial information is based on certain assumptions and is intended for illustrative purposes only. The combined information describes a hypothetical situation and thus, due to its nature, the presentation does not reflect the actual results of operations. The assumed acquisition date was the start of the 2014 calendar year.

## T01 — Overview 2015

|                                  | Base line for 2014 <sup>4</sup><br>(EUR million) | Initial Outlook 2015 <sup>5</sup><br>(year-on-year pct. growth) | Updated Outlook 2015<br>(year-on-year pct. growth) | Financial year 2015 <sup>3</sup><br>(y-o-y pct. growth) | Evaluation  |
|----------------------------------|--|---|--|---|-------------|
| MSR                              | 5,528  | Broadly stable  | Broadly stable                                     | +0.1 %  | As expected |
| OIBDA before exceptional effects | 1,461  | > 10 %  | 15–20 %  | +20.5 %   | As expected |
| CapEx                            | 1,161  | High single-digit pct. decline                                  | Low double-digit pct. decline                      | (11.1 %)  | As expected |

### Significant events

#### Integration and transformation of E-Plus continues

The change in legal form of E-Plus Mobilfunk to a limited liability company under German law (GmbH) was entered in the commercial register on 26 January 2015. On 4 February 2015, a profit transfer agreement was concluded with Telefónica Germany GmbH & Co. OHG effective as of 1 January 2015, with the result that E-Plus Mobilfunk GmbH, including its income tax group subsidiary companies, was included in the income tax group of the Telefónica Deutschland Group effective as of 1 January 2015.

#### yourfone sold to Drillisch

The sale of yourfone GmbH to Drillisch was closed on 2 January 2015. The Telefónica Deutschland Group reported net inflows of EUR 57 million from the sale in the reporting period and generated a gain on disposal of EUR 15 million, which was recognised in the Consolidated Income Statement under other income.

#### Framework redundancy plan adopted

In February 2015, the Management Board and Works Councils of the Telefónica Deutschland Group agreed a framework redundancy plan that will apply until the end of 2018. Based on the regulations set out in this plan, the implementation of the 2015 redundancy programme for around 800 FTEs began in the first quarter of 2015 as planned and came close to being finalised by the end of the period under review.

4 Combined figures for 2014 are approximate and the result of the aggregation and then consolidation of Telefónica Deutschland and E-Plus Group financials according to Telefónica Deutschland Group accounting policies. The combined figures are further adjusted by exceptional effects, such as capital gains or restructuring costs based on estimates made by Telefónica management and resulting in combined figures we believe are more meaningful as a comparable basis. Financials also exclude material one-offs such as capital gains or restructuring costs (EUR 414 million in 2014).

5 All expected regulatory effects (MTR cuts and others) are included in the outlook. Restructuring costs from the integration of E-Plus Group are excluded from OIBDA Outlook. CapEx excludes investments in spectrum and includes specific restructuring investments.

#### Promissory notes and registered bonds placed

On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds. The transaction was announced on 2 February 2015 with a target volume of EUR 250 million but was implemented at a volume of EUR 300 million due to the high oversubscription.

The promissory notes were issued in unsecured tranches with terms of five, eight and ten years, with both fixed and floating interest rates. The registered bonds were issued in unsecured tranches with terms of 12, 15 and 17 years with fixed interest rates. All tranches were issued by Telefónica Germany GmbH & Co. OHG, Munich.

The fixed-rate tranche with a nominal value of EUR 52 million and a term of five years bears interest at 0.961 %; the floating-rate tranche with a nominal value of EUR 60.5 million bears interest at 6-months Euribor +65 bp.

The fixed-rate tranche with a nominal value of EUR 19.5 million and a term of eight years bears interest at 1.416 %; the floating-rate tranche with a nominal value of EUR 1.5 million bears interest at 6-months Euribor +85 bp.

The fixed-rate tranche with a nominal value of EUR 29.5 million and a term of ten years bears interest at 1.769 %; the floating-rate tranche with a nominal value of EUR 9 million bears interest at 6-months Euribor +105 bp.

The tranches maturing in 12, 15 and 17 years have volumes of 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.

The issue proceeds of the overall transaction were used for general business purposes.

#### Change in the Supervisory Board of Telefónica Deutschland

María Pilar López Álvarez stepped down from the Supervisory Board of Telefónica Deutschland with effect from the end of the Annual General Meeting on 12 May 2015.

Laura Abasolo García de Baquedano was elected as her successor. Her term in office ends with the Annual General

Meeting that resolves on the approval of the actions of the Supervisory Board for the financial year 2016.

#### **Annual General Meeting resolves dividend of EUR 0.24 per share**

The Annual General Meeting of Telefónica Deutschland for the financial year 2014 was held on 12 May 2015. In addition to presenting the Annual Financial Statements of Telefónica Deutschland, including the Group Management Report and the Consolidated Financial Statements, 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 13 May 2015.

#### **Mobile phone frequency auction: Telefónica Deutschland Group secures valuable spectrum**

By the decision of the German Federal Network Agency (BNetzA) on 22 April 2015, the Telefónica Deutschland Group was admitted to the auction of frequencies in the ranges 700 MHz, 900 MHz, 1.8 GHz and 1.5 GHz. The auction began on 27 May 2015 and ended on 19 June 2015.

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 for a total of approximately EUR 1,198 million (REGULATORY INFLUENCES ON THE TELEFÓNICA DEUTSCHLAND GROUP, PAGE 22).

#### **National roaming improves network quality for all customers**

By the end of May 2015, the UMTS networks of the former Telefónica Deutschland Group (O<sub>2</sub>) and the E-Plus Group (E-Plus) had been opened up to all customers of the group, bundling the strength of both networks for the first time. As a result, the customers of all own brands and partner brands can be offered the densest UMTS network infrastructure in urban areas and the most widespread coverage in rural areas. This step improves the user experience of mobile data services even in areas where our customers do not yet have LTE.

#### **Conclusion of new supplier agreements to expand mobile communications network**

In the second quarter of 2015, the Telefónica Deutschland Group concluded agreements with various suppliers of equipment and services for the Telefónica Deutschland Group mobile communications network. This meant the fulfilment of another requirement for the implementation of the integration of the mobile communications networks of the former Telefónica Deutschland Group (O<sub>2</sub>) and the E-Plus Group (E-Plus) and for the further accelerated roll-out of LTE. Under these agreements, the suppliers will provide radio access network equipment and services in the fields of network roll-

out and network maintenance for the Telefónica Deutschland Group from 2015 to 2018.

#### **Transfer of mobile network sites**

In the course of its network integration, the Telefónica Deutschland Group transferred around 7,700 mobile network sites to Deutsche Telekom. A corresponding agreement was signed on 17 July 2015. As planned, the company has realised part of the announced synergies from the network integration with this transaction. Furthermore, Telefónica Deutschland can now utilise resources which would have been required to dismantle these redundant sites to accelerate the roll-out of its LTE network. The Telefónica Deutschland Group can continue to use these sites without restriction over the course of the integration of the O<sub>2</sub> and E-Plus networks until they are no longer needed. The implementation of the transaction resulted in restructuring expenses for network optimisation in the mid-double digit millions. The financial impact of the transfer is included within the synergy expectations relating to the network integration as announced previously.

The mobile network sites were transferred to Deutsche Telekom on 1 October 2015.

#### **Start of use of network capacity by Drillisch**

As part of the merger with the E-Plus Group and the merger clearance process, the Telefónica Deutschland Group committed to sell some of its network capacity. In 2014, the Telefónica Deutschland Group signed an MBA MVNO ("Mobile Bitstream Access Mobile Virtual Network Operator") agreement with Drillisch (ANNUAL REPORT 2014, 2.2 OVERVIEW OF THE FINANCIAL YEAR 2014 – SIGNIFICANT EVENTS). As of 1 July 2015, Drillisch can now access the network capacity of the Telefónica Deutschland Group as planned according to the agreed mobile bitstream access model.

#### **Dividend proposal for the financial year 2015**

On 5 November 2015, the Management Board of Telefónica Deutschland announced its intention to propose a cash dividend of EUR 0.24 per share to the next Annual General Meeting, which is scheduled for 19 May 2016.

#### **Agreement on subsequent purchase price adjustment with KPN**

Pursuant to the agreement dated 23 July 2013 in the amended versions as of 26 and 28 August and 5 December 2013, 24 March, 7 August and 30 September 2014 and 18 June 2015, Telefónica Deutschland, Telefónica, S.A. and Koninklijke KPN N.V., The Hague, Netherlands ("KPN") concluded an agreement regarding the acquisition of KPN's German mobile business E-Plus by Telefónica Deutschland.

In December 2015, KPN and Telefónica Deutschland agreed on a subsequent purchase price adjustment in accordance with the purchase agreement. Thus, the adjusted

cash component of the purchase price amounts to EUR 3,501,027,199.20.

## Results of operations

*Revenues increased to EUR 7.9 billion./Mobile service revenues broadly stable./Lower expenses due to realisation of synergies./OIBDA before exceptional effects increases to EUR 1.8 billion.*

The acquisition of the E-Plus Group as of 1 October 2014 has changed the results of operations of the Telefónica Deutschland Group significantly. As the integration of the E-Plus Group is progressing rapidly, we do not consider the separate reporting of the results of operations of the former E-Plus Group appropriate.

To allow a better comparison, selected indicators in the following section are also presented on a combined basis<sup>3</sup> for the financial year 2014.

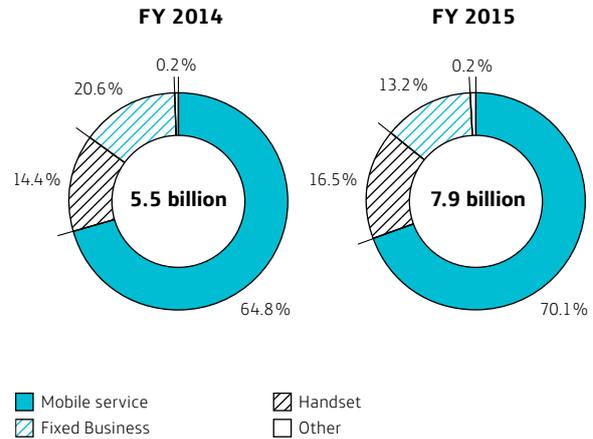
A presentation of business performance compared with the previous year can be found in the > TABLE 03: CONSOLIDATED INCOME STATEMENT, PAGE 31.

### Revenue increased

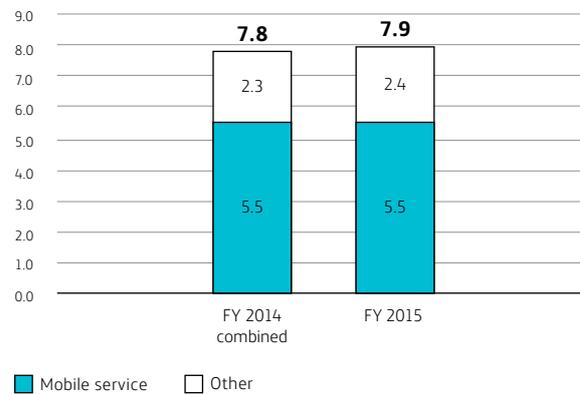
In the financial year 2015, we increased our revenues by EUR 95 million or 1.2% to EUR 7,888 million on the basis of combined<sup>3</sup> figures for 2014. This is due to the higher level of revenues from mobile business, and particularly the growth in handset revenues. Mobile service revenues saw a broadly stable development. Revenues from fixed business were lower on account of the smaller DSL customer base. The strong growth in mobile data business and higher sales of mobile devices had a positive impact on revenue development.

Based on the reported figures, the financial year 2015 saw a year-on-year increase of EUR 2,366 million or 42.9%. The increase in revenues is primarily due to growth in the mobile business as a result of the merger with the E-Plus Group from 1 October 2014.

**G 14— Revenues on a reported basis (in %)**



**G 15— Revenues on a combined basis<sup>3</sup> (Euros in billion)**



### Mobile service revenues broadly stable on combined basis<sup>3</sup>

Our mobile services revenues for the financial year 2015 amounted to EUR 5,532 million and were largely stable as expected, with moderate growth of EUR 4 million or 0.1% based on combined<sup>3</sup> figures for 2014.

In a demanding market and competitive environment in Germany, we performed well thanks to our focus on customer retention measures for our own brands and the strong growth in customer numbers, especially in partner and pre-paid business. Our postpay mobile customer base increased net by 709 thousand in the financial year 2015 (increase in the financial year 2014 combined<sup>3</sup>: 946 thousand).<sup>6</sup> The in-

<sup>6</sup> Excluding an impact from a business customer base harmonisation at the E-Plus Group.

creased share of prepaid customers in our mobile access base (55.7%) led to a reduction in average revenue per user (ARPU) to 10.7 EUR compared with the prior-year level (2014 combined<sup>3</sup>: 11.0 EUR). Network enhancements have resulted in an improved customer experience. Since the launch of national roaming in the first half of 2015 our customers are able to use both mobile networks of O<sub>2</sub> and E-Plus, while LTE network coverage is continuously increasing. 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 thanks to the expansion of the O<sub>2</sub> Blue All-in portfolio and the implementation of our data automatic and data upselling mechanisms (▶ GOALS AND STRATEGIES, PAGE 9).

Based on the reported figures, mobile service revenues increased by EUR 1,952 million or 54.5% to EUR 5,532 million year on year to in the financial year 2015; this was due in particular to the increased customer base following the merger with the E Plus Group.

#### Significant growth in handset revenues

Handset revenues are subject to fluctuation, as they depend on the launch of new mobile devices. In the financial year 2015, handset revenues amounted to EUR 1,300 million. The additional revenues resulting from the merger with the E-Plus Group and increased sales figures for mobile devices, including to mobile partners, contributed to the year-on-year increase of EUR 505 million or 63.6%.

Revenues from mobile business, comprising mobile service revenues and handset revenues, amounted to EUR 6,832 million in the financial year 2015. This corresponds to a year-on-year increase of EUR 2,457 million or 56.2%.

#### Decline in revenues from fixed business slows down

In the financial year 2015, revenues from fixed business amounted to EUR 1,043 million. This corresponds to a decline of EUR 95 million or 8.3% compared with the same period of the previous year. This is attributable to the reduced customer base as a result of the progressive decommissioning of the ULL broadband access infrastructure and the decline in fixed voice accesses. Over the course of the financial year 2015, the improved traction of the retail DSL business helped to stem the decline in the wholesale ADSL and voice carrier business, mainly driven by the good demand for our "O<sub>2</sub> DSL All-in" tariffs as well as the continuing positive customer development in the VDSL business.

#### Other revenues increase by 46%

In the financial year 2015, other revenues increased by 45.9% year on year to EUR 12 million, particularly as a result of increased mobile marketing activities.

#### Other income

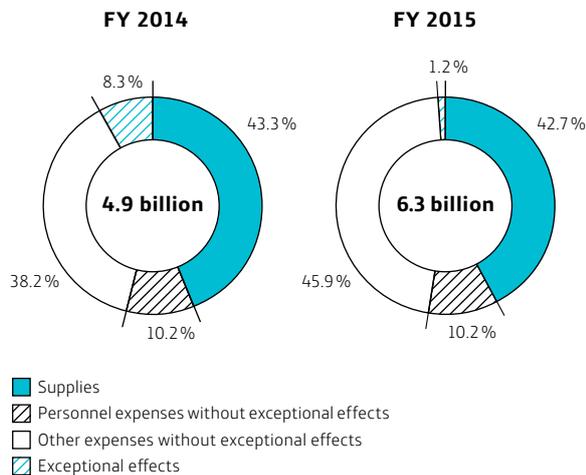
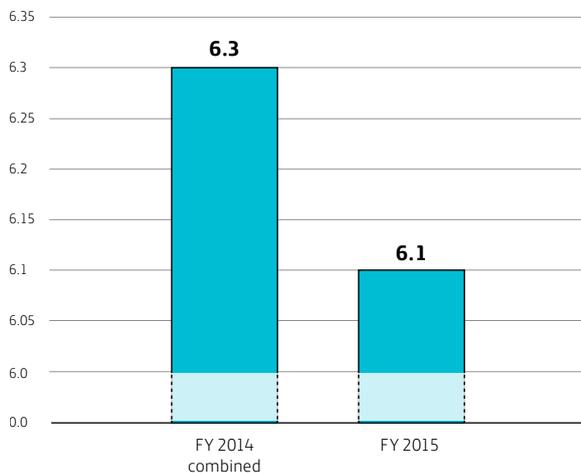
In the financial year 2015, other income increased by EUR 159 million or 150.4% year on year to EUR 265 million. Besides own work capitalised, exceptional effects were included in 2015, which comprise a non-recurring gain on the disposal of yourfone GmbH in the amount of EUR 15 million and income from an agreement on the final purchase price for the acquisition of the E-Plus Group in an amount of EUR 104 million.

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

In the financial year 2015, operating expenses, comprising supplies, personnel expenses and other expenses, increased by EUR 1,401 million or 28.3% year on year to EUR 6,349 million. The growth in operating expenses is primarily attributable to the merger with the E-Plus Group with effect from 1 October 2014. A contrary effect had the fast realisation of synergies from integration. Expenses for restructuring in the context of the integration in an amount of EUR 73 million were mainly recognised in other expenses.

## T02 — Revenue Breakdown

| (in Euros million)      | January 1 to December 31 |              |              |              |
|-------------------------|--------------------------|--------------|--------------|--------------|
|                         | 2015                     | 2014         | Change       | % Change     |
| <b>Mobile business</b>  | <b>6,832</b>             | <b>4,375</b> | <b>2,457</b> | <b>56.2</b>  |
| Mobile service revenues | 5,532                    | 3,580        | 1,952        | 54.5         |
| Handset revenues        | 1,300                    | 795          | 505          | 63.6         |
| <b>Fixed business</b>   | <b>1,043</b>             | <b>1,138</b> | <b>(95)</b>  | <b>(8.3)</b> |
| <b>Other revenues</b>   | <b>12</b>                | <b>8</b>     | <b>4</b>     | <b>45.9</b>  |
| <b>Revenues</b>         | <b>7,888</b>             | <b>5,522</b> | <b>2,366</b> | <b>42.9</b>  |

**G16—Operating Expenses on a reported basis (in %)****G17—Sum of operating expenses and other income without exceptional effects on a combined basis<sup>3</sup> (Euros in billions)****Supplies driven by revenue growth**

In the financial year 2015, supplies amounted to EUR 2,712 million. This corresponds to a year-on-year increase of EUR 568 million or 26.5 %, mainly due to the merger with the E-Plus Group. The expenses for handsets sold increased to a smaller degree than the corresponding revenues from mobile hardware.

**Personnel expenses decline during the year**

In the financial year 2015, personnel expenses decreased by EUR 173 million or 20.9 % to EUR 655 million. Adjusted for personal related restructuring expenses (2015: EUR 4 million; 2014: EUR 321 million), the increase would have amounted to 28.5 %. This was due in particular to the higher costs as a result of the merger with the E-Plus Group. Personnel expenses declined during the financial year as a result of the reduction in the number of FTEs and were, adjusted for provisions for restructuring, 11.7 % lower in the second half of 2015 than in the first half.

**Increase in other expenses**

In the financial year 2015, other expenses amounted to EUR 2,982 million, an increase of EUR 1,006 million or 50.9 % on the financial year 2014. Adjusted for restructuring expenses (2015: EUR 69 million; 2014: EUR 87 million), the increase would have amounted to 54.2 %. This development was due in particular to the merger with the E-Plus Group. Savings resulted from the implementation of integration-related measures, such as the reduction in the number of shops and commercial measures.

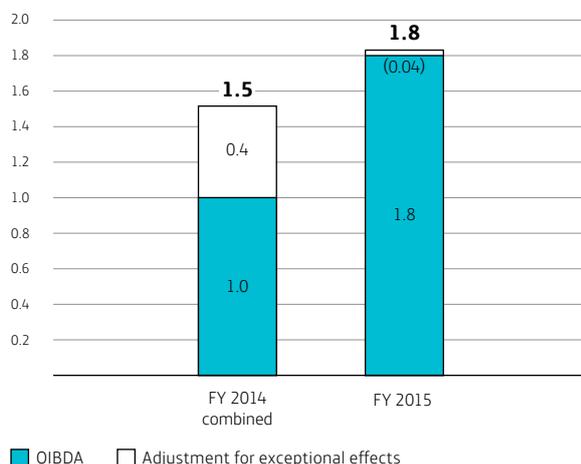
**Progress in integration reflected in positive OIBDA development**

We generated OIBDA adjusted for exceptional effects of EUR 1,760 million in the financial year 2015, which corresponds to a growth of EUR 300 million or 20.5 % based on combined<sup>3</sup> figures for the financial year 2014. This reflects the slightly higher level of revenues generated, our value-optimised handset sales model and the lower cost base thanks to the accelerated realisation of synergies from the integration. At 22.3 %, the resulting OIBDA margin before exceptional effects was up on the figure of 18.7 % on a combined<sup>3</sup> basis for the financial year 2014.

The exceptional effects in the financial year 2015 account for net earnings in the amount of EUR 43 million. These comprise a non-recurring 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 net of expenses to reach the agreement in an amount of EUR 102 million. In contrary, restructuring expenses incurred in connection with the merger with the E-Plus Group in the amount of EUR 73 million. OIBDA in the previous year included restructuring expenses of EUR 409 million (2014 combined<sup>3</sup>: EUR 414 million).

OIBDA for the financial year 2015 amounted to EUR 1,804 million, an increase of EUR 1,124 million or 165.5 % as against the previous year. This was due in particular to the merger with the E-Plus Group with effect from 1 October 2014. At 22.9 %, the resulting OIBDA margin was higher than in the previous year (2014: 12.3 %). Applying the combined<sup>3</sup> figures for the financial year 2014, OIBDA would have increased by EUR 757 million or 72.3 %.

### G 18 — OIBDA without exceptional effects on a combined basis<sup>3</sup> (Euros in billions)



### Increased depreciation and amortisation due to consolidation of E-Plus

At EUR 2,067 million, depreciation and amortisation increased by 58.9% compared with the previous year (2014: EUR 1,300 million).

This increase was in particular due to the inclusion of E-Plus Group, especially the resulting amortisation of customer lists and licences as well as due to the partially shorter useful life of certain assets resulting from the merger of the two networks.

Operating income improved by EUR 358 million or 57.6% year on year to EUR –263 million (2014: EUR –621 million).

The net financial expense 2015 amounted to EUR –48 million (2014: EUR –34 million). The year-on-year development was primarily due to the company's on average higher level of net debt compared with the previous year. Net financial expense mainly includes interest for the bonds issued in November 2013 and February 2014, interest as a result of the initial placement of promissory notes and registered bonds on 13 March 2015, as well as interest from finance lease commitment.

The Telefónica Deutschland Group did not record any positive taxable income in 2015 and hence will not pay any current income tax once again. Accordingly, the tax expenses of EUR 72 million in the financial year primarily relate to changes in deferred taxes. In the previous period, an expense of EUR 34 million resulted from deferred taxes.

The aforementioned effects led to a result of EUR –383 million in the current financial year compared with EUR –689 million in the previous year.

### T 03 — Consolidated Income Statement

| (Euros in millions)  | January 1 to December 31 |                   |              |                 |
|--|--------------------------|-------------------|--------------|-----------------|
|  | 2015                     | 2014 <sup>1</sup> | Change       | % Change        |
| <b>Revenues</b>  | <b>7,888</b>             | <b>5,522</b>      | <b>2,366</b> | <b>42.9</b>     |
| Other income   | 265                      | 106               | 159          | >100            |
| Operating expenses   | (6,349)                  | (4,948)           | (1,401)      | 28.3            |
| Supplies   | (2,712)                  | (2,144)           | (568)        | 26.5            |
| Personnel expenses   | (655)                    | (828)             | 173          | (20.9)          |
| Other expenses   | (2,982)                  | (1,976)           | (1,005)      | 50.9            |
| <b>Operating income before depreciation and amortisation (OIBDA)</b> | <b>1,804</b>             | <b>679</b>        | <b>1,124</b> | <b>&gt;100</b>  |
| <b>OIBDA margin</b>  | <b>22.9%</b>             | <b>12.3%</b>      |              | <b>10.6%-p.</b> |
| Depreciation and amortisation  | (2,067)                  | (1,300)           | (766)        | 58.9            |
| <b>Operating income</b>  | <b>(263)</b>             | <b>(621)</b>      | <b>358</b>   | <b>(57.6)</b>   |
| Net financial income (expense)                                       | (48)                     | (34)              | (13)         | 38.1            |
| <b>Profit (loss) before tax for the period</b>                       | <b>(311)</b>             | <b>(655)</b>      | <b>345</b>   | <b>(52.6)</b>   |
| Income tax   | (72)                     | (34)              | (38)         | >100            |
| <b>Total profit (loss) for the period</b>                            | <b>(383)</b>             | <b>(689)</b>      | <b>307</b>   | <b>(44.5)</b>   |

<sup>1</sup> Unless indicated otherwise, values include retrospective adjustments from the purchase price allocation (PPA) within the twelve-months-period following the acquisition of the E-Plus Group as of October 2014 (IFRS 3).

## Financial position

*The net leverage ratio will be kept at or below 1.0x in the medium term./Telefónica Germany is benefiting from intragroup cash pooling./Net financial debt increased to EUR 1,225 million./Free cash flow declined moderately to EUR 700 million as a result of the lower level of working capital while at the same time OIBDA is increasing./Intangible assets and investments increased significantly in the year under review.*

### 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.

One key performance indicator in this respect is the net leverage ratio<sup>2</sup>. 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

Loans are procured using bilateral facilities with banks and Telefónica, S.A as well as capital market instruments. Basically Telefónica Deutschland Group, examines the current market situation permanently to analyse alternative funding opportunities in order to optimise sustainably the capital structure.

#### Further reduction in intragroup loans

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 from this loan agreement amounts to EUR 500 million as of 31 December 2015.

#### Unused credit facilities provide financial flexibility

The group's financial flexibility remains secure thanks to the availability of unused credit facilities totalling EUR 750 million. These are bilateral revolving credit facilities with various banks in the amount of EUR 710 million with a remaining term of more than one year and a working capital facility in

the amount of EUR 40 million with a remaining term of less than one year.

#### 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 %     |

#### Successful placement of promissory notes and registered bonds

On 13 March 2015, the Telefónica Deutschland Group successfully completed an initial placement of promissory notes and registered bonds with different maturities to 2032 and a total volume of EUR 300 million. With this transaction, we took advantage of the current low interest rates on the promissory note market to strengthen the group's financing structure and extend the maturity structure of our financial liabilities.

#### Telefónica Deutschland Group continues benefiting from the 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. In this way, we are benefiting 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. On 24 June 2015, these overdraft facilities were temporarily increased by EUR 170 million until 31 January 2016. The normal agreement with Telfisa Global B.V. has a term of one year and, in addition to rights of special termination and information, grants the participants from the Telefónica Deutschland Group the option of offsetting deposit claims against loans granted by Telfisa Global B.V. 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

In connection with the monthly payments for the “O<sub>2</sub> My Handy” model, we have concluded factoring agreements with certain credit institutions regarding the sale of receivables in order to strengthen our working capital. That means that the payments for the “O<sub>2</sub> My Handy” models are made to us without delay if we have concluded a factoring agreement with the credit institutions for these receivables. Five factoring transactions with a net cash effect of EUR 67 million, EUR 113 million, EUR 74 million, EUR 110 million and EUR 180 million were concluded in the financial year 2015. 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 2015 (NOTE NO. 5.4 TRADE AND OTHER RECEIVABLES, PAGE 107).

### 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, we recognise liabilities to the leasing company and receivables from the customer. 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 were concluded. Further information can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2015 (NOTE NO. 5.10 INTEREST-BEARING DEBT, PAGE 112).

### Financial efficiency and payment flexibility increased by extension of payment periods

In order to obtain greater financial efficiency and cash flexibility, Telefónica has reached agreements with certain commercial suppliers to extend payment periods. All postponements will result in payment of interests expressly agreed. 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 accrual of interest agreed for the delay in the payment of the debt are recognised as financial expense.

## Finance analysis

### Growth in net financial debt due to factors including investments in mobile frequencies

Table 5 shows the composition of net financial debt – i.e. the net amount of interest-bearing financial liabilities less cash and cash equivalents and interest-bearing financial assets and receivables. Compared with 31 December 2014, net financial debt increased by EUR 1,206 million to EUR 1,225 million as of 31 December 2015. This resulted in a net leverage ratio<sup>7</sup> of 0.7x.

The increase in net financial debt was mainly attributable to a year-on-year reduction in cash and cash equivalents of EUR 1,169 million. This decrease was mainly due to the payment of the obligations from the mobile frequency auction in the amount of EUR 978 million, the payment of the dividend for the financial year 2014 in the amount of EUR 714 million and other financing activities.

The cash payment from KPN in an amount of EUR 134 million less payments to reach the agreement of EUR 2 million which resulted from the agreement on the final purchase price for the acquisition of the E-Plus Group and the free cash flow pre dividends and payments for spectrum as well as pre-acquisition of E-Plus of EUR 700 million had an opposite effect.

The > GRAPH 19: DEVELOPMENT OF NET FINANCIAL DEBT, PAGE 34 shows the development of net financial debt in the financial year 2015.

### Off balance sheet obligations

Our contractual obligations as of 31 December 2015 are shown in > TABLE 05: OPERATING LEASE OBLIGATIONS, PURCHASE OBLIGATIONS AND OTHER CONTRACTUAL OBLIGATIONS, PAGE 33. 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.

<sup>7</sup> Leverage is defined as net financial debt divided by LTM (last twelve months) OIBDA before exceptional effects (EUR 1,760 million in 2015; EUR 1,088 million in 2014).

## T05 — Operating lease obligations, purchase obligations and other contractual obligations

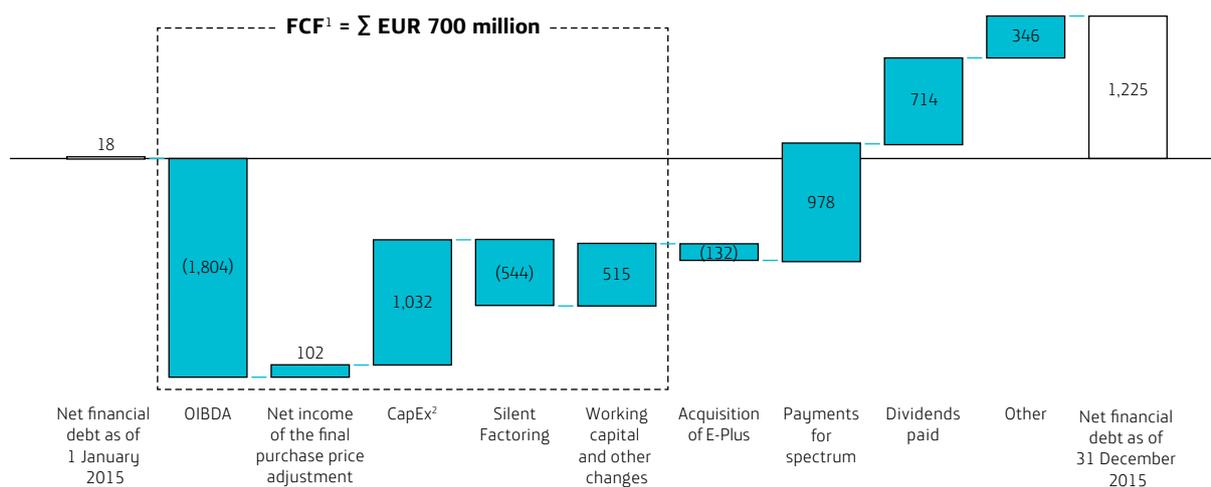
| (Euros in millions)                                    | Payment due by period |              |              |              |
|--|-----------------------|--------------|--------------|--------------|
|  | Less than 1 year      | 1 to 5 years | Over 5 years | Total        |
| Operating lease obligations                            | 513                   | 1,164        | 817          | 2,494        |
| Purchase obligations and other contractual obligations | 1,561                 | 267          | 701          | 2,529        |
| <b>Total</b>   | <b>2,074</b>          | <b>1,431</b> | <b>1,518</b> | <b>5,023</b> |

## T06—Development of consolidated net financial debt

| (Euros in millions)                   | As of December 31 |                   |         |          |
|---------------------------------------|-------------------|-------------------|---------|----------|
|                                       | 2015              | 2014 <sup>2</sup> | Change  | % Change |
| A Liquidity                           | 533               | 1,702             | (1,169) | (68.7)   |
| B Current financial assets            | 324               | 456               | (133)   | (29.1)   |
| C Current financial debt              | 564               | 619               | (55)    | (8.8)    |
| D=C-A-B Current net financial debt    | (292)             | (1,539)           | 1,247   | (81.0)   |
| E Non-current financial assets        | 169               | 250               | (81)    | (32.4)   |
| F Non-current financial debt          | 1,686             | 1,808             | (122)   | (6.7)    |
| G=F-E Non-current net financial debt  | 1,517             | 1,557             | (41)    | (2.6)    |
| H=D+G Net financial debt <sup>1</sup> | 1,225             | 18                | 1,206   | >100     |

- 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 321 million in 2015 and EUR 454 million in 2014; non-current: EUR 157 million in 2015 and EUR 236 million in 2014), positive fair value hedge for fixed interest financial liabilities (current: EUR 2 million in 2015 and EUR 2 million in 2014; non-current: EUR 12 million in 2015 and EUR 12 million in 2014) as well as loans to third parties (current: EUR 1 million in 2015 and EUR 1 million in 2014; non-current: EUR 1 million in 2015 and EUR 1 million in 2014).
- C + F** Current and non-current net financial debt include bonds, promissory notes and registered bonds issued (EUR 1,420 million in 2015 and EUR 1,115 million in 2014), other loans (EUR 501 million in 2015 and EUR 726 million in 2014), finance lease payables (current: EUR 180 million in 2015 and EUR 382 million in 2014; non-current: EUR 32 million in 2015 and EUR 204 million in 2014) as well as current interest-bearing trade payables (EUR 119 million in 2015 and EUR 0 million in 2014).
- Note:**  
Handset-receivables are shown under trade and other receivables in the Consolidated Statement of Financial Position. Pending payments for spectrum amounting to EUR 220 million (including capitalised costs of borrowed capital) are shown under trade payables against third parties in the Consolidated Statement of Financial Position and are therefore not included in the net financial debt calculation.
- 2 Unless indicated otherwise, values include retrospective adjustments from the purchase price allocation (PPA) within the twelve-months-period following the acquisition of E-Plus Group as of October 2014 (IFRS 3).

## G19—Development of net financial debt (Euro in millions)



- 1 Free cash flow pre dividends and payments for spectrum as well as pre-acquisition of E-Plus net of cash acquired
- 2 Excluding investments in Spectrum in June 2015 amounting to EUR 1,198m (including capitalized costs on borrowed capital)

## 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 2015 and 2014. The cash flows from operating activities, investing activities and financing activities discussed below include the Q4 2014 cash inflows/outflows of the E-Plus Group, which was acquired by the Telefónica Deutschland Group on 1 October 2014.

#### Cash flow from operating activities was driven by OIBDA increase and movements in working capital

Cash flow from operating activities was EUR 1,838 million in the financial year 2015, and thus EUR 428 million higher than the amount of the previous year (2014: EUR 1,410 million). This increase is mainly due to the sharp rise in OIBDA (2015: EUR 1,804 million) in the amount of EUR 1,124 million in comparison to the prior year (2014: EUR 679 million), the payment of EUR 150 million received from Drillisch in connection with the MBA MVNO as well as by new agreements signed with certain commercial suppliers to extend payment periods which did not lead to cash-outflows in 2015 amounting to EUR 119 million.

These effects are partially offset by the restructuring provision. The prior year also includes a one-off effect of EUR 269 million due to other advance payments received for future service.

#### Cash flow from investing activities increased mainly due to investments in frequency auction

Cash flow from investing activities amounted to EUR –1,984 million in the financial year 2015 compared to the previous year. The cash outflow decreased by EUR 1.940 million (2014: EUR –3,924 million) compared to the previous year

mainly because of the cash outflows due to the acquisition of E-Plus Group in 2014.

In 2015, payments on investments in property, plant and equipment and intangible assets<sup>8</sup> totalled EUR 2,061 million (2014: EUR 689 million) and are mainly related to investments for the roll-out of the LTE network, the expansion of the UMTS technology capacities, improvement of performance as well as improved coverage of the mobile networks and investments in frequency auction.

#### Development of cash flow from financing activities influenced by capital increase transaction concluded in 2014

Cash flow from financing activities amounted to EUR –1,023 million in the reporting year and decreased in comparison to the previous year (2014: EUR 3,523 million) by EUR 4,546 million. This decrease is mainly due to the cash inflow from the cash capital increase concluded in 2014. The cash outflows in 2015 from financing activities are mainly due to the dividend payments of EUR 714 million, the partial repayment of EUR 225 million of the loan with an initial volume of EUR 1,250 million, which Telefonica Germany GmbH & Co. OHG concluded with Telfisa Global B.V as lender and the settlement of existing leasing agreements. This was partly offset by the cash inflow from the initial placement of promissory notes and registered bonds issued in March 2015 with a nominal amount of EUR 300 million.

<sup>8</sup> Investment expenditure respectively CapEx (EUR 1,032 million; 2014: EUR 849 million); plus payments on investments mobile phone frequency auction (EUR 978 million; 2014: EUR 0 million); plus the change in liabilities for investments made (EUR 61 million; 2014: EUR –211 million); and plus the change in reserve for outstanding invoices for investments (EUR –10 million; 2014: EUR 51 million); results in payments in investments for property, plant and equipment and intangible assets of EUR 2,061 million (2014: EUR 689 million).

## T 07 — Consolidated Statement of Cash Flows

| (Euros in millions)  | January 1 to December 31 |                   |
|--|--------------------------|-------------------|
|  | 2015                     | 2014 <sup>1</sup> |
| <b>Cash and cash equivalents at the beginning of the period</b>                            | <b>1,702</b>             | <b>709</b>        |
| Cash flow from operating activities  | 1,838                    | 1,410             |
| Cash flow from investing activities  | (1,984)                  | (3,924)           |
| Cash flow from financing activities  | (1,023)                  | 3,523             |
| <b>Net increase (decrease) in cash and cash equivalents</b>                                | <b>(1,169)</b>           | <b>994</b>        |
| <b>Less cash and cash equivalents attributable to assets and liabilities held for sale</b> | <b>–</b>                 | <b>(16)</b>       |
| <b>Cash and cash equivalents at the end of the period</b>                                  | <b>533</b>               | <b>1,702</b>      |

<sup>1</sup> Unless indicated otherwise, values include retrospective adjustments from the purchase price allocation (PPA) within the twelve-months-period following the acquisition of E-Plus Group as of October 2014 (IFRS 3).

### Cash and cash equivalents lower year on year

The cash inflows and outflows described above led to a decrease in cash and cash equivalents by EUR 1,169 million year-on-year. Cash and cash equivalents amounted to EUR 533 million as of 31 December 2015 (2014: EUR 1,702 million).

### Free cash flow pre dividends and payments for spectrum as well as the acquisition of E-Plus down year on year due to lower working capital

Free cash flow pre dividends and payments for spectrum as well as the acquisition of E-Plus declined by EUR 26 million, amounting to EUR 700 million as of 31 December 2015 (2014: EUR 725 million). This development was primarily attributable to the EUR 891 million decrease in working capital, which was only partially offset by the increase in the operating cash flow<sup>9</sup> (OpCF) of EUR 839 million as well as other changes in payments in the amount of EUR 26 million.

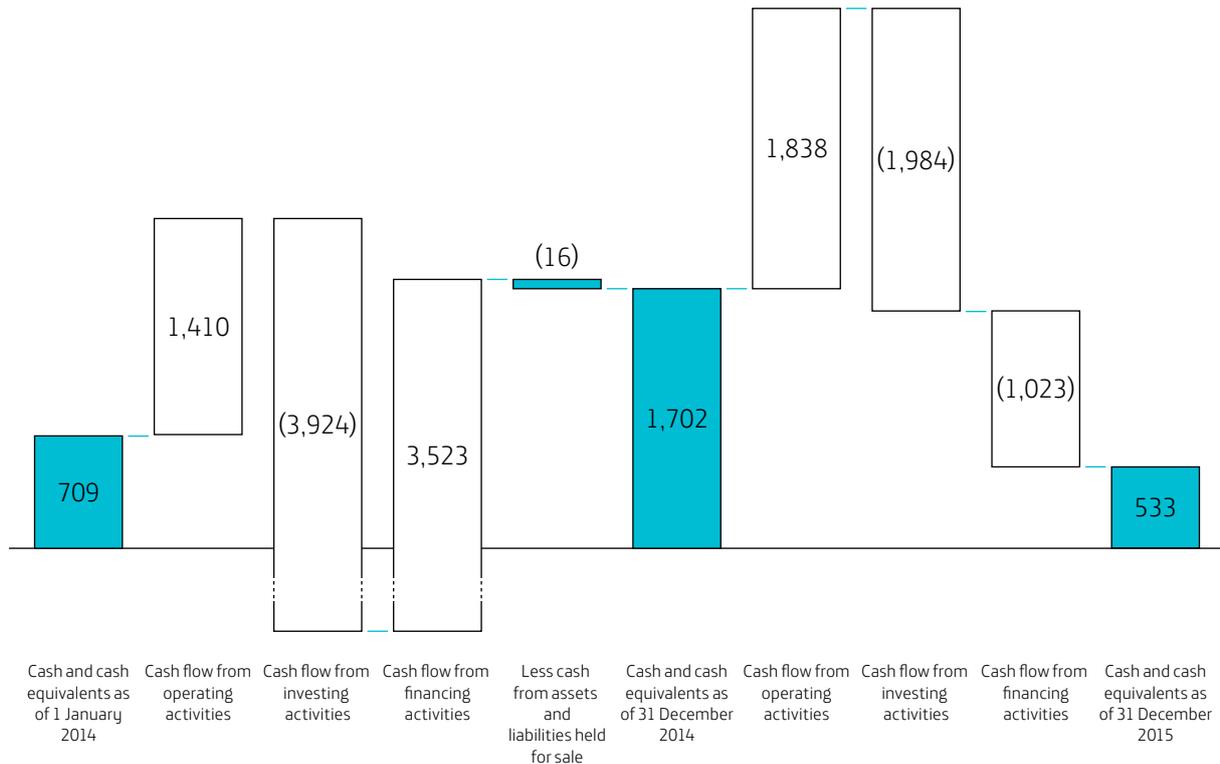
The decrease in the change in working capital for the financial year 2015 compared to previous year change of EUR 891 million is mainly attributable to the increase in non-

current deferred income due to advance payments received for future services in the previous year, and additionally resulted from the change in the restructuring provision. This was partly offset by the advance payments received in 2015 in connection with the MBA MVNO agreement with Drillisch as well as the extension of payment periods with commercial suppliers which did not lead to cash-outs in 2015.

The increase in operating cash flow results from the higher OIBDA in comparison to the financial year 2014 (2015: EUR 1,702 million after deducting the net income of the final purchase price adjustment from the acquisition of E-Plus of EUR 102 million; 2014: EUR 679 million) which, reduced by investments (CapEx) excluding investments in spectrum (2015: EUR 1,032 million; 2014: EUR 849 million) leads to an improvement in income.

<sup>9</sup> OIBDA minus CapEx adjusted by net income of the final purchase price adjustment from the acquisition of E-Plus.

## G 20 — Development of cash flow (Euro in millions)



## T 08— Reconciliation of cash flow and OIBDA minus CapEx

| (Euros in millions)   | 1 January to 31 December |                   |              |                    |
|---|--------------------------|-------------------|--------------|--------------------|
|   | 2015                     | 2014 <sup>1</sup> | Change       | % Change           |
| <b>OIBDA</b>  | <b>1,804</b>             | <b>679</b>        | <b>1,124</b> | <b>&gt;100.0</b>   |
| - Other income and expenses resulting from finalization of purchase price <sup>2</sup>  | (102)                    | –                 | (102)        | 100.0              |
| - CapEx <sup>3</sup>  | (1,032)                  | (849)             | (183)        | 21.6               |
| <b>= Operating cash flow (OpCF)</b>   | <b>670</b>               | <b>(169)</b>      | <b>839</b>   | <b>&gt;(100.0)</b> |
| + Silent Factoring <sup>4</sup>   | 544                      | 203               | 341          | >100.0             |
| +/- Other working capital movements   | (515)                    | 717               | (1,233)      | >(100.0)           |
| <b>Change in working capital</b>  | <b>29</b>                | <b>920</b>        | <b>(891)</b> | <b>(96.8)</b>      |
| +/- Gains/(losses) from sale of companies   | (15)                     | –                 | (15)         | >100.0             |
| +/- Proceeds from sale of companies   | 57                       | (0)               | 57           | >(100.0)           |
| +/- Proceeds from sale of fixed assets and other effects  | 1                        | 1                 | 0            | 12.2               |
| + Net interest payments   | (33)                     | (24)              | (9)          | 38.0               |
| + Taxes paid  | 0                        | (6)               | 6            | >(100.0)           |
| + Proceeds/Payment on financial assets  | (10)                     | 4                 | (14)         | >(100.0)           |
| <b>= Free cash flow pre dividends and payments for spectrum<sup>5</sup> as well as pre-acquisition of E-Plus net of cash acquired</b> | <b>700</b>               | <b>725</b>        | <b>(26)</b>  | <b>(3.5)</b>       |
| + Acquisition of E-Plus net of cash acquired <sup>2</sup>   | 132                      | (3,239)           | 3,371        | >(100.0)           |
| <b>= Free cash flow pre dividends and payments for spectrum<sup>5</sup></b>   | <b>832</b>               | <b>(2,514)</b>    | <b>3,346</b> | <b>&gt;(100.0)</b> |
| - Payments for spectrum   | (978)                    | –                 | (978)        | >100.0             |
| - Dividends <sup>6</sup>  | (714)                    | (525)             | (189)        | 36.0               |
| <b>= Free cash flow post dividends and spectrum</b>   | <b>(860)</b>             | <b>(3,039)</b>    | <b>2,179</b> | <b>(71.7)</b>      |

- 1 Unless indicated otherwise, values include retrospective adjustments from the purchase price allocation (PPA) within the twelve-months-period following the acquisition of the E-Plus Group as of October 2014 (IFRS 3).
- 2 In 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.
- 3 Excluding investments in spectrum in June 2015 amounting to EUR 1,198 million (including capitalised costs on borrowed capital).
- 4 Full impact (YTD) of silent factoring in the twelve month period in 2015 of EUR 554 million and of EUR 203 million in the twelve month period 2014 (transactions have been executed in January, March, June, September and December 2015 respectively in March, June and September of the year 2014).
- 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 amounting to EUR 978 million.
- 6 Dividend payment of EUR 714 million in May 2015. Dividend payment of EUR 525 million in May 2014.

## Net assets

The following analysis of the asset and capital structure compares the assets and liabilities as of 31 December 2015 with the figures as of 31 December 2014 (TABLE 09: CONSOLIDATED STATEMENT OF FINANCIAL POSITION, PAGE 38).

As of 31 December 2015, the group reported assets of EUR 16,654 million (2014: EUR 17,936 million). This represents a decrease of 7.2%.

### Intangible assets increased in particular due to acquisition of frequency usage rights

Intangible assets including goodwill amounted to EUR 9,014 million as of 31 December 2015 (2014: EUR 8,555 million). The year-on-year increase of EUR 458 million or 5.4% resulted from software additions of EUR 293 million and the acquisition of frequency usage rights. 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 for a total of approximately EUR 1,198 million. (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26). This was offset by the amortisation of intangible assets with a finite useful life. The depreciation and amortisation reported for the financial year 2015 amounted to EUR 1.090 million (2014: EUR 629 million).

### Property, plant and equipment down year on year due to depreciation

The carrying amount of property, plant and equipment amounted to EUR 4,507 million as of 31 December 2015 (2014: EUR 4,842 million), down EUR 335 million or 6.9% on the previous year. Current additions to property, plant and equipment amounted to EUR 739 million (2014: EUR 656 million) and mainly related to investments in connection with an accelerated network expansion including the further roll-out

**T 09 — Consolidated Statement of Financial Position**

| (Euros in millions)                                | As of December 31 |                   |                |              |
|--|-------------------|-------------------|----------------|--------------|
|  | 2015              | 2014 <sup>1</sup> | Change         | % Change     |
| Goodwill and other intangible assets               | 9,014             | 8,555             | 458            | 5.4          |
| Property, plant and equipment                      | 4,507             | 4,842             | (335)          | (6.9)        |
| Trade and other receivables                        | 1,677             | 1,781             | (104)          | (5.9)        |
| Deferred tax assets                                | 505               | 581               | (76)           | (13.0)       |
| Other financial assets                             | 73                | 68                | 5              | 8.0          |
| Other non-financial assets                         | 221               | 213               | 8              | 3.6          |
| Inventories  | 123               | 104               | 20             | 18.8         |
| Cash and cash equivalents                          | 533               | 1,702             | (1,169)        | (68.7)       |
| Assets held for sale                               | –                 | 90                | (90)           | (100.0)      |
| <b>Total assets = Total equity and liabilities</b> | <b>16,654</b>     | <b>17,936</b>     | <b>(1,282)</b> | <b>(7.2)</b> |
| Interest-bearing debt                              | 2,254             | 2,430             | (176)          | (7.3)        |
| Provisions   | 712               | 1,028             | (316)          | (30.8)       |
| Trade and other payables                           | 2,425             | 2,302             | 123            | 5.4          |
| Other non-financial liabilities                    | 48                | 18                | 30             | >100.0       |
| Deferred income                                    | 895               | 704               | 191            | 27.1         |
| Liabilities held for sale                          | –                 | 42                | (42)           | (100.0)      |
| <b>Equity</b>                                      | <b>10,321</b>     | <b>11,412</b>     | <b>(1,091)</b> | <b>(9.6)</b> |

1 Unless indicated otherwise, values include retrospective adjustments from the purchase price allocation (PPA) within the twelve-months-period following the acquisition of the E-Plus Group as of October 2014 (IFRS 3).

of the LTE network, the expansion of UMTS technology capacities, the expansion of IP technologies and improved coverage with mobile data services offering even quicker download times.

These additions were offset by depreciation of EUR 977 million (2014: EUR 696 million).

**Lower investments (CapEx) on a combined basis<sup>3</sup>**

With the acquisition of the E-Plus Group as of 1 October 2014, the business activity of the Telefónica Deutschland Group has changed significantly. As the integration of the E-Plus Group is progressing rapidly, we do not consider a separate disclosure of investments (CapEx) of the former E-Plus Group to be appropriate.

To allow a better comparison, CapEx is also disclosed on a combined<sup>3</sup> basis as follows: CapEx amounted to EUR 1,032 million in 2015 compared with EUR 1,161 million on a combined<sup>3</sup> basis in 2014. The reduction resulted primarily from the realisation of synergies, which more than offset the investment in the roll-out of the LTE network and the integration of the network.

**Slight decrease of trade and other receivables**

As of 31 December 2015, trade and other receivables decreased year on year by 5.9% and amounted to EUR 1,677 million (2014: EUR 1,781 million). This decrease is reporting date related and reflects the increased factoring volume.

**Deferred tax assets down slightly**

Deferred tax assets amounted to EUR 505 million, a reduction by 13% as against the previous year (2014: EUR 581 million).

**Other financial assets slightly above prior-year level**

Other financial assets amounted to EUR 73 million as of 31 December 2015, thereby slightly increased against the previous year (31 December 2014: EUR 68 million). This item primarily consisted of the positive fair value of two interest rate swaps, equity investments in start-up enterprises, a silent factoring deposit and claims for reimbursement under insurance policies.

**Other non-financial assets almost at prior-year level**

As of 31 December 2015, other financial assets amounted to EUR 221 million (2014: EUR 213 million) and included advance payments for rents for antenna sites and leased lines in particular.

**Inventories increase due to the launch of new products**

As of 31 December 2015, inventories amounted to EUR 123 million (2014: EUR 104 million). The increase of EUR 20 million or 18.8% was primarily due to the launch of new products, special offers at the year end and higher average prices of mobile phones.

### Cash and cash equivalents decline

Cash and cash equivalents totalled EUR 533 million at year-end 2015 (2014: EUR 1,702 million). This decrease of EUR 1,169 million or 68.7 % is due to various effects (LIQUIDITY ANALYSIS, PAGE 35).

### Interest-bearing debt down on previous year

Interest-bearing debt declined by EUR 176 million or 7.3 %, from EUR 2,430 million as of 31 December 2014 to EUR 2,254 million as of 31 December 2015. This development was attributable in particular to the decline in finance lease liabilities of EUR 374 million and the EUR 225 million repayment of the Telfisa loan. In addition to the initial placement of promissory notes and registered bonds at a nominal amount of EUR 300 million that was completed on 13 March 2015, this was offset by agreements with individual suppliers to extend payment periods. The existing liabilities to these suppliers in an amount of EUR 119 million are reported under the interest-bearing debt due to the contractually agreed interest.

### Provisions lower than in the previous year

Provisions fell by EUR 316 million or 30.8 % year on year to EUR 712 million. This development was mainly due to the reduction of the restructuring provisions of around EUR 178 million as well as the decrease in provision for dismantling and removal of assets in an amount of EUR 107 million.

The provision for restructuring of EUR 220 million as of 31 December 2015 (2014: EUR 399 million) is allocated to personnel adjustments, the termination of contracts with sales representatives, expenses in connection with the transfer of mobile network sites (OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26) and other measures. The majority of the provision amount recognised as of 31 December 2015 is attributable to severance payments in connection with personnel adjustments. These relate to the planned reduction mainly until 2016. An amount of EUR 73 million was recognised for restructuring in the financial year 2014, with EUR 69 million reported in other expenses and EUR 4 million in personnel expenses (NOTE NO. 6.3 PERSONNEL EXPENSES, PAGE 123, AND 6.4 OTHER EXPENSES, PAGE 124).

### Increase in trade and other payables

Trade and other payables amounted to EUR 2,425 million at year-end 2015. The increase compared with 31 December 2014 (EUR 2,302 million) of EUR 123 million or 5.4 % resulted from the outstanding payment obligations from the mobile phone frequency auction (EUR 220 million) disclosed in trade payables. In addition, other payables increased mainly by takeover of obligations from transfer of mobile network sites to Deutsche Telekom (EUR 123 million) in the course of the network integration process. A reduction in other trade payables reported at the end of the financial year had an opposite effect.

### Other non-financial liabilities above previous year

Other non-financial liabilities amounted to EUR 48 million as of 31 December 2015 (2014: EUR 18 million). These include wage tax and social security contributions in particular.

### Year-on-year increase in deferred income

Deferred income increased by EUR 191 million or 27.1 % year on year, amounting to EUR 895 million as of 31 December 2015. This development was due in particular to the payment of EUR 150 million received from Drillisch in connection with the MBA MVNO agreement. Advance payments for prepaid credit also increased by EUR 33 million.

### Equity declines

In the financial year 2015, equity declined by EUR 1,091 million or 9.6 % to EUR 10,321 million (2014: EUR 11,412 million). This development was due in particular to the dividend payment on 12 May 2015 in the amount of EUR 714 million, as well as the loss for the period of EUR 383 million.

# Employees\_

*Our company wants to remain one of the best places to work in Germany./Our number of employees has decreased by 1,472 to 9,464./Our priority is to continue with the integration and to empower our employees to succeed./ We offer a wide range of programmes to balance work and family life.*

Our employees face the everyday challenges of a fast-evolving telecommunications industry. An industry that finds itself in continuous change and that requires constant learning.

To help our employees to meet these challenges, we offer and promote a wide range of initiatives for ongoing learning and development of the key digital and leadership skills. We encourage them to dedicate time to use those learning opportunities and we also give them the freedom to further develop their own capabilities and know-how. Therefore we make sure that the Telefónica Deutschland Group's skill framework meets the requirements of the market.

We promote a working environment based on equal opportunities for all our employees and we are committed to supporting a work-family balance where our employees can easily combine their careers with their family life.

## First- and second-level management

The first level of management in Telefónica Deutschland Group – the Corporate Board – is made up of the Management Board and all the members of the Executive Committee. The Corporate Board has a long-term perspective and is responsible for the Strategy and Business Plan of Telefónica. They meet once every month in Munich or Düsseldorf. The Board of Directors leads the Commercial Operations of the company and reports about it to the Supervisory Board. The Executive Committee is responsible for initiating strategic projects, labour agreements and all other agreements related to the company and its operations.

The second or middle-level of management is responsible for the implementation of the decisions made by the Board of Directors.

As of 31 December 2015, the first level of management of Telefónica Deutschland Group had 14 members. The second level of management had 48 members.

## **Key priorities for personnel management are set**

### Business Transformation

In 2015, a number of initiatives have been implemented to keep driving Telefónica Deutschland Group's integration and transformation into the leading digital telco. These initiatives include measures to realign our resources and core business to the company's strategy.

### Culture Change

Our employees are a key element of our success.

Our Culture Change initiatives promote a certain culture framework among our employees to inspire them, to give them freedom, but also to stand by decisions, to be open, to actively approach customers, to learn how and, above all why people and businesses use technology, but also to question processes, products and ways of thinking. At the end of the day, this culture framework is the foundation for innovation.

### Employee Proposition

Our Employee Proposition 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. Thanks to this we are able to foster the loyalty of our employees and attract the best talents in Germany. We participate in the leading 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 December 2015 we opened our new in-house Shared Service Centre in Düsseldorf.

### Number of employees and staff structure changed significantly

In 2015, Telefónica Deutschland Group had 10,080 employees (2014: 7,222 employees) based on an average view on each end of the quarters of the year 2015 and 2014, respectively. Thereby the employees of the E-Plus Group are included in the fourth quarter of 2014 only. By the closing date of 2015, the number of employees amounts to 9,464 (2014: 10,936 employees). The number of employees thus decreased by 13.5 % compared with the previous year, mainly as a result of the Business Transformation undertaken after the integration of the E-Plus Group.

The basis for these calculations can be viewed in the Consolidated Financial Statements as of 31 December 2015. The fluctuation rate was 21,8 % (2014: 10.2 %).

### G 21 — Employees as of 31 December



The business has a relatively young workforce. The average age of our employees in 2015 was around 39.5 years (2014: 38.0 years). A total of 1,912 employees, representing around 20.3 % of the workforce, worked part time in 2015 (2014: 2,230 employees, 20.4 %), based on closing dates of 2015 and 2014.

### Diversity Management is lived 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 undertook to specifically support women in positions of leadership.

Female employees accounted for 39.9 % of our workforce in 2015. In the 2015 financial year, ten women in leadership positions (2014: 14) were represented in the business-leading Senior Management, corresponding to a proportion of 15.2 % (2014: 14.1 %) based on closing date of 2015 or 2014. In the Women-on-Board Index 100 II 2015, we achieved first place out of 100 listed German corporations.

At the end of 2015, workers of 73 different nationalities were employed with the Telefónica Deutschland Group. People with disabilities are also welcome in our corporation.

Because we take the obligation of 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, since 2009 we have been working with the Stiftung Pfennigparade (Penny Parade Foundation) and providing a work-related perspective to people with disabilities. At the end of 2015, 268 employees with disabilities were employed at our company.

### Employee satisfaction and employer appeal are measured regularly

We regularly carry out internal employee satisfaction surveys. Given the ongoing integration, we have increased the opportunity for employees to give us feedback. We run quarterly "pulse checks" which focus on the progress of the transformation and an annual employee survey which focusses on engagement and work climate. We also use qualitative and quantitative feedback from our staff to optimise our business management.

We support our employees with a wide range of programmes to balance work and family 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. Thus, 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.

### Training and further education are important goals

One of our most important goals in 2015 was to further develop our employees' skills. In 2015, the Telefónica Deutschland Group invested a total of EUR 6 million in the training and further education of its employees. This represents an increase of around 46 % of the expenditure in this area compared with the previous year (2014: EUR 4.1 million), also resulting from a higher proportion of online training courses and web seminars. In 2015, a total of 8,800 employees participated in one of our further education courses (2014: 8,300 employees). The number of course hours taken up amounted to 186,500 hours in the reporting year (2014: 181,000).

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 because the business units are closer to the target groups and have a much better understanding of their needs.

This decentralization has one exception: Leadership, Change and Culture training will remain the responsibility of HR. Also all training regarding compliance, data protection, in-

dustrial safety and safety guidelines referring to the exchange of information will be organised by the General Counsel.

We collaborate with the Universitas in Barcelona. Universitas is Telefónica S.A. Group's corporate University and was created with the aim of aligning the training strategy for our professionals with the needs and strategy of the business. Our leaders have access to its global learning offer and use it to lead the design of the company's strategy in Germany and its implementation.

### **Apprenticeship and integrated study secure jobs in the future**

Through the training of young employees we secure our future and, at the same time, do justice to the social responsibility that we have as an employer. In the 2015 financial year, we prepared 120 young people (Trainees and Dual Students) for their professional future at our company. A total of 55 young people successfully completed their apprenticeship and we were able to take on 44 of them, which represents 80 %.

Furthermore, we offer those starting their studies the opportunity to complete studies with in-depth practical experience (integrated studies) at our company. These students can attend integrated courses at various academic institutions in different locations. Subject areas include business administration, electrical engineering and information technology, computer science, business informatics and international management. In 2015, 51 students have taken up this opportunity.

# Corporate Responsibility

*CR measures are geared towards the value chain./ We enable everyone to participate in the digital revolution./ Equal opportunities by addressing specific target groups./ Our products and services make use of the advantages of digitalisation to improve the quality of life./ We strive to set standards as a fair partner for our customers and stakeholders./ We protect the climate by reduced energy consumption.*

Even prior to the merger, corporate responsibility (CR) was an important element of the corporate policy of both the E-Plus Group and the Telefónica Deutschland Group. The two companies pursued various projects with ecological and social relevance. However, the new post-merger position as Germany's largest mobile communications provider required the harmonisation of the CR strategy in order to optimally leverage the opportunities provided by the company's new size and the digitalisation process, while meeting the increased expectations of shareholders and other stakeholders. Accordingly, the Telefónica Deutschland Group performed a detailed analysis of its CR activities in 2015. The aim was to

develop a comprehensive sustainability strategy in order to enshrine CR within the company's DNA and allow it to pursue an integrated approach along the entire value chain. The multi-stage strategic development process forms the basis for the publication of a CR report for the financial year 2015 in accordance with the Global Reporting Initiative's G4 guidelines, which describe a framework for sustainability reporting.

#### **Derivation of an integrated CR strategy**

The Telefónica Deutschland Group has defined all of the CR topics that are relevant to its business activities and established a CR guideline. The resulting CR structure is based on the comprehensive evaluation of company-, market- and industry-specific analyses. Our stakeholders' expectations were incorporated in the process by way of a representative online survey of more than 1,300 private and business customers, investors and analysts, suppliers, and representatives of not-for-profit organisations. We used a statistical model to determine the Telefónica Deutschland Group's sustainability impact. This analysis resulted in three CR dimensions – "Environment", "Responsible Business Conduct" and "Society" – to which various CR topics were allocated.

## G 22 — Overview of CR issues of Telefónica Deutschland Group

| Corporate Responsibility Issues |  |
|---------------------------------|--|
| Environment                     | Climate/Energy                           |
|                                 | Pollution                                |
|                                 | Mobile Communication & Health            |
|                                 | Water                                    |
|                                 | Biodiversity                             |
|                                 | Resources/Materials                      |
| Responsible Business            | Data Security                            |
|                                 | Working Conditions                       |
|                                 | Fair Partnership                         |
|                                 | Compliance                               |
| Society                         | Equal opportunities in the digital world |
|                                 | Quality of Life                          |
|                                 | Corporate Citizenship                    |

In workshops, the Management Board and senior management discussed the results and defined “Enabling equal opportunities in the digital world” and “Improving the quality of life” from the “Society” CR dimension and “A fair partner for all stakeholders” from the “Responsible Business Conduct” CR dimension as key topics. Our aim is to be as good as, if not better than, the competition. Activities in the “Environment”

CR dimension are concentrated on the topic of “Climate and energy”. According to the focus topics gained from the materiality analysis we have redefined the reported indicators.

In 2016, we will expand the existing measures for the identified CR topics, plan additional activities and define corresponding performance indicators on the basis of the strategy while continuing to pursue the transformation process. The Corporate Responsibility department is working in close cooperation with the specialist departments to achieve this, particularly through the cross-departmental CR Committee. Under the responsibility of the Director Corporate Affairs, who reports directly to the CEO, the department manages and coordinates all of the company's CR activities and examines target attainment. The CR targets are examined and approved by the management team and the Management Board.

### Enabling equal opportunities in the digital world

Thanks to digitalisation, we are experiencing one of the biggest revolutions in human history when it comes to generating growth and prosperity. With the aim of becoming the leading digital telecommunications company in Germany, we are committed to enabling all people to participate in digital life and enjoy the benefits of digitalisation. This includes offering our customers an excellent network and product experience and making their day-to-day life easier with digital solutions. To this end, our company is continuing to rapidly pursue network integration and the expansion of the LTE network (GOALS AND STRATEGIES, PAGE 9).

To help our customers to familiarise themselves with innovations and use digital devices and products for themselves, O<sub>2</sub> gurus are available and ready to provide useful tips on our products at all times.

We also provide target group-specific support in order to ensure equal opportunities in terms of digital inclusion. For example, we have been running the youth programme Think Big, a joint initiative of the Telefónica Foundation and the German Children and Youth Foundation (DKJS), for a number of years. With workshops, coaching and financial project support, Think Big inspires and supports 14- to 25-year-olds in finding their bearings in the digital world, enhancing their technological skills, developing ideas and entrepreneurship, and starting their own social projects. Since 2010, around 75,200 young people have participated and more than 3,200 projects have been implemented. The young people document the results on the programme's website, [WWW.THINK-BIG.ORG](http://WWW.THINK-BIG.ORG).

However, the Telefónica Deutschland Group is also firmly committed to making it easier for older people to access digital and mobile media. With this in mind, the company is pursuing the “Tablet PCs for Senior Citizens” project, which the E-Plus Group initiated in 2012 in cooperation with the “Digitale Chancen” foundation. Selected retirement homes in Germany are provided with tablet PCs with free flat-rate internet for an eight-week period. Internet “newbies” are

also given instructions by supporters from the world of the media and politics. As of the end of 2015, tablet PCs had been handed out to retirement homes at 16 locations in Germany, with the project reaching around 1,400 senior citizens.

## T 10— Society

|   | 2014    | 2015    |
|---|---------|---------|
| Donations and investments in non-profit projects (in EUR) | 218,933 | 172,112 |
| Participants in Think Big (young people) (Count)          | 14,708  | 19,518  |

### Improving the quality of life

If everyone is given access to the digital world, this will allow the full potential of digitalisation to be unlocked and Big Data and the Internet of Things will be able to enrich our lives. For the Telefónica Deutschland Group, this specifically means making the day-to-day life of our customers easier by providing the best possible product experience and digital solutions. For example, data communication between machines (M2M) allows our customers to make their processes more efficient – often with added value for the environment, too. In future, real-time campaigning will allow us to offer specially tailored services and a unique customer experience. Meanwhile, Advanced Data Analytics will help us to build the best network and invest in precisely the services our customers require ( GOALS AND STRATEGIES, PAGE 9).

### A fair partner for all stakeholders

Telefónica Deutschland supports all stakeholders in the digital revolution as a fair and responsible partner. The topics of compliance and data protection are extremely important to our company. After all, soon everything and everyone will be connected. Within this development, our role is to ensure that customers retain ownership of their data at all times and to champion freedom of participation in order to enable customers, employees, investors, partners and suppliers to shape their digital life however they want to. Our customers should be given transparency, control and freedom of choice when it comes to their data. As an example, this also applies to our anonymisation platform, which serves as the basis for Big Data solutions.

However, we consider fairness to mean even more than this. The principle also guides the way we deal with customers, investors, partners and suppliers on a day-to-day basis. In 2015, for example, the Telefónica brands Blau and simyo took second and third place in the mobile phone category of the German Fairness Prize awarded by the German Institute for Service Quality (DISQ) and news broadcaster n-tv. We support our employees in achieving a healthy work-life balance with a modern workplace concept including flexible

working hours and working from home, as well as childcare facilities and a health programme. We also place great importance on diversity in the workforce ( EMPLOYEES, PAGE 40). We meet our responsibility within the supply chain by ensuring a fair and transparent decision-making process when it comes to our suppliers and service providers.

For 2016, we have undertaken to expand this commitment and develop additional measures in order to meet the needs of our target groups to an even greater extent. To this end, we are pursuing an intensive dialogue with our stakeholders.

- We contact our customers via shops and hotlines, as well as innovative formats such as the “O<sub>2</sub> Pop-up Shop” and various different forums.
- Dialogue with our employees takes the form of a regular employee satisfaction survey ( EMPLOYEES, PAGE 40) and events like “Management Board Dialogue”, which are broadcast live to all locations.
- Regular contact with our suppliers and business partners is also important to us. This is based on the principles of sustainable supplier management and an active feedback culture.
- Our representative office in Berlin serves as an interface with politicians, businesses and associations. Telefónica Deutschland regularly invites participants to engage in dialogue on current ITC policy issues via formats such as the “Telefónica Blue Hour”.
- The Telefónica BASECAMP is a central point for the debate on digitalisation. In event series like “Digital Masterminds”, “Mobile Living” and “UdL Digital Talk”, the trends, opportunities and challenges of digitalisation are discussed with digital multipliers, companies, consumers, politicians and scientists.
- We also engage in an intensive dialogue with capital market participants.

### Sustainable action for greater energy efficiency

Digitalisation is not only changing everyday life – it is also having an impact on the environment. As our contribution to fighting climate change and improving energy efficiency, we are focusing on our activities in the areas of network, office space and mobility as well as purchased goods and services. At around 95 %, the majority of our electricity consumption is attributable to the network. Accordingly, Telefónica Germany GmbH & Co. OHG set itself the goal of reducing energy consumption in its network by 30 % per customer access between 2007 and 2015. We have already achieved this target – we improved from 2007 until 2015 in total by 34 %. In addition to our existing ISO 14.001 and ISO 9001 standards, which cover almost 80 % of all our office locations, we will introduce in 2016 an externally certified energy management system in accordance with ISO 50.001. We will continue to work on offering an energy-efficient network. We intend to achieve this through the further consolidation and modernisation of the network, among other things. We are also

continuing to focus on ensuring a green energy supply for our network, shops, call centres and office space. The quantification of the new target is currently still being developed.

With a view to resource conservation, the Telefónica Deutschland Group has had a mobile phone recycling scheme in place since 2004, allowing consumers to dispose of their old devices responsibly. In 2015, we relaunched this programme for the merged company in cooperation with our partners NABU (Naturschutzbund Deutschland e.V.) and AfB (Arbeit für Menschen mit Behinderung gemeinnützige GmbH). Devices that still work are deleted using certified methods, reconditioned and reused. Devices that no longer work are disposed of properly and in an ecologically sound manner. For every mobile phone we receive, we make a contribution to NABU for the restoration of the Lower Havel valley. With over 67,200<sup>10</sup> devices received, we have exceeded our target of collecting 50,000 old mobile phones as a merged company in the two years to the end of 2015. This will be our minimum annual target from 2016 onwards.

### T 11 — Old mobile phones

|  | 2014   | 2015    |
|--|--------|---------|
| Number of collected used mobile phones <sup>11</sup> | 53,868 | 100,182 |

### T 12 — Energy<sup>12</sup>

| (In GWh)   | 2014 | 2015 |
|--|------|------|
| Total energy consumption   | 620  | 859  |
| Electricity  | 590  | 817  |
| thereof network  | 561  | 776  |
| thereof offices, shops, call centres                               | 29   | 41   |
| Fuel   | 30   | 42   |
| Energy from renewable energy sources                               | 354  | 602  |
| Proportion of electricity consumption from renewable energy (in %) | 60   | 74   |

### T 13 — GHG Emissions<sup>13</sup>

| (In tCO <sub>2</sub> eq <sup>14</sup> )          | 2014    | 2015    |
|--|---------|---------|
| Total emissions                                  | 292,372 | 403,140 |
| direct emissions (Scope 1)                       | 7,079   | 9,541   |
| indirect emissions (Scope 2)                     | 281,303 | 388,257 |
| Other indirect emissions (Scope 3) <sup>15</sup> | 3,990   | 5,342   |

- 11 The number of used mobile phones includes mobile phones which are brought into the recycling process, and refurbished in the Re-Use process. In 2015, Telefónica Deutschland Group collected within their mobile phone recycling programme 45,812 used mobile phones. Of these, 40,429 used mobile phones were recycled (melting) and 5,383 refurbished. In addition, for Re-Use Telefónica Deutschland Group received more 54,370 used mobiles outside the mobile phone recycling programme.
- 12 The electricity consumption network is the result of the multiplication of the number of wireless and wireline sites and an average electricity consumption per site. The average energy consumption per site has been calculated on the basis of historical consumption data. By the acquisition of the E-Plus Group as of 1 October 2014, the figures in regard to energy and CO<sub>2</sub> emissions are comparable to the prior year only to a limited degree. The financial year 2014 contains the information of Telefónica Deutschland Group for the whole financial year and the information of E-Plus Group for the fourth quarter of 2014. In contrast, in 2015 all quarters of the respective groups have been taken into account.
- 13 GHG emissions inventory based on ISO 14.064, Greenhouse Gas Protocol & ITU-T L.1420. For the calculation of electricity consumption in CO<sub>2</sub> emissions, a uniform Germany-wide conversion factor has been used. This amounts to 475.41 g of CO<sub>2</sub> per kWh, despite the fact that a share of 74% (60% last year) was purchased from renewable energy sources.
- 14 CO<sub>2</sub>eq = CO<sub>2</sub>, CH<sub>4</sub> & N<sub>2</sub>O.
- 15 Other indirect emissions (Scope 3) from business travels.

10 In 2015, Telefónica Deutschland Group collected 45,812 used mobile phones, in 2014 21,416.

# Report on Events after the Reporting Period\_

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There were no significant events after the end of the financial year 2015.

# Report on Risks and Opportunities\_

*Risks and opportunities are continuously monitored and identified at an early stage./Risk management is involved in all decision-making processes./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 Euros, 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 Euros as well as Euro-denominated equity and debt, there is 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 primarily arises from the variable-interest cash pooling accounts of the Telefónica Deutschland Group with Telfisa Global B.V., Netherlands, a Telefónica, S.A. Group company, as well as from variable-interest loan agreements and borrower and interest rate swaps. In November 2013 and February 2014, interest rate swaps were signed in connection with the issue of bonds for a partial amount of the nominal value of the respective bond. 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 only recognises adjustments on doubtful receivables with a credit risk.

The Telefónica Deutschland Group has concluded cash pooling and deposit agreements with Telfisa Global B.V. with regard to its cash surpluses in accordance with Telefónica corporate policy, and it 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. The Group maintains credit facilities totalling EUR 750 million with various banks that are currently unused.

### 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.

Further information regarding risk management and financial instruments can be found in the Notes to the Con-

solidated Financial Statements for the financial year ended 31 December 2015 (NOTE NO. 17 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT, PAGE 150).

## Risk management and risk reporting

### Fundamental risk management principles

In the course of our business activities, we are confronted with various business, legal, 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 immediate and complete transparency with regard to new risks and changes to existing risks.

Risk management is a fixed 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 progressively pursue and evaluate risks and their management and development. Responsible employees are individually trained in order to ensure a uniform, structured process of risk identification and evaluation. In addition, fundamental training is provided 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 and Telefónica Deutschland's total risk and that of its subsidiaries are the subject of regularly 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 prejudice 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 ascertain the risks illustrated in the following section with significant influence on business development, we use a 5x5 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 23 — Risk profile

### Economic Impact on cash flow base

|           |   |   |  |          |               |
|-----------|---|---|--|----------|---------------|
| very high | 15  | 16  | 20   | 23       | 25            |
| high      | 9   | 12  | 17   | 21       | 24            |
| medium    | 4   | 10  | 13   | 18       | 22            |
| low       | 2   | 5   | 11   | 14       | 19            |
| very low  | 1   | 3   | 6  | 7        | 8             |
|           | remote  | possible  | very possible                                      | probable | very probable |
|           | <b>Likelihood</b>                                     |   |  |          |               |
|           | <span style="color: #00A0C0;">■</span> Critical Risks | <span style="color: #00A0C0;">▨</span> Moderate Risks | <span style="color: #00A0C0;">□</span> Minor Risks |          |               |

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 (critical, moderate and minor risks). All risks with a very high potential level of damages are seen as critical 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.

As a matter of principle, the lower threshold value for the risk reporting to the Management Board is currently EUR 7.5 million. In addition, risks with only a low potential impact are not described in detail, but rather are reported in summary form. 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 risks from the business risk, operational risk and financial risk areas are discussed in accordance with their ranking 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 estimated as minor will change within the forecast period in such a way as to have a potentially greater effect than the risks currently estimated as critical.

## 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. A potential delay to the network expansion resulting from that could also have a negative impact on expected revenues.

In 2015, the Telefónica Deutschland Group 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 Deutschland Group and E-Plus Mobilfunk 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. The risk of deficient frequency resources currently exists only in the long run.

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, had appealed against the decision of the presidential chamber of the German 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 risks described above applying again.

Furthermore, there is a moderate risk of a negative impact on the performance and expansion of our mobile telecommunications network in the event of delays in the approval of usage rights, particularly for radio relay frequencies, by the German Federal Network Agency and of a change in the specifications for the maximum permitted transmission power due to new regulations regarding the electromagnetic fields.

### Non-approval of planned business combinations, acquisitions and disposals or cooperations

The Telefónica Deutschland Group constantly evaluates opportunities to achieve increases in efficiency and operating profit, including through cooperations, additional purchases and mergers, as well as through the sale or spin-off of business segments or parts of companies. Agreements between companies who are active in the same or neighbouring sub-

stantive markets are subject to the supervision and, by and large, the requirement for approval from the responsible cartel authorities (European Commission, German Federal Cartel Office (BKartA), German Federal Network Agency (BNetzA)). Furthermore, it is possible that approval may only be issued subject to certain conditions. The withholding of approval or the stipulation of extensive remedies carries the significant risk that the profitability of the agreement is reduced, planned savings, synergies and growth expectations cannot be generated to the full extent, or contractual damages may become due.

### Termination fees in mobile communications

Termination fees in mobile communications have sunk in Europe in recent years, while Germany has also seen considerable reductions in the past years. Various reviews of these fees and court processes regarding regulatory measures are still in progress. The European Commission intends to further reduce fixed and mobile termination rates and has issued a recommendation for the calculation of these tariffs by the relevant national regulatory authorities. The mobile termination rates currently defined by the BNetzA will apply until November 2016. There is a moderate risk of a further reduction in these rates, and hence in the revenue from this area.

### Termination fees in fixed communications

Like all operators of their own networks, the Telefónica Deutschland Group is subject to regulation with regard to the prices that can be charged to competitors for termination services to its own network. The current termination rates for the fixed network are valid until December 2016. A further significant change in the termination rate is unlikely. Based on the affected chargeable traffic, we assess the risk to our revenues as moderate.

### Other regulatory influences on fees

Price-regulated services include international roaming and SMS and data services within roaming.

With the publication of a corresponding regulation on 29 November 2015, the European Commission resolved the gradual abolishment of roaming charges for international calls within the European Union by 15 June 2017 (REGULATORY INFLUENCES ON THE TELEFÓNICA DEUTSCHLAND GROUP, PAGE 22). Accordingly, the risk that the regulatory authorities will adjust roaming tariffs has materialised compared with the previous year.

Nevertheless, the regulatory authorities can 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 prejudicially 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

For some time now, there have been calls from politicians and the German Ministry of the Interior for more stringent regulatory requirements in accordance with section 111 TKG for collecting and validating customer data, particularly for prepaid contracts. An increase in the requirements for the selling and registration process entails a risk that established sales channels could no longer be used, or could not be used with the same degree of efficiency, which could result in additional costs for acquiring new customers. In order to guard against this regulatory risk, 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. In addition, the registration processes are continuously improved in close coordination with the regulatory authority so as to reduce the need for more stringent requirements. In view of the measures implemented to counter this risk, we now consider it to be low.

#### Additional regulatory requirements to improve customer protection

Legislative initiatives to improve customer protection have been discussed and adopted at national and European level in the past. In addition to the potential effects on roaming and termination fees in particular, as described in previous reporting periods, these initiatives also include increased requirements with regard to informing customers about the costs and conditions of telecommunications contracts. The requirements from the implementation of the Consumer Rights Directive in national law have been successfully implemented at the company. If we are unable to implement the new requirements in full or on schedule, particularly those arising from the planned transparency regulation, then individual sales channels could experience restrictions. This results in a risk that the announced customer growth and the planned increase in our revenues cannot be achieved or will be delayed. To counter this risk, the necessary technical changes have already been commissioned and manual processes have been prepared internally and at outsourcing partners. Taking these measures into account, the risk is considered low.

#### Regulatory requirements in connection with the acquisition of the E-Plus Group

In accordance with the conditions imposed by the European Commission for the acquisition of the E-Plus Group, the Telefónica Deutschland Group would have been required to provide a potential new competitor with infrastructure and network capacity in return for payment. There were no new participants in this year's frequency auction. To meet the requirements, we entered into extensive agreements with Drillisch on the provision of infrastructure, network capacities and services. An extensive project has been launched to ensure strict compliance with the contracts concluded and hence prevent the possibility of significant fines. Considering these measures the risk is assessed as moderate.

#### **Insurance**

Considering the existing opportunities and evaluating financial efficiency, the Telefónica Deutschland Group counters some risks by taking out insurance policies. In particular, risks in connection with the operation of the technical infrastructure and potential breaches of copyright or patent rights 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.

#### **Macroeconomic factors**

Macroeconomic factors can prejudice consumer spending and the growth prospects for the German telecommunications market in general. This could have a negative influence on our market penetration of new value-added services, the use of our networks for voice and data traffic, our customer numbers and hence our revenues.

Recessionary general conditions could likewise lead to an increase in payment defaults and/or delays by our customers, greater customer migration and difficulties in gaining new customers. In light of the overall current economic climate, we consider there to be a low risk of a negative influence on the desired growth and earnings targets.

#### **Acquisition and sale of parts of the business as well as joint activities**

There is a low risk that we may make acquisitions or sales or enter into joint operations which could generate lower than expected revenues, profit or liquidity. The risk could also mean that it will not be possible to fully generate synergies in the event of delays or issues with the integration.

## Operational risks

### Service quality

The success of our business activity is dependent on our ability to attract new customers and retain existing customers. A key factor for success in this respect is anticipating technical requirements and the desires of customers 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 telecommunications and fixed 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 significant risk. 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 prejudicially 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.

### Termination of leases for technical sites by the lessor

The Telefónica Deutschland Group depends on leased sites for technical facilities, particularly antenna sites, for the expansion and operation of its mobile and fixed network. If there is an unexpected significant increase in the number of leases terminated by the lessors and the affected sites cannot be substituted by redundant sites of the Telefónica Deutschland Group, this would represent a risk to our business activities, as new sites would have to be found and set up at considerable expense. Following the merger of the Telefónica Deutschland Group with E-Plus Mobilfunk GmbH and the successive interconnection of the companies, we now consider this risk to be low.

### 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<sub>2</sub> in Germany is also the subject of a licence agreement with O<sub>2</sub> 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. 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.

An infringement of legal provisions poses an intrinsic risk to the business activities, success and reputation of the company. Infringements of antitrust law represent a significant risk due to the possibility of significant fines and penalties being imposed.

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.

### **Specific risks resulting from the acquisition of the E-Plus Group**

#### Loss of expertise and management resources

The integration of the E-Plus Group is progressing and will continue to demand a great deal of time and attention on the part of the management. Should the integration efforts keep management from other responsibilities, this could be detrimental to the company's success.

In addition, the Telefónica Deutschland Group is dependent on successful integration, the implementation of the joint strategy and the future commitment of employees in key positions. A loss of employees in key positions and/or expertise could delay or negatively influence the further integration of the E-Plus Group in the Telefónica Deutschland Group, which could detrimentally affect the business success of the Telefónica Deutschland Group.

Taking account of the organisational measures taken, particularly the rapid appointment of employees in key positions, we consider this risk to be low.

#### Failure to achieve the anticipated synergies

Any significant delay or unplanned increase in costs in the integration of the E-Plus Group with the Telefónica Deutschland Group could detrimentally influence or delay the attainment of the planned synergy effects or lead to a reduction in customer satisfaction associated with increased customer migration, which could significantly detrimentally affect the business activity as well as the financial and earnings position of the Telefónica Deutschland Group. A delay in achieving the synergies could lead to the purchase price being perceived as excessive on the market and could have a negative impact on the share price performance.

In addition, a risk remains that the assumptions underlying the calculation of synergies about the future development of the company and the market environment do not occur as anticipated. If unforeseen changes occur in the macroeconomic situation, the legal and regulatory regime, the competitive environment, the customer behaviour, the acceptance of the product portfolio or the technological development, or should the synergy calculation supportive

corporate strategy be fully or partly changed, this could have a negative impact on the timely achievement of the calculated synergies.

Major projects have been launched to ensure the timely achievement of synergies. In particular, measures to reduce operating costs have been initiated, such as the harmonisation of processes, integration of IT systems, merging mobile and transport networks, site streamlining, reducing redundant staff and supplier consolidation. In addition, projects have been launched to improve market position. For example, selected end customer and business customer products are already offered in all sales channels of both groups. Furthermore, national roaming is allowing customers to use the UMTS networks of both groups in order to ensure higher customer satisfaction and demonstrate the benefits of the transaction for the customer. For completed actions see › OVERVIEW OF THE FINANCIAL YEAR 2015 — SIGNIFICANT EVENTS, PAGE 26.

After the start of the joint operations, a separate area was established which aims to ensure the smooth integration of the two companies, as well as the timely implementation of the projects initiated to achieve the synergies. A matrix organisation with defined responsibilities in all operational areas as well as close interaction with the strategy area supports the exchange of information and allows adaptation to changing circumstances at any time. The Management Board is briefed regularly on target attainment and the status of projects.

In view of the established measures, the projects that have been successfully completed or initiated, the ongoing review and adaptation of the strategy to achieve the synergies, the current synergy level and the financial results recorded to date, we consider the risk of failure to achieve the synergies to be low.

#### Legal risks of the acquisition of the E-Plus Group

Despite a change-of-control clause or other provisions concerning payment obligations or other contractual obligations in a number of contracts of the E-Plus Group that could bring about a detrimental change in the contractual relationships, the inherent risk could be minimised but not totally eliminated. By requirements of the European Commission in the context of the merger process, the extension of the majority of the wholesale agreements was obtained despite the contractual change-of-control clauses which could be an obstacle to the extension of wholesale, supply or service agreements. Anyhow, in the event that contractual extensions cannot be obtained in the context of the transaction, this could have a significant impact on the earnings position and operating business of the Telefónica Deutschland Group. Furthermore, we could be exposed to risks from problems that have not been revealed as part of the due diligence investigations preceding the transaction or that are covered only to a limited extent by exemptions from liability or warranty in the purchase agreement. Based on the information currently avail-

able and the status of the project, we consider this risk to be moderate.

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 Group 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. The Telefónica Deutschland Group will exercise its right to comment and will support 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 or potential similar suits would have to be classified as significant.

#### Tax law risks of the acquisition of the E-Plus Group

The structure of the acquisition of E-Plus Mobilfunk could result in the Telefónica Deutschland Group being held liable for tax liabilities or utilised shareholder loans of KPN Mobile Germany.

The restructuring of the E-Plus Mobilfunk prior to the transaction also included the reorganisation and combination of subsidiaries and the transfer of non-current assets and liabilities from KPN Mobile Germany (formerly E-Plus Mobilfunk) to a newly established company (established with the name E-Plus Transition GmbH & Co KG and subsequently renamed E-Plus Mobilfunk). All tax and payment liabilities of KPN Mobile Germany for the period prior to 1 January 2014 have been excluded from transfer and remain with KPN Mobile Germany. However, owing to the legal situation in Germany, E-Plus Mobilfunk remains liable in addition to the principal debtor for a period of five years after the restructuring. As part of the spin-off, KPN Mobile Germany exempted the Telefónica Deutschland Group from all such obligations. The same was agreed with KPN in the context of the purchase agreement. However, should both KPN Mobile Germany and KPN be unable to fulfil their exemption agreements, E-Plus Mobilfunk could still be called upon.

In view of the fact that this only relates to contingent liabilities in the event that the aforementioned companies of the KPN Group are unable to meet their financial obligations,

and considering that these companies are regarded as solvent, we consider the risk as low.

#### **Personnel**

We are in competition with other companies for qualified and experienced personnel. For this reason, we implement employee surveys, internal projects and a well-balanced remuneration, training and work structure in order to maintain high employee satisfaction and the positioning of the Telefónica Deutschland Group as an attractive employer. Taking as a basis the results of internal and external surveys, we consider the risk of a shortage in personnel to be low.

#### **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. This represents a significant risk because of the potential financial impact of a different interpretation.

Changes in tax laws or in the interpretation of tax laws by courts or tax authorities may also have a material adverse effect on our business activities as well as our financial position and results of operations.

In addition, there is a low risk that we could be unable to use our tax loss carryforwards.

##### **Liquidity**

The capital-intensive nature of our business makes significant investments necessary. We have established a comprehensive investment programme for which significant outlay will also be required in the foreseeable future. Among other things, the programme is aimed at the maintenance and optimisation of our mobile telecommunications and fixed networks and further investments for the expansion of the network and the LTE technology. The costs for the frequency usage rights, which are necessary for the operation of our existing networks and technology, the costs and the rental expenses for their availability and the costs associated with our fixed networks form a significant part of our cost base and could increase. We are confident that we can comply with our financial obligations in the next twelve months. We have negotiated favourable payment and delivery conditions with our suppliers and concluded cash pooling and factoring contracts to improve our working capital. However, there is no guarantee that such arrangements or agreements will also be possible in future, or can be concluded at favourable conditions. Furthermore, we may not be capable of generating sufficient inflows of financial funds to cover our investment requirements in future. With regard to our further growth,

our planned strategy, the market developments or the development of new technology, we may therefore need additional sources of finance for our working capital. As a result, we may have to take up additional debt or equity, possibly to a considerable extent. Our ability to take up additional capital to finance our business activity could be influenced by various factors, e.g. changes in market interest rates, restrictive agreements in connection with our debt instruments or the downgrading of our credit rating or the credit rating of our majority shareholder. Future loan agreements could contain clauses that limit our financing opportunities or work against us in the implementation of business changes. Because we are exposed to the credit risks of our customers, the recovery of receivables could be complicated and, as a result, could adversely affect our working capital position. Overall, we consider the risk concerning liquidity to be low.

#### Other (global) risks

There were no significant 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 Telefónica Deutschland Group.

The opportunities and growth potential ascertained 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 the budget creation for the coming twelve months as well as within the long-term planning.

Opportunities are neither recognised in the risk register nor quantified.

#### Opportunities

##### 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 2016 through the further rollout 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 with the internet or growing popularity of existing data-intensive services.

Should the individual facets of the German telecommunications market, such as smartphone penetration, demand for LTE or 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, PAGE 9, in 2016 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 1800 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 UMTS and LTE network quality more positively than illustrated in our outlook, our share of mobile data business could grow more strongly than predicted and thus our revenue 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, financial services, M2M and in the smart home area. There are also further projects which we plan to introduce shortly. 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 there is a permanent availability of "self-care" solutions at any time and on any day of the week as well as the avoidance of possible waiting loops. 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. Group

As a part of one of the largest telecommunications corporations in the world, 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 revenue and our earnings position and lead to us exceeding our forecast.

#### Opportunities for higher 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 cost synergies. Higher revenue synergies could be generated if, for example, the market success of Drillisch exceeds expectations.

## Summary of the risk and opportunities situation

Based on our assessment, the greatest potential effects result from the intensive competition on the German telecommunications market, the regulatory environment and from the need to ensure high-quality service. Risks concerning the integration of the E-Plus Group into the Telefónica Deutschland Group are increasingly receding. The most notable positive development compared with the previous year concerns the change in the short-term licence and frequency risk.

In 2015, the Telefónica Deutschland Group 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 Deutschland Group and E-Plus Group, meaning that we now have sufficient frequencies at our disposal in the short and medium terms to provide the services offered and achieve our strategic goals in the long term (REGULATORY INFLUENCES ON THE TELEFÓNICA DEUTSCHLAND GROUP, PAGE 22).

In addition, with the publication of a corresponding regulation on 29 November 2015, the European Commission resolved the gradual abolishment of roaming charges for international calls within the EU by 15 June 2017. Accordingly, the risk that the regulatory authorities will adjust roaming tariffs has materialised compared with the previous year (REGULATORY INFLUENCES ON THE TELEFÓNICA DEUTSCHLAND GROUP, PAGE 22).

In accordance with our assessment, the situation regarding significant risks and opportunities for the Telefónica Deutschland Group has not changed significantly in comparison with the previous year, with the exception of the issues described above.

At present, no risks have been identified by us that would be capable of endangering the continued existence of our company, either in isolation or in combination with other risks.

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 forms a solid basis for our future business development and ensures the resources needed in order to pursue the opportunities presenting themselves to the company. Considering our technologically high-value product offering, 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 of being able to successfully meet the challenges arising from the risks and opportunities mentioned in 2016.

# 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 Act./ Group-wide requirements for the ICS implemented at the E-Plus Group in 2015.*

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 on page 48 and following pages 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 set-up 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. In the accounting-related IT systems, access authorisations are defined in order to ensure that accounting-related data is protected from unauthorised access, use and change.

However, every control system is subject to certain limitations on its effectiveness. Irrespective of the specific features of an ICS, there can be no absolute certainty with regard to its ability to prevent or detect all incorrect accounting disclosures.

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 func-

tionality 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 is set to continue./The market for mobile telecommunications services is expected to remain stable./By year-end 2016 the cumulated savings level from synergies will reach >50% of the total expected operating cash flow synergies./Mobile service revenues are anticipated to be slightly negative to broadly stable./OIBDA before exceptional effects is expected to increase by a low to mid-single-digit % compared with the prior-year./CapEx is expected to grow in the low tens in year-on-year percentage terms in 2016.*

## Economic outlook

The leading economic research institutes expect economic growth in Germany to continue in 2016. They are forecasting a 1.8% increase in gross domestic product. Private consumer spending will remain the pillar of the German economy in 2016. Private consumer spending are meant to rise with almost 2% in 2016. At the same time, the favourable conditions of the labour market and the sustained positive income expectations among private households are creating considerable scope for purchases, while the incentive to save remains low within the low-interest environment.

A risk to the consumer economy, and thus also to the overall economic development in Germany, is still posed by any escalation at international trouble spots.

Growth in economic performance of 1.7% is forecast for the euro area in 2016.

Source: German Federal Government Autumn Report, Focus Economics Consensus Forecast Euro Area

### T 14 — GDP growth 2014–2016 for Germany and the Euro area

| In %      | 2014 | 2015 | 2016 |
|-----------|------|------|------|
| Germany   | 1.5  | 1.7  | 1.8  |
| Euro area | 0.8  | 1.5  | 1.7  |

## Market expectations

Market developments in Germany, one of Europe's largest telecommunications markets, will again be driven by rising customer demand for mobile and fixed line broadband and data services. The boom in smartphones and tablets, in addition to growing demand for LTE, are driving growth in mobile data services. 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, is increasing data usage. This means that the monetisation of mobile data business will remain a strong focus of mobile telecommunications providers. A further trend is the "Internet of Things", the intelligent connection of devices and machines with the internet with multiple application possibilities.

At the same time, the negative trend for mobile voice and SMS 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 2016.

Source: Analysys Mason, Bitkom

## Outlook 2016

Since the merger of Telefónica Deutschland and E-Plus in 2014, the company has become an established player, thereby driving significant structural change in the German telecoms market. The market now has three established mobile network operators with similar market shares, setting the scene for a continuous rational market. Nevertheless, we have seen increased market dynamics in the non-premium segment of the market. As the largest MVNO partner in the German market, Telefónica Deutschland Group is well positioned to benefit from the growth in the wholesale segment, which we expect to persist in 2016. Against this competitive background Telefónica Deutschland Group will pursue a clear multi-brand strategy, with a strong focus on the development of its premium brand O<sub>2</sub>. We will continue to take a leading role within the framework of a competitive marketplace.

Across all brands Telefónica Deutschland Group will focus on the opportunity for monetising data growth. Germany still lags other European markets in terms of customer data usage, and we expect data growth to continue to accelerate in 2016 and to eventually drive an inflection point in the company's MSR and ARPU trajectory. In the near future, this trajectory will still be negatively affected by the shift in new customer acquisition trends from retail to wholesale, as well as the legacy customer base mix. The company will continue to make significant efforts to develop its customer base through retention and upselling mechanisms. For 2016 we thus expect mobile service revenue to be slightly negative to broadly stable year on year. The outlook for MSR includes expected effects from the elimination of roaming charges in Europe by 2017 and the associated glide path. Moreover, as in 2015 fixed-line revenues will continue to be negatively affected by the progressive decommissioning of the ULL broadband access infrastructure.

Telefónica Deutschland Group also successfully executed a number of important integration initiatives in 2015, with a range of large projects to follow in 2016. These projects include the network integration, the transformation of the IT landscape and the migration of brands and customers to a joint platform. These projects have long lead times and are cost-intensive especially in the first half of 2016, while savings generated from them will be significant but mostly beneficial in future years. The efficient execution of these projects is of crucial importance for the transformation of Telefónica Deutschland Group to a digital powerhouse with a lean infrastructure model, enabling us to offer further compelling, differentiated products and services for customers across segments.

In terms of synergy generation for 2016, Telefónica Deutschland Group will continue to benefit from the initiatives executed in 2015, especially in the first half of 2016. Additional in-year savings from employee restructuring and site decommissioning will come through mainly in the second half of the year. The MBA MVNO deal with Drillisch will continue to generate revenue synergies in 2016. In addition to the 35 % of total expected operating cash flow synergies achieved in 2015, there will be no incremental CapEx-related synergies in 2016, but further incremental Opex and revenue-related in-year benefits of ca. EUR 150 million mostly from the annualisation of 2015 measures. By year-end 2016, the cumulated savings level from synergies will reach >50 % of the total expected operating cash flow (Opex – CapEx) synergies of EUR 800 million after five years.

This translates into an expected low to mid single-digit year-on-year OIBDA percentage growth before exceptional effects, primarily driven by synergies. In contrast, over half of the annual OIBDA growth in 2015 was driven by commercial and other cost savings principally relating to the reduction in new customer acquisition costs and handset subsidies

from January 2015 in the context of our rational market strategy.

In terms of CapEx development, Telefónica Deutschland Group is pushing ahead in 2016 with the roll-out of the LTE network, focusing both on increasing coverage and adding capacity, with the target of reaching eye level with the competition in terms of customer network perception by year-end 2016. Capital expenditure is thus expected to grow in the low tens in year-on-year percentage terms in 2016, excluding any spectrum effects.

### T 15 — Outlook 2016

| (Euros in millions)                 | Base line<br>2015 | Outlook 2016<br>(year on year)         |
|-------------------------------------|-------------------|--|
| MSR                                 | 5,532             | Slightly negative to<br>broadly stable |
| OIBDA<br>before exceptional effects | 1,760             | Low to mid-single-digit<br>% growth    |
| CapEx <sup>16</sup>                 | 1,032             | % growth<br>in the low tens            |

From a balance sheet perspective, the company leverage target of at or below 1.0x net debt/OIBDA remains unchanged, as we continue to believe in a high level of financial flexibility while moving through the early years of the integration process. This leverage target will be continually reviewed. In terms of dividend policy, we view ourselves as a dividend-paying company with the intention to support a high payout ratio in relation to free cash flow, thus offering shareholders the potential for future dividend growth. We will consider expected future synergies when making dividend proposals.

In 2015, the new Telefónica Deutschland Group successfully maintained its focus on three key strategic priorities: maintaining market momentum, integrating quickly and transforming the company. Over the course of 2016, the company will shift focus from integration to transformation, all the while maintaining momentum in a rational but dynamic market environment. We will continue to build a company which will lead its peers both in terms of the way we approach our legacy business and in terms of our ability to drive innovation and the development of new business areas, most importantly Advanced Data Analytics and the Internet of Things. By continually improving our digital capabilities, we strive to offer our customers the latest products, technology and services and thereby an element of choice in their daily lives, as the Leading German Digital Onlife Telco.

16 Excluding investments in spectrum in June 2015. Spectrum capital expenditure amounted to EUR 1,198 million (including capitalised costs on borrowed capital).

# Other Declarations\_

## Report on Relations with Affiliated Companies

In the period from 1 January to 31 December 2015, 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 (2) sentence 2 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 De-

cember 2015 amounted to EUR 5,225 thousand. Expenses amounting to EUR 27 thousand were recognised in the financial year for compensation claims after former member of the Management Board left the company.

The current service agreements of the members of the Management Board of Telefónica Deutschland Holding AG were concluded on 2 July 2014 and came into force on 1 October 2014. The service agreement of one of the Management Board members was amended by way of an amendment agreement on 22 January 2015. As a matter of principle, the employment contracts of the Management Board members expire on 30 September 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 merger bonus for the successful completion of the E-Plus transaction (paid in 2015), 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, school fees, employer expenditures, 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 2015 (NOTE NO. 14 TRANSACTIONS WITH MANAGEMENT BOARD AND SUPERVISORY BOARD, PAGE 141).

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 in 2014 and 2015. 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 two members 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. For further information, please refer to the Notes to the Consolidated Financial Statements for the year ended 31 December 2015 (NOTE NO. 15 SHARE-BASED PAYMENTS, PAGE 143).

- 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.

- 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 for the first time in October 2015.

#### 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.

With the exception of the Chair of the Supervisory Board from the second quarter of 2015, the members of the Supervisory Board who work for Telefónica, S.A. or Telefónica Europe plc. 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 personally 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 2015 (NOTE NO. 14 TRANSACTIONS WITH MANAGEMENT BOARD AND SUPERVISORY BOARD, PAGE 141).

#### Takeover-related Disclosures (pursuant to section 315 (4) and section 289 (4) of the HGB)

##### Composition of subscribed capital

The registered share capital of Telefónica Deutschland Holding AG amounts to EUR 2,974,554,993. 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 2015 and at the time this Management Report was prepared, 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 have no right to securitise 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 Holding AG or other agreements about limitations on voting rights or the transferability of shares. In addition to the statutory provisions on insider trading, the company informs permanent insiders on silent periods of four weeks (recommended restrictions on trading) associated with the publication of quarterly and annual results. Otherwise, there are no internal governance provisions that provide for further 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 2015, Telefónica Germany Holdings Limited, Slough, United Kingdom, holds approximately 63% of the shares of Telefónica Deutschland Holding AG 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 % of the shares in Telefónica Deutschland Holding AG via Telefónica Germany Holdings Limited. As of 31 December 2015, KPN holds approximately 15.5 % 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 Holding AG 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 Holding AG exercise their control rights directly in accordance with the statutory provisions and the articles of association.

#### **Appointment and recall 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 recall as well as for the appointment of the Chair of the Management Board (Chief Executive Officer, CEO). Substitute members of the Management Board can be appointed. As of 31 December 2015, the Management Board of Telefónica Deutschland Holding AG consisted of three members. Management Board members are appointed by the Supervisory Board for a term of no more than five years. They can be reappointed and their term can be extended provided one period of office does not exceed a period of five years. The Supervisory Board may recall 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 recall – such as mutual termination – remain unaffected.

Telefónica Deutschland Holding AG 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 recall of Management Board members. If this majority is not reached in the first round of voting by the Supervisory Board, the appointment or recall 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 Holding AG 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 2015, the following authorisations of the Management Board for the issuing of shares exist:

##### Authorised capital

As of 31 December 2015, the Management Board is authorised, with the approval of the Supervisory Board, to increase the share capital of the company in the period until 17 September 2017, on one or more occasions, by a total of EUR 292,808,507 by issuing up to 292,808,507 new no-par value shares in exchange for cash and/or non-cash contributions (authorised capital 2012/I). The authorisation stipulates that shareholders' subscription rights can, in certain cases, be completely or partially disapplied (section 4 (3) of the articles of association).

##### 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 contingently 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 Management Board is authorised to buy back own shares by the Annual General Meeting of 5 October 2012 pursuant to section 71 (1) no. 8 AktG.

**Change of control/compensation agreements**

Telefónica Deutschland Holding AG'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 its outstanding non-current liabilities 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 employment contracts of the Management Board members of Telefónica Deutschland Holding AG 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 increased to EUR 10 million./Profit for the period is affected by non-recurring effects as it was in the previous year.*

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

## Business activities

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. Telefónica Deutschland's revenues are generated from the remuneration of the services it performs for its subsidiaries. This includes the 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.

## Results of operations

Telefónica Deutschland is responsible for the management of the Telefónica Deutschland Group and its operating business activities as a service provider and holding company. In the financial year 2015, the reimbursement of these management costs resulted in revenues of EUR 10 million. As expected revenues were thus at a comparable level as in the prior year. Aside the revenues, the net result of EUR 130 million was determined by non-recurring effects within the other operating income (EUR 134 million). While the remaining costs for personnel and within the other operating expenses were declining, in sum they remain higher revenues because of the costs triggered by non-recurring effects (especially consulting fees). Adjusted by the special effects the intended almost balanced result could be reached.

### Revenues up on previous year

Revenues of EUR 10 million were generated in the year under review (2014: EUR 9 million). They primarily consisted of reimbursed costs for the remuneration of the Management Board members (personnel costs) and other administrative expenses assumed by Telefónica Germany GmbH & Co. OHG in accordance with the agreements on the reimbursement of management services. In addition, billed management services in an amount of EUR 240 thousand are included to the extent that they are performed by Telefónica Deutschland for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH.

### Other operating income as in prior year affected by non-recurring effects

Other operating income declined from EUR 788 million in the financial year 2014 to EUR 134 million in the financial year 2015. As of 31 December 2015, this item primarily related to income from the subsequent purchase price adjustment for the cash component from the E-Plus acquisition whereas the previous year was mainly effected by a non-recurring effect resulting from the contribution of the stake in E-Plus Mobilfunk GmbH & Co. KG to Telefónica Germany GmbH & Co. OHG.

### Slight decline in personnel expenses due to change in Management Board composition

Personnel expenses amounted to EUR 5 million in the year under review (2014: EUR 6 million). It contains the remuneration of the Management Board including social security contributions.

This slight decrease is caused by several effects. In the prior year a member of the Management Board left the board for a compensation of EUR 3 million. Contrary to this, the remuneration of the Management Board has increased following the successful merger with E-Plus.

### Sharp decrease in other operating expenses

Other operating expenses fell by EUR 44 million in the financial year 2014 to EUR 10 million in the financial year 2015. They primarily consist of legal and consulting costs for external service providers. This decrease was mainly due to the costs reported in the previous year in connection with the capital increase therein.

**T 16— Income Statement**

| (Euros in millions)                            | January 1 to December 31 |            |              |               |
|--|--------------------------|------------|--------------|---------------|
|  | 2015                     | 2014       | Change       | % Change      |
| <b>Revenues</b>                                | <b>10</b>                | <b>9</b>   | <b>1</b>     | <b>9.1</b>    |
| Other income                                   | 134                      | 788        | (654)        | (83.0)        |
| Operating expenses                             | (15)                     | (50)       | 35           | (69.9)        |
| Personnel expenses                             | (5)                      | (6)        | 1            | (19.0)        |
| Other expenses                                 | (10)                     | (44)       | 34           | (77.0)        |
| <b>Operating income</b>                        | <b>129</b>               | <b>747</b> | <b>(618)</b> | <b>(82.7)</b> |
| Net financial income (expense)                 | 0                        | 0          | 0            | >100          |
| <b>Profit (loss) before tax for the period</b> | <b>130</b>               | <b>747</b> | <b>(618)</b> | <b>(82.6)</b> |
| Income tax                                     | –                        | (0)        | 0            | (100.0)       |
| <b>Total profit (loss) for the period</b>      | <b>130</b>               | <b>747</b> | <b>(618)</b> | <b>(82.6)</b> |

**Profit for the period affected by non-recurring effects**

In 2015, the company generated a profit for the year of EUR 130 million (2014: EUR 747 million). Non-recurring effects affected the profit of both years. This development was primarily attributable to the reduction in other operating income after the contribution of E-Plus Mobilfunk GmbH & Co. KG to Telefónica Germany GmbH & Co. OHG had led to a sharp increase in other operating income in the previous year.

**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.

**Bonds**

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

**Slight reduction in financial assets**

Financial assets in the amount of EUR 11,427 million (2014: EUR 12,141 million) related to the shares in Telefónica Germany GmbH & Co. OHG, Munich. On the basis of a shareholder resolution dated 7 May 2015, a withdrawal from Telefónica Deutschland totalling EUR 714 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.

**Higher cash pool receivables lead to an increase in receivables from affiliated companies**

The increase in receivables from affiliated companies was primarily due to the higher level of cash pool receivables from Telfisa Global B.V., Amsterdam, which inclined from EUR 31 million in 2014 to EUR 137 million in 2015. The reason for that increase was the final agreement on the cash component of the purchase price concerning the acquisition of the E-Plus Group.

**Other assets up compared with 2014**

As in the previous year, other assets in the amount of EUR 15 million (2014: EUR 2 million) primarily related to tax receivables in the year under review. This increase was mainly due to capital gains tax prepayments of Telefónica Deutschland in the amount of EUR 15 million in connection with a merger during the course of the year.

**Provisions down on the previous year**

Provisions for pensions stayed basically on the same level.

The reduction in other provisions from EUR 9 million in 2014 to EUR 5 million at the end of the year under review was primarily attributable to the reduction in provisions for outstanding invoices, especially for consulting services received.

**Payables lower than in the previous year**

Trade payables and payables to affiliated companies amount to almost EUR 0 million. The amounts from previous year were due to non-recurring effects from consulting services in connection with the acquisition of E-Plus (2014: EUR 3 million) as well as cost allocations (2014: EUR 6 million) from two capital increases performed.

**Reduction in equity**

In the financial year 2015, equity declined by EUR 584 million or 4.8 % to EUR 11,586 million (2014: EUR 12,170 million). The changes in equity were mainly due to the dividend payment on 12 May 2015 in the amount of EUR 714 million, as well as the profit for the period of EUR 130 million.

**Employees**

As in 2014, Telefónica Deutschland did not have any employees in the financial year 2015.

**Report on events after the reporting period**

There were no significant events after the end of the financial year 2015.

**Risks and opportunities**

Telefónica Deutschland's business development is fundamentally exposed to the same risks and opportunities as that of the Telefónica Deutschland Group. As a matter of principle, Telefónica Deutschland participates in the risks of its subsidiaries and equity interests in line with the stake held. Further information can be found in the section › REPORT ON RISKS AND OPPORTUNITIES, PAGE 48.

As the parent company of the Telefónica Deutschland Group, Telefónica Deutschland is included in the group-wide risk management system. Further information can be found in the section › RISK MANAGEMENT AND RISK REPORTING, PAGE 49. The description of the internal control system for Telefónica Deutschland required in accordance with section 289 (5) HGB can be found in the section › ACCOUNTING-RELATED INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM, PAGE 58.

**T 17 — Balance Sheet**

| (Euros in millions)                 | As of December 31 |               |              |               |
|-------------------------------------|-------------------|---------------|--------------|---------------|
|                                     | 2015              | 2014          | Change       | % Change      |
| <b>Fixed Assets</b>                 |                   |               |              |               |
| Investments in affiliated companies | 11,437            | 12,151        | (714)        | (5.9)         |
| <b>Current assets</b>               |                   |               |              |               |
| Receivables from affiliates         | 141               | 37            | 104          | >100.0        |
| Other financial assets              | 15                | 2             | 13           | >100.0        |
| <b>Total assets</b>                 | <b>11,593</b>     | <b>12,190</b> | <b>(597)</b> | <b>(4.9)</b>  |
| <b>Equity</b>                       | <b>11,586</b>     | <b>12,170</b> | <b>(584)</b> | <b>(4.8)</b>  |
| <b>Provisions</b>                   | <b>7</b>          | <b>11</b>     | <b>(4)</b>   | <b>(38.3)</b> |
| <b>Liabilities</b>                  | <b>1</b>          | <b>9</b>      | <b>(9)</b>   | <b>(94.5)</b> |
| <b>Total equity and liabilities</b> | <b>11,593</b>     | <b>12,190</b> | <b>(597)</b> | <b>(4.9)</b>  |

## Management declaration

The company has published this declaration, which also contains the declaration of compliance pursuant to section 161 AktG, on its website ([WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN/CORPORATE-GOVERNANCE/MANAGEMENT-DECLARATION.HTML](http://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 forms part of this combined management report.

## Outlook 2016

Telefónica Deutschland 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 section › REPORT ON EXPECTED DEVELOPMENTS, PAGE 60. In light of the existing contracts on the remuneration of management services, we expect Telefónica Deutschland AG's revenues for the next financial year to remain at a similar level as in the financial year 2015. Revenues are expected to continue to nearly cover the operating costs incurred by Telefónica Deutschland in future periods, resulting in a near breakeven in terms of earnings.

Munich, 5 February 2016

Telefónica Deutschland Holding AG

The Management Board



Thorsten Dirks



Rachel Empey



Markus Haas



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for the financial year  
ended 31 December 2015

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## Consolidated Financial Statements\_

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# Consolidated Statement of Financial Position\_

| Assets (Euros in millions)    | Notes | As of 31 December |                   |
|-------------------------------|-------|-------------------|-------------------|
|                               |       | 2015              | 2014 <sup>1</sup> |
| <b>A) Non-current assets</b>  |       | <b>14,406</b>     | <b>14,406</b>     |
| Goodwill                      | [5.1] | 1,955             | 1,955             |
| Other intangible assets       | [5.2] | 7,059             | 6,600             |
| Property, plant and equipment | [5.3] | 4,507             | 4,842             |
| Trade and other receivables   | [5.4] | 157               | 236               |
| Other financial assets        | [5.5] | 63                | 49                |
| Other non-financial assets    | [5.6] | 160               | 142               |
| Deferred tax assets           | [6.6] | 505               | 581               |
| <b>B) Current assets</b>      |       | <b>2,248</b>      | <b>3,530</b>      |
| Inventories                   | [5.7] | 123               | 104               |
| Trade and other receivables   | [5.4] | 1,520             | 1,545             |
| Other financial assets        | [5.5] | 10                | 19                |
| Other non-financial assets    | [5.6] | 61                | 71                |
| Cash and cash equivalents     | [5.8] | 533               | 1,702             |
| Assets held for sale          | [8]   | –                 | 90                |
| <b>Total assets (A+B)</b>     |       | <b>16,654</b>     | <b>17,936</b>     |

| Equity and Liabilities (Euros in millions)        | Notes  | As of 31 December |                   |
|---|--------|-------------------|-------------------|
|   |        | 2015              | 2014 <sup>1</sup> |
| <b>A) Equity</b>                                  | [5.9]  | <b>10,321</b>     | <b>11,412</b>     |
| Subscribed capital                                |        | 2,975             | 2,975             |
| Additional paid-in capital                        |        | 4,800             | 4,800             |
| Retained earnings                                 |        | 2,546             | 3,637             |
| Total equity attributable to owners of the parent |        | 10,321            | 11,412            |
| <b>B) Non-current liabilities</b>                 |        | <b>2,779</b>      | <b>2,919</b>      |
| Interest-bearing debt                             | [5.10] | 1,686             | 1,808             |
| Trade and other payables                          | [5.11] | 154               | 19                |
| Provisions  | [5.12] | 516               | 787               |
| Deferred income                                   | [5.11] | 424               | 305               |
| <b>C) Current liabilities</b>                     |        | <b>3,554</b>      | <b>3,605</b>      |
| Interest-bearing debt                             | [5.10] | 568               | 622               |
| Trade and other payables                          | [5.11] | 2,272             | 2,283             |
| Provisions  | [5.12] | 196               | 241               |
| Other non-financial liabilities                   | [5.6]  | 48                | 18                |
| Deferred income                                   | [5.11] | 471               | 400               |
| Liabilities held for sale                         | [8]    | –                 | 42                |
| <b>Total equity and liabilities (A+B+C)</b>       |        | <b>16,654</b>     | <b>17,936</b>     |

1 In the Consolidated Statement of Financial Position as of 31 December 2015, the prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

# Consolidated Income Statement

| (Euros in millions)  | Notes        | 1 January to 31 December |                   |
|--|--------------|--------------------------|-------------------|
|  |              | 2015                     | 2014 <sup>1</sup> |
| Revenues   | [6.1]        | 7,888                    | 5,522             |
| Other income   | [6.2]        | 265                      | 106               |
| Supplies   |              | (2,712)                  | (2,144)           |
| Personnel expenses   | [6.3]        | (655)                    | (828)             |
| Other expenses   | [6.4]        | (2,982)                  | (1,976)           |
| <b>Operating income before depreciation and amortisation (OIBDA)</b>     |              | <b>1,804</b>             | <b>679</b>        |
| Depreciation and amortisation  | [5.1], [5.2] | (2,067)                  | (1,300)           |
| <b>Operating income</b>  |              | <b>(263)</b>             | <b>(621)</b>      |
| Finance income   |              | 10                       | 10                |
| Exchange gains   |              | 2                        | 1                 |
| Finance costs  |              | (56)                     | (43)              |
| Exchange losses  |              | (4)                      | (2)               |
| <b>Net financial income/(expense)</b>                                    | [6.5]        | <b>(48)</b>              | <b>(34)</b>       |
| <b>Profit/(loss) before tax</b>  |              | <b>(311)</b>             | <b>(655)</b>      |
| Income tax   | [6.6]        | (72)                     | (34)              |
| <b>Total profit/(loss) for the period</b>                                |              | <b>(383)</b>             | <b>(689)</b>      |
| <b>Profit/(loss) for the period attributable to owners of the parent</b> |              | <b>(383)</b>             | <b>(689)</b>      |
| <b>Profit/(loss) for the period</b>                                      |              | <b>(383)</b>             | <b>(689)</b>      |
| <b>Earnings per share</b>  | [9]          |                          |                   |
| <b>Basic earnings per share in EUR</b>                                   |              | <b>(0.13)</b>            | <b>(0.43)</b>     |
| <b>Diluted earnings per share in EUR</b>                                 |              | <b>(0.13)</b>            | <b>(0.43)</b>     |

1 In the Consolidated Income Statement as of 31 December 2015, the prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

# Consolidated Statement of Comprehensive Income\_

| (Euros in millions)   | Notes  | 1 January to 31 December |                   |
|---|--------|--------------------------|-------------------|
|   |        | 2015                     | 2014 <sup>1</sup> |
| <b>Profit/(loss) for the period</b>   |        | <b>(383)</b>             | <b>(689)</b>      |
| <b>Other comprehensive income/(loss)</b>  |        |                          |                   |
| <b>Items that will not be reclassified to profit/(loss)</b>                           |        | <b>7</b>                 | <b>(31)</b>       |
| Remeasurement of defined benefit plans  | [5.12] | 11                       | (45)              |
| Income tax impact   | [5.12] | (3)                      | 15                |
| <b>Other comprehensive income/(loss)</b>  |        | <b>7</b>                 | <b>(31)</b>       |
| <b>Total comprehensive income</b>   |        | <b>(375)</b>             | <b>(720)</b>      |
| Total comprehensive income/(loss) for the period attributable to owners of the parent |        | (375)                    | (720)             |
| <b>Total comprehensive income/(loss)</b>  |        | <b>(375)</b>             | <b>(720)</b>      |

<sup>1</sup> In the Consolidated Statement of Comprehensive Income as of 31 December 2015, the prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

# Consolidated Statement of Changes in Equity

| (Euros in millions)                       | Subscribed capital | Additional paid-in capital | Retained earnings | Total equity attributable to owners of the parent | Equity        |
|---|--------------------|----------------------------|-------------------|---|---------------|
| <b>As of 1 January 2014</b>               | <b>1,117</b>       | <b>–</b>                   | <b>4,882</b>      | <b>5,999</b>                                      | <b>5,999</b>  |
| Profit/(loss) for the period <sup>1</sup> | –                  | 0                          | (689)             | (689)   | (689)         |
| Other comprehensive income/(loss)         | –                  | –                          | (31)              | (31)  | (31)          |
| <b>Total comprehensive income/(loss)</b>  | <b>–</b>           | <b>0</b>                   | <b>(720)</b>      | <b>(720)</b>                                      | <b>(720)</b>  |
| Dividends                                 | –                  | –                          | (525)             | (525)   | (525)         |
| Capital increases                         | 1,858              | 4,832                      | –                 | 6,690   | 6,690         |
| Costs of capital increases                | –                  | (33)                       | –                 | (33)  | (33)          |
| Other movements                           | –                  | –                          | 1                 | 1   | 1             |
| <b>As of 31 December 2014</b>             | <b>2,975</b>       | <b>4,800</b>               | <b>3,637</b>      | <b>11,412</b>                                     | <b>11,412</b> |
| <b>As of 1 January 2015</b>               | <b>2,975</b>       | <b>4,800</b>               | <b>3,637</b>      | <b>11,412</b>                                     | <b>11,412</b> |
| Profit/(loss) for the period              | –                  | –                          | (383)             | (383)   | (383)         |
| Other comprehensive income/(loss)         | –                  | –                          | 7                 | 7   | 7             |
| <b>Total comprehensive income/(loss)</b>  | <b>–</b>           | <b>–</b>                   | <b>(375)</b>      | <b>(375)</b>                                      | <b>(375)</b>  |
| Dividends                                 | –                  | –                          | (714)             | (714)   | (714)         |
| Other movements                           | –                  | –                          | (2)               | (2)   | (2)           |
| <b>As of 31 December 2015</b>             | <b>2,975</b>       | <b>4,800</b>               | <b>2,546</b>      | <b>10,321</b>                                     | <b>10,321</b> |

<sup>1</sup> In the Consolidated Statement of Changes in Equity as of 31 December 2015, the prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

# Consolidated Statement of Cash Flows

| (Euros in millions)  | January 1 to December 31 |                   |
|--|--------------------------|-------------------|
|  | 2015                     | 2014 <sup>1</sup> |
| <b>Cash flow from operating activities</b>   |                          |                   |
| <b>Profit/(loss) for the period</b>  | <b>(383)</b>             | <b>(689)</b>      |
| <b>Adjustments to profit/(loss)</b>  |                          |                   |
| Net financial income/(expense)   | 48                       | 34                |
| Gains on disposal of assets  | (14)                     | (0)               |
| Income tax   | 72                       | 34                |
| Depreciation and amortisation  | 2,067                    | 1,300             |
| Retrospectively purchase price adjustment <sup>3</sup>   | (102)                    | –                 |
| <b>Change in working capital</b>   |                          |                   |
| Other current and non-current assets   | 36                       | (89)              |
| Other non-current liabilities and provisions   | (82)                     | 609               |
| Other current liabilities and provisions   | 127                      | 241               |
| <b>Others</b>  |                          |                   |
| Taxes paid   | 0                        | (6)               |
| Interest received  | 15                       | 10                |
| Interest paid <sup>4</sup>   | (47)                     | (34)              |
| Payment received for E-Plus <sup>3</sup>   | 102                      | –                 |
| <b>Cash flow from operating activities</b>   | <b>1,838</b>             | <b>1,410</b>      |
| <b>Cash flow from investing activities</b>   |                          |                   |
| Proceeds on disposals of property, plant and equipment and intangible assets   | 0                        | 1                 |
| Payment on investments relating to mobile phone frequency auctions <sup>4</sup>  | (978)                    | –                 |
| Payments on investments in property, plant and equipment and intangible assets   | (1,083)                  | (689)             |
| Proceeds on disposals of companies <sup>2</sup>  | 57                       | –                 |
| Acquisition of E-Plus net of cash acquired <sup>3</sup>  | 30                       | (3,239)           |
| Proceeds/Payments made on financial assets   | (10)                     | 4                 |
| <b>Cash flow from investing activities</b>   | <b>(1,984)</b>           | <b>(3,924)</b>    |
| <b>Cash flow from financing activities</b>   |                          |                   |
| Payments made for capital increase costs   | (6)                      | (25)              |
| Proceeds from capital increases  | –                        | 3,620             |
| Proceeds from interest-bearing debt  | 350                      | 700               |
| Repayment of interest-bearing debt   | (653)                    | (246)             |
| Dividends paid   | (714)                    | (525)             |
| <b>Cash flow from financing activities</b>   | <b>(1,023)</b>           | <b>3,523</b>      |
| <b>Less cash and cash equivalents attributable to assets and liabilities held for sale (refer to Note No. 8 Discontinued Operations and Disposal Groups)</b> | <b>–</b>                 | <b>(16)</b>       |
| <b>Net increase/(decrease) in cash and cash equivalents</b>  | <b>(1,169)</b>           | <b>994</b>        |
| <b>Cash and cash equivalents at the beginning of the period</b>  | <b>1,702</b>             | <b>709</b>        |
| <b>Cash and cash equivalents at the end of the period (excluding cash and cash equivalents held for sale)</b>  | <b>533</b>               | <b>1,702</b>      |

1 In the Consolidated Statement of Cash Flows as of 31 December 2015, the previous-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7, Business Combinations.

2 A cash and cash equivalents balance of EUR 16 million was included in assets held for sale as of 31 December 2014 and was transferred in the transaction. Therefore the net cash received amounted to EUR 41 million.

3 An agreement on the final purchase price was reached with KPN in the financial year 2015. The preliminary purchase price was reduced by EUR 134 million. 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 flow from operating activities. The remaining amount of EUR 30 million is presented in cash flow from investing activities.

4 As of 31 December 2015 the total amount of interest paid EUR 50 million is presented in interest paid EUR 47 million as well as payment on investments relating to mobile phone frequency auctions EUR 2 million.

# Notes to the Consolidated Financial Statements\_

## for the year ended 31 December 2015

### 1.

#### Reporting Entity

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared as of and for the year ending 31 December 2015 and comprise 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](http://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 2015, Telefónica Deutschland Holding AG has share capital of EUR 2,974,554,993, 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 non-par share grants one vote at the Annual General Meeting.

As of 31 December 2015, 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).

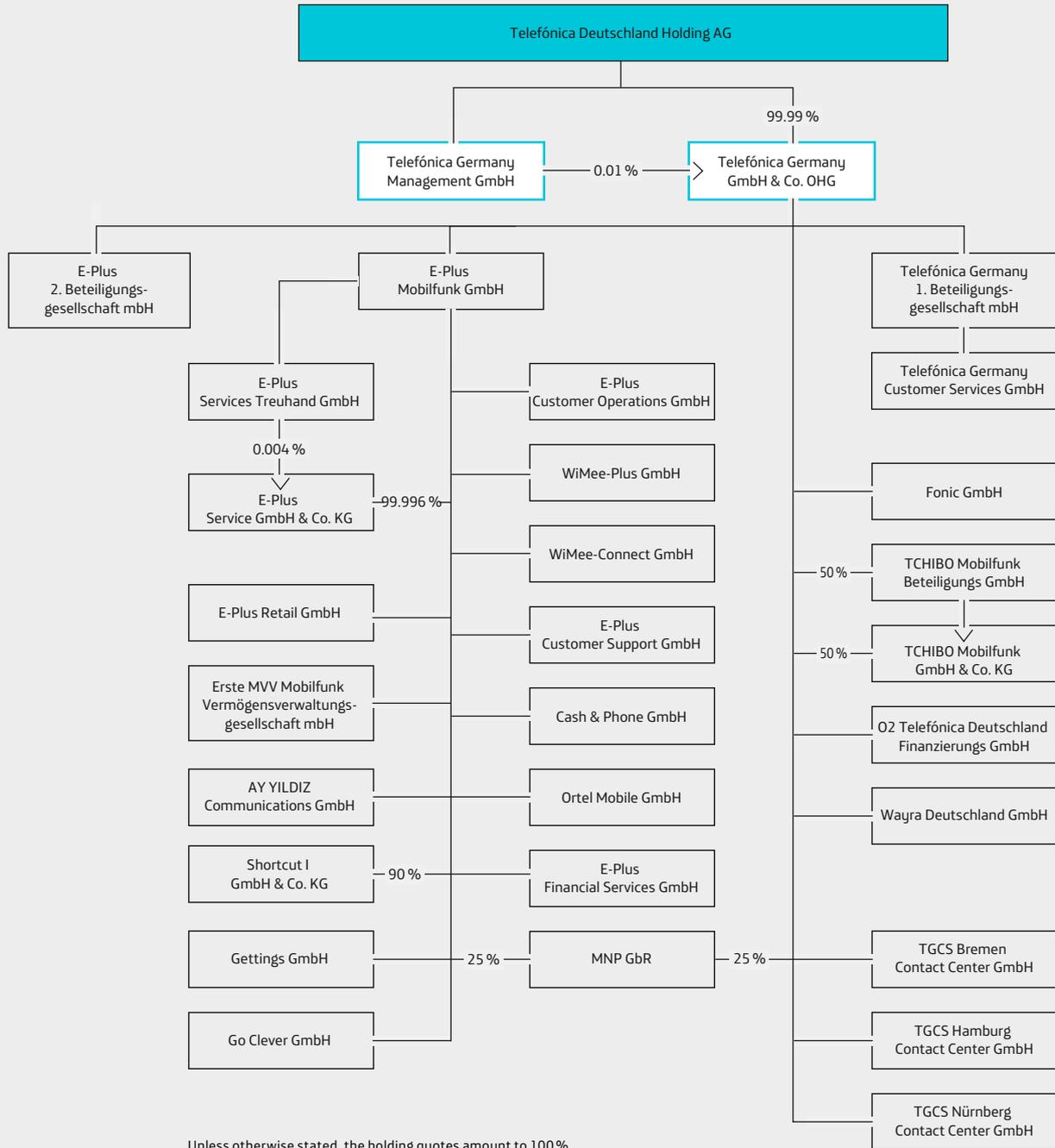
As of 31 December 2015, Telefónica Deutschland Holding AG had authorised capital 2012/I of EUR 292,808,507.

As of 31 December 2015, 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.. 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 since 1 October 2014 has also contained 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. 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 2015, the companies included in the Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart:



The sale of yourfone GmbH to Drillisch was completed on 2 January 2015 (see Notes No. 2 Significant events and transaction in the financial year).

In the financial year 2015, simyo GmbH, E-Plus 1. Beteiligungsgesellschaft mbH and BLAU Mobilfunk GmbH were merged with Telefónica Germany GmbH & Co. OHG with effect from 30 June 2015. Previously blau Service GmbH was merged with BLAU Mobilfunk GmbH.

## 2.

### Significant Events and Transactions in the Financial Year

#### **Integration and transformation of E-Plus continues**

The change in legal form of E-Plus Mobilfunk to a limited liability company under German law (GmbH) was entered in the commercial register on 26 January 2015. On 4 February 2015, a profit transfer agreement was concluded with Telefónica Germany GmbH & Co. OHG effective as of 1 January 2015, with the result that E-Plus Mobilfunk GmbH, including its income tax group subsidiary companies, was included in the income tax group of the Telefónica Deutschland Group effective as of 1 January 2015.

#### **yourfone sold to Drillisch**

The sale of yourfone GmbH to Drillisch was closed on 2 January 2015. The Telefónica Deutschland Group reported net inflows of EUR 57 million from the sale in the reporting period and generated a gain on disposal of EUR 15 million, which was recognised in the Consolidated Income Statement under other income.

#### **Framework redundancy plan adopted**

In February 2015, the Management Board and Works Councils of the Telefónica Deutschland Group agreed a framework redundancy plan that will apply until the end of 2018. Based on the regulations set out in this plan, the implementation of the 2015 redundancy programme for around 800 FTEs began in the first quarter of 2015 as planned and came close to being finalised by the end of the period under review.

#### **Promissory notes and registered bonds placed**

On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds. The transaction was announced on 2 February 2015 with a target volume of EUR 250 million but was implemented at a volume of EUR 300 million due to the high oversubscription.

The promissory notes were issued in unsecured tranches with terms of five, eight and ten years, with both fixed and floating interest rates. The registered bonds were issued in unsecured tranches with terms of 12, 15 and 17 years with fixed interest rates. All tranches were issued by Telefónica Germany GmbH & Co. OHG, Munich.

The fixed-rate tranche with a nominal value of EUR 52 million and a term of five years bears interest at 0.961 %; the floating-rate tranche with a nominal value of EUR 60.5 million bears interest at 6-months Euribor +65 bp.

The fixed-rate tranche with a nominal value of EUR 19.5 million and a term of eight years bears interest at 1.416 %; the floating-rate tranche with a nominal value of EUR 1.5 million bears interest at 6-months Euribor +85 bp.

The fixed-rate tranche with a nominal value of EUR 29.5 million and a term of ten years bears interest at 1.769 %; the floating-rate tranche with a nominal value of EUR 9 million bears interest at 6-months Euribor +105 bp.

The tranches maturing in 12, 15 and 17 years have volumes of 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.

The issue proceeds of the overall transaction were used for general business purposes.

#### **Change in the Supervisory Board of Telefónica Deutschland**

María Pilar López Álvarez stepped down from the Supervisory Board of Telefónica Deutschland with effect from the end of the Annual General Meeting on 12 May 2015.

Laura Abasolo García de Baquedano was elected as her successor. Her term in office ends with the Annual General Meeting that resolves on the approval of the actions of the Supervisory Board for the financial year 2016.

#### **Annual General Meeting resolves dividend of EUR 0.24 per share**

The Annual General Meeting of Telefónica Deutschland for the financial year 2014 was held on 12 May 2015. In addition to presenting the Annual Financial Statements of Telefónica Deutschland, including the Group Management Report and the Consolidated Financial Statements, 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 13 May 2015.

#### **Mobile phone frequency auction: Telefónica Deutschland Group secures valuable spectrum**

By the decision of the German Federal Network Agency (BNetzA) on 22 April 2015, the Telefónica Deutschland Group was admitted to the auction of frequencies in the ranges 700 MHz, 900 MHz, 1.8 GHz and 1.5 GHz. The auction began on 27 May 2015 and ended on 19 June 2015.

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 for a total of approximately EUR 1,198 million.

#### **National roaming improves network quality for all customers**

By the end of May 2015, the UMTS networks of the former Telefónica Deutschland Group (O<sub>2</sub>) and the E-Plus Group (E-Plus) had been opened up to all customers of the group, bundling the strength of both networks for the first time. As a result, the customers of all own brands and partner brands can be offered the densest UMTS network infrastructure in urban areas and the most widespread coverage in rural areas. This step improves the user experience of mobile data services even in areas where our customers do not yet have LTE.

#### **Conclusion of new supplier agreements to expand mobile communications network**

In the second quarter of 2015, the Telefónica Deutschland Group concluded agreements with various suppliers of equipment and services for the Telefónica Deutschland Group mobile communications network. This meant the fulfilment of another requirement for the implementation of the integration of the mobile communications networks of the former Telefónica Deutschland Group (O<sub>2</sub>) and the E-Plus Group (E-Plus) and for the further accelerated roll-out of LTE. Under these agreements, the suppliers will provide radio access network equipment and services in the fields of network roll-out and network maintenance for the Telefónica Deutschland Group from 2015 to 2018.

#### **Transfer of mobile network sites**

In the course of its network integration, the Telefónica Deutschland Group transferred around 7,700 mobile network sites to Deutsche Telekom. A corresponding agreement was signed on 17 July 2015. As planned, the company has realised part of the announced synergies from the network integration with this transaction. Furthermore, Telefónica Deutschland can now utilise resources which would have been required to dismantle these redundant sites to accelerate the roll-out of its LTE network. The Telefónica Deutschland Group can continue to use these sites without restriction over the course of the integration of the O<sub>2</sub> and

E-Plus networks until they are no longer needed. The implementation of the transaction resulted in restructuring expenses for network optimisation in the mid-double digit millions. The financial impact of the transfer is included within the synergy expectations relating to the network integration as announced previously.

The mobile network sites were transferred to Deutsche Telekom on 1 October 2015.

#### **Start of use of network capacity by Drillisch**

As part of the merger with the E-Plus Group and the merger clearance process, the Telefónica Deutschland Group committed to sell some of its network capacity. In 2014, the Telefónica Deutschland Group signed an MBA MVNO (“Mobile Bitstream Access Mobile Virtual Network Operator”) agreement with Drillisch (Annual Report 2014, section 2.2, Overview of the Financial Year 2014 – Significant Events). As of 1 July 2015, Drillisch can now access the network capacity of the Telefónica Deutschland Group as planned according to the agreed mobile bitstream access model.

#### **Dividend proposal for the financial year 2015**

On 5 November 2015, the Management Board of Telefónica Deutschland announced its intention to propose a cash dividend of EUR 0.24 per share to the next Annual General Meeting, which is scheduled for 19 May 2016.

#### **Agreement on subsequent purchase price adjustment with KPN**

Pursuant to the agreement dated 23 July 2013 in the amended versions as of 26 and 28 August and 5 December 2013, 24 March, 7 August and 30 September 2014 and 18 June 2015, Telefónica Deutschland, Telefónica, S.A. and Koninklijke KPN N.V., The Hague, Netherlands (“KPN”) concluded an agreement regarding the acquisition of KPN’s German mobile business E-Plus by Telefónica Deutschland.

In December 2015, KPN and Telefónica Deutschland agreed on a subsequent purchase price adjustment in accordance with the purchase agreement. Thus, the adjusted cash component of the purchase price amounts to EUR 3,501,027,199.20.

### 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).

In addition, the accounting policies are the same as those used to prepare the published previous year’s Consolidated Financial Statements for the year ending 31 December 2014, with the exception of the changes to IFRS and the measurement changes described in Note No. 4 Accounting Policies (sections a) and g)). Furthermore, the additional requirements of German commercial law pursuant to section 315a (1) of the German Commercial Code (HGB) are applied.

The Consolidated Financial Statements of Telefónica Deutschland Holding AG were forwarded to the Supervisory Board on 5 February 2016.

#### **Functional currency and presentation currency**

These Consolidated Financial Statements are presented in Euro, 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 Euro (Euros in millions). The figures in these Consolidated Financial Statements are rounded according to established commercial principles. Additions of the figures can thus lead to amounts that deviate from those shown in the tables.

**Other**

The Consolidated Statement of Financial Position is structured in current and non-current in accordance with IAS 1. The Consolidated Income Statement is prepared using the nature of expense method.

**Comparative information**

The Consolidated Statement of Financial Position presented in these Consolidated Financial Statements relates to information as of 31 December 2015, which is compared against information as of 31 December 2014<sup>1</sup>.

As a result of the acquisition of the E-Plus Group as of 1 October 2014, the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Cash Flows and the Consolidated Statement of Changes in Equity of the Telefónica Deutschland Group have changed significantly, thus rendering a comparison difficult. As the integration of the E-Plus Group is progressing rapidly, a separate reporting of the former E-Plus Group is not appropriate from our point of view.

**Seasonal business activity**

Previous earnings performance has provided no indication that the business activity is subject to material seasonal fluctuations.

**4.****Accounting Policies**

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

**a) Acquisitions**

Business combinations are accounted for in accordance with the purchase method. Telefónica Deutschland as the acquirer and the acquiree may have a relationship that existed before a business combination was contemplated. If the business combination in effect settles such a pre-existing relationship, Telefónica Deutschland as 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. Later 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.

<sup>1</sup> In the Consolidated Financial Statements as of 31 December 2015, the prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

## b) Goodwill

For business combinations occurring 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. Whenever an equity interest is held 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 No. 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 expenditure on internally generated goodwill and brands is recognised in the Consolidated Income Statement 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, where appropriate, adjusted prospectively.

### Licences

Mainly the acquisition costs of the licences granted by public authorities to provide telecommunications services are subsumed here 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 bases**

This item primarily represents 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 the 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, where 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<br>in years |
|---|-----------------------------------|
| Buildings   | 5–20                              |
| Plant and machinery<br>(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 not yet available for use 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 only tested for impairment 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 2015, 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 at the Telefónica Deutschland Group in connection with the joint operations and its share of the revenues are recognised in the Consolidated Income Statement.

#### g) Foreign currency transactions

Transactions denominated in a foreign currency are translated to Euro 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:

| (EUR/foreign currency) | Exchange rate                |                              | Average rate |       |
|------------------------|------------------------------|------------------------------|--------------|-------|
|                        | As of<br>31 December<br>2015 | As of<br>31 December<br>2014 | 2015         | 2014  |
| USD                    | 1.089                        | 1.214                        | 1.109        | 1.326 |
| GBP                    | 0.734                        | 0.779                        | 0.726        | 0.806 |
| BRL                    | 4.251                        | 3.225                        | 3.643        | 3.117 |
| CHF                    | 1.084                        | 1.202                        | 1.068        | 1.215 |

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

#### h) Inventories

Inventories are stated at the lower of cost and net realisable value and are written down in this regard, 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 to condition. Estimates of the net realisable value are based on the most reliable evidence available at the time of the estimates are made of the amount the inventories are expected to realise. These estimates take into consideration the fluctuations of price or costs and 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 reduced accordingly through profit and loss. The change in inventory is recognised within supplies.

#### i) 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 does not allocate financial instruments to the category held-to-maturity in the reporting period.

#### **Financial assets**

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

##### Financial assets at fair value through profit or loss

Financial assets measured at fair value through profit or loss comprise financial assets that are designated as measured at fair value through profit or loss on initial recognition. This includes derivatives in the form of interest rate swaps that qualify for hedge accounting whose market values are positive on the reporting date. Changes to the fair value recorded on initial recognition for assets of this category are recognised in profit or loss at the date of value increase or decrease.

##### 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 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 derecognised 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. If objective evidence of impairment exists, these changes are recognised in the Consolidated Income Statement. Upon the disposal of 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 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 to the Consolidated Income Statement. Reversals with respect to equity investments classified as available-for-sale are recognised in the other comprehensive income. 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 for impairment exists if there is a significant (> 20 %) or prolonged decline (over a period of six months) in the fair value of the instrument.

**Financial liabilities**

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

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 No. 5.10 Interest-bearing liabilities). The fair value used of 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 Statement. 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 forms a hedge comprised 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 trans-

actions 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 measured 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 Statement 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 obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss.

## **j) Provisions**

#### **Pension obligations**

The Telefónica Deutschland Group's obligations under defined benefit pension plans are determined using the projected unit credit method and are in principle 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 by reference to 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 but 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.

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.

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 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.

For further details, see q) Significant change of estimates, assumptions and judgements.

## k) Revenues and expenses

Revenues and expenses are recognised in the Consolidated Income Statement in line with the accrual basis of accounting (i.e. when the goods or services represented by them take place) 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, are reported with a negative effect on revenues.

The revenues of the Telefónica Deutschland Group include all income attributable to the company's typical business activity.

The Telefónica Deutschland Group principally obtains revenues from providing the following telecommunications services: traffic, connection fees, regular (normally monthly) network usage fees, interconnection services, network and equipment leasing, handset sales, added value services (e.g. text and data messaging) and maintenance. Products and services may be sold separately or in promotional packages (bundled services).

### **Traffic, connection fees and regular network usage fees**

Revenues from calls carried on Telefónica Deutschland Group networks (traffic) include an initial call establishment fee plus a variable call rate, based on call length, distance and type of service. Both fixed line and mobile traffic are recognised as revenues as the service is provided. For prepaid calls, the amount of unused traffic generates deferred revenues that are recognised in deferred income in the Consolidated Statement of Financial Position. Revenues from unused credit are received when the company is no longer obliged to provide service or utilisation can no longer be expected, whichever is earlier. Revenues from 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 covered by the rate paid by the customer.

Initial call establishment fees are recognised in deferred income and are subsequently realised in profit or loss for the period over the average estimated term of the customer relationship, which may vary according to 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-mobile and vice versa calls and 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 when delivered to the end customer. Revenues from instalment sales are recognised in 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 o) 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.

**Multi-component agreements**

The Group offers bundled packages which combine multiple elements from the fixed line, mobile and internet business. They are assessed to determine whether it is necessary to separate the separately identifiable elements and apply the corresponding revenue recognition policy to each element. Total package 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.

All expenses related to bundled promotional packages are recognised in the Consolidated Income Statement as incurred.

**l) Income tax**

Income tax includes both current and deferred taxes. Current and deferred tax is recognised in the Consolidated Income Statement 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.

#### **m) 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 Statement and the Consolidated Statement 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.

#### **n) Share-based payments**

Telefónica, S.A. grants share options to employees of the Telefónica Deutschland Group. The determination of 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.

#### **o) Leases**

The assessment of a lease for accounting purposes 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 Statement.

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. These are classified at the inception of the lease, in accordance

with its 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 apportioned between the financing and reduction of the principal of the lease liability so as to achieve a constant interest rate on the remaining liability balance over the period. Finance costs and income are recognised over the term of the lease in the financial result in the Consolidated Income Statement.

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 k) 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.

#### p) 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 estimated 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.

**q) Significant change of estimates, assumptions and judgements****Dismantling obligation**

As a result of the annual review of recognised costs of the dismantling of a portion of the network as well as due to changes in development of interests provisioning requirement were reduced as of 31 December 2015 by EUR 37 million.

The time-adjustment of the provision consequently resulted in a corresponding adjustment of the associated assets. The useful life of the non-current assets attributable to this part of the network was accordingly adjusted downwards in the financial year.

**Purchase price adjustment**

For the purchase price allocation as part of the business combination with the E-Plus Group, estimates and assumptions regarding recognition and measurement of assets and liabilities have been made.

The initially reported preliminary fair values were based on information that was available at the time of acquisition. The purchase price was based on the preliminary status of the negotiations and information.

The preliminary fair values of assets and liabilities have been adjusted until the expiration of the twelve-month period based on subsequent information and estimates. The purchase price that has been assumed until the expiration of the twelve-month period has also been re-evaluated and adjusted as a result of the ongoing price negotiations.

The difference between the purchase price assessed at the expiry of the twelve-month period and the final purchase price was charged in the profit and loss statement to other operating income and consequently disclosed in cash flow from operating activities.

#### **Trade payables**

Trade payables are reclassified to other financial liabilities when the agreements on their interest-bearing extension of payment terms are concluded to reflect the changed nature of these liabilities.

### **r) 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 as well as expenses and income for companies jointly controlled with third parties (joint operations). Similar line items are combined so that the corresponding share of total assets, liabilities, expenses and income as well as the 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.

### **s) Accounting policies adopted as of 31 December 2015**

Accounting policies applied in the financial year from 1 January 2015 to 31 December 2015 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 19 – Defined Benefit Plans: Employee Contributions

On 21 November 2013, the IASB published a slight amendment to IAS 19 Defined Benefit Plans: Employee Contributions, which was adopted by the EU on 17 December 2014. The Telefónica Deutschland Group has applied this amended standard since 1 January 2015. Mandatory application within the EU was planned for financial years beginning on or after 1 February 2015. This change represents a relief for the company with regard to recording employee or third party contributions to a pension plan. As a result of this change to IAS 19.93, it is permitted for a company to record contributions from employees or third-parties in the periods in which the associated performance is rendered as a reduction in the current service costs, provided the contributions are independent of the number of years of service.

### Annual Improvements to the IFRSs 2010–2012 and Annual Improvements to the IFRSs 2011–2013

Under its annual improvements project, in December 2013 the IASB published the “Annual Improvements to the IFRSs 2010–2012” and “Annual Improvements to the IFRSs 2011–2013”. EU approval was granted on 17 and 18 December 2014 and contain a obligation of application for financial years beginning on or after 1 February 2015 or 1 January 2015. The amendments made under the annual improvements project mainly serve to provide necessary clarifications within various standards. The “Annual Improvements to the IFRSs 2010–2012” relate to amendments to IAS 16, IAS 24, IAS 38, IFRS 2, IFRS 3, IFRS 8 and IFRS 13. The “Annual Improvements to the IFRSs 2011–2013” relate to amendments to IAS 40, IFRS 1, IFRS 3 and IFRS 13.

The aforementioned amendments had no effect or no significant effect on the net assets, financial position or result of operations of the Group.

### t) New standards and IFRIC interpretations issued, but whose application is not yet mandatory as of 31 December 2015

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 and amendments                  |   | Application for financial years beginning on or after |
|---|---|---|
| IFRS 14                                   | Regulatory Deferral Accounts  | 1 January 2016 <sup>2</sup>                           |
| Amendments to IAS 16 and IAS 38           | Clarification of Acceptable Methods of Depreciation and Amortisation                  | 1 January 2016  |
| Amendments to IFRS 11                     | Accounting for Acquisitions of Interests in Joint Operations                          | 1 January 2016  |
| Amendments to IAS 16 and IAS 41           | Bearer Plants   | 1 January 2016  |
| Amendments to IAS 27                      | Equity Method in Separate Financial Statements  | 1 January 2016 <sup>1</sup>                           |
| Annual Improvements 2012–2014 Cycle       | Amendments to IAS 19, IAS 34, IFRS 5 and IFRS 7                                       | 1 January 2016 <sup>1</sup>                           |
| Amendments to IFRS 10, IFRS 12 and IAS 28 | Applying the Consolidation Exception  | 1 January 2016 <sup>1</sup>                           |
| Amendments to IAS 1                       | Presentation of Financial Statements: Disclosure Initiative                           | 1 January 2016 <sup>1</sup>                           |
| Amendments to IAS 12                      | Income tax  | 1 January 2017 <sup>1</sup>                           |
| IFRS 15                                   | Revenue from Contracts with Customers   | 1 January 2018 <sup>1</sup>                           |
| IFRS 9 and amendments to IFRS 7           | Financial Instruments   | 1 January 2018 <sup>1</sup>                           |
| IFRS 16                                   | Leases  | 1 January 2019 <sup>1</sup>                           |
| Amendments to IFRS 10 and IAS 28          | Sale or Contribution of Assets between an Investor and its Associate or Joint Venture | <sup>3</sup>  |

1 Endorsement by EU still outstanding, information for first-time adoption according to IASB.

2 Endorsement in EU law not yet proposed based on the announcement by the European Financial Reporting Advisory Group (EFRAG) on 30 October 2015.

3 In accordance with the IASB resolution of 17 December 2015 the initial application was postponed indefinitely.

### **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 endorsement of the EU took place on 18 of December 2015.

### **Annual Improvements 2012 – 2014 Cycle**

Under its annual improvements project, the IASB published “Annual Improvements to the IFRSs 2012 – 2014” which were included into European rights on 15 of 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.

### **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.

### **Amendments to IFRS 10 and 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 are constitute a business. In accordance with the IASB resolution of 17 December 2015 the initial application schedule was postponed indefinitely.

Except of the amendments on IFRS 10 and IAS 28 the amendments just described must be applied for financial years on or after 1 January 2016, with earlier application permitted. The adaption into European law is partly outstanding. No impact or no significant impact is expected on the Consolidated Financial Statements.

### **Amendments to IAS 12 Income Tax**

On 19 January 2016, the IASB issued amendments to IAS 12 Income Taxes. The amendments, Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12), 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. Earlier 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.

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, duration 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 Telefónica Germany 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.

According to the current level of knowledge, Telefónica Germany Group particularly expects effects from the following circumstances:

- The group offers products within multiple – element arrangements (see k) Revenues and expenses). In some of these contracts the realizable amount of an identified component depends on future deliverables. In such cases the adoption of IFRS 15 leads to a value-based shift of revenues between the individual components and consequently lead to a temporally different presentation of revenues.
- Expenses are recognised in profit or loss when the underlying service is performed (see k) Revenues and expenses). As far as customer acquisition costs are directly attributable to the contracts these costs are to be allocated over the estimated customer retention period.

#### **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 Telefónica Deutschland Group is currently analysing the standard for its potential impact.

**IFRS 16 Leases**

On 13 January 2016, the IASB issued IFRS 16 Leases. Replacing IAS 17 and other existing interpretations. Regarding IFRS 16, basically all contracts of the lessee which are identified as leasing contracts have to be recorded thus the right of use has to be taken into account as assets. Furthermore, the new standard eliminates the distinction between operating and finance lease of IAS 17. According to that the net value of the lease liability has to result in a liability. Exceptions are permissible if there are leased assets with low value or short-term contracts. Implementation of the standard is mandatory for financial years beginning on or after 1 January 2019 whereas an early application is permitted. The Telefónica Deutschland Group is currently analysing the standard for its potential impact.

The Group is planning to implement the changes pursuant to the mandatory application.

## 5.

**Selected Explanatory Notes to the Consolidated Statement of Financial Position****5.1. Goodwill**

The carrying amount of goodwill as of 31 December 2015 was EUR 1,955 million.

| (Euros in millions)   | 2015         | 2014 <sup>1</sup> |
|---|--------------|-------------------|
| <b>Carrying amount of goodwill at 1 January</b>                                     | <b>1,955</b> | <b>706</b>        |
| Acquisitions (refer to Note No. 7 Business Combinations)                            | –            | 1,256             |
| Reclassifications (refer to Note No. 8 Discontinued Operations and Disposal Groups) | –            | (7)               |
| <b>Carrying amount of goodwill at 31 December</b>                                   | <b>1,955</b> | <b>1,955</b>      |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

As of 31 December 2015, goodwill comprised the following components:

- Goodwill added in the reporting year with a carrying amount of EUR 1,256 million, resulting from the acquisition of E-Plus Mobilfunk GmbH & Co. KG with its direct and indirect subsidiaries by Telefónica Deutschland Holding AG effective 1 October 2014.
- The carrying amount of the goodwill in the amount of EUR 423 million resulted from the acquisition of MediaWays GmbH by HighwayOne Germany GmbH, which was executed on 30 September 2002. On 2 October 2002, HighwayOne Germany GmbH and MediaWays GmbH merged into Telefónica Deutschland GmbH. On 23 March 2011, Telefónica Deutschland GmbH was changed to Telefónica Germany Customer Services GmbH.
- The carrying amount of the goodwill of EUR 282 million resulted from the acquisition of HanseNet Telekommunikation GmbH by Telefónica Germany Customer Services GmbH from Telecom Italia Deutschland Holding GmbH, Hamburg, on 16 February 2010. Under the agreement dated 4 March 2011, and as of the agreed merger date on 1 January 2011, Telefónica Germany Customer Services GmbH has transferred the carrying amount of goodwill to Telefónica Germany GmbH & Co. OHG.
- Due to the disposal of yourfone GmbH (for further information see Note No. 8.2. Disposal Group in 2014), EUR 7 million of the goodwill was reclassified to assets held for sale.

The impairment test carried out at the level of the cash-generating unit Telecommunications did not result in a need to recognise any write-downs to goodwill as of the end of 2015, because the recoverable amount of EUR 14,526 million, based on the fair value less costs to sell, was higher than the carrying amount. No write-downs occurred in financial year 2014 either.

The impairment test is described in Note No. 4 Accounting Policies.

## 5.2. Other intangible assets

The other intangible assets comprise the following:

| (Euros in millions)                       | Service concession arrangements and licences | Customer bases | Software       | Thereof own work capitalised | Brand names | Others      | Construction in progress/prepayments on intangible assets | Other intangible assets |
|---|--|----------------|----------------|------------------------------|-------------|-------------|---|-------------------------|
| <b>Gross cost</b>                         |  |                |                |                              |             |             |   |                         |
| <b>As of 1 January 2014</b>               | <b>9,831</b>                                 | <b>267</b>     | <b>1,331</b>   | <b>161</b>                   | <b>–</b>    | <b>91</b>   | <b>21</b>   | <b>11,540</b>           |
| Additions                                 | –  | –              | 187            | 32                           | –           | 3           | 3   | 192                     |
| Disposals                                 | (0)  | –              | (562)          | (56)                         | –           | (2)         | –   | (565)                   |
| Reclassifications <sup>2</sup>            | 0  | (47)           | 28             | –                            | (1)         | (0)         | (32)  | (52)                    |
| Change in group structure <sup>1</sup>    | 1,057  | 2,857          | 143            | (17)                         | 105         | 6           | 14  | 4,182                   |
| <b>As of 31 December 2014<sup>1</sup></b> | <b>10,888</b>                                | <b>3,076</b>   | <b>1,126</b>   | <b>120</b>                   | <b>104</b>  | <b>98</b>   | <b>6</b>  | <b>15,297</b>           |
| <b>As of 1 January 2015</b>               | <b>10,888</b>                                | <b>3,076</b>   | <b>1,126</b>   | <b>120</b>                   | <b>104</b>  | <b>98</b>   | <b>6</b>  | <b>15,297</b>           |
| Additions                                 | –  | –              | 293            | 29                           | –           | 0           | 1,198   | 1,491                   |
| Disposals                                 | –  | (1)            | (309)          | (2)                          | (24)        | (30)        | –   | (364)                   |
| Reclassifications                         | –  | 0              | 65             | –                            | 24          | (24)        | (3)   | 62                      |
| <b>As of 31 December 2015</b>             | <b>10,888</b>                                | <b>3,075</b>   | <b>1,176</b>   | <b>147</b>                   | <b>104</b>  | <b>45</b>   | <b>1,201</b>  | <b>16,487</b>           |
| <b>Accumulated amortisation</b>           |  |                |                |                              |             |             |   |                         |
| <b>As of 1 January 2014</b>               | <b>(7,457)</b>                               | <b>(77)</b>    | <b>(1,038)</b> | <b>(110)</b>                 | <b>–</b>    | <b>(85)</b> | <b>–</b>  | <b>(8,656)</b>          |
| Additions                                 | (313)  | (101)          | (175)          | (33)                         | (5)         | (12)        | –   | (606)                   |
| Disposals                                 | 0  | –              | 562            | 56                           | –           | 2           | –   | 565                     |
| Reclassifications                         | 0  | –              | 1              | –                            | –           | –           | –   | 1                       |
| <b>As of 31 December 2014<sup>1</sup></b> | <b>(7,770)</b>                               | <b>(178)</b>   | <b>(649)</b>   | <b>(87)</b>                  | <b>(5)</b>  | <b>(95)</b> | <b>–</b>  | <b>(8,697)</b>          |
| <b>As of 1 January 2015</b>               | <b>(7,770)</b>                               | <b>(178)</b>   | <b>(649)</b>   | <b>(87)</b>                  | <b>(5)</b>  | <b>(95)</b> | <b>–</b>  | <b>(8,697)</b>          |
| Additions                                 | (442)  | (328)          | (292)          | (6)                          | (21)        | (7)         | –   | (1,090)                 |
| Disposals                                 | –  | 1              | 309            | 2                            | 24          | 30          | –   | 364                     |
| Reclassifications                         | –  | (29)           | (5)            | –                            | (21)        | 50          | –   | (5)                     |
| <b>As of 31 December 2015</b>             | <b>(8,211)</b>                               | <b>(534)</b>   | <b>(638)</b>   | <b>(91)</b>                  | <b>(23)</b> | <b>(22)</b> | <b>–</b>  | <b>(9,428)</b>          |
| <b>Net book value</b>                     |  |                |                |                              |             |             |   |                         |
| As of 1 January 2014                      | 2,374  | 190            | 293            | 51                           | –           | 6           | 21  | 2,884                   |
| <b>As of 31 December 2014<sup>1</sup></b> | <b>3,118</b>                                 | <b>2,898</b>   | <b>477</b>     | <b>34</b>                    | <b>99</b>   | <b>3</b>    | <b>6</b>  | <b>6,600</b>            |
| <b>As of 31 December 2015</b>             | <b>2,676</b>                                 | <b>2,541</b>   | <b>538</b>     | <b>56</b>                    | <b>81</b>   | <b>22</b>   | <b>1,201</b>  | <b>7,059</b>            |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

2 The transfers mainly relate to assets from yourfone GmbH, classified as assets held for sale as of December 31, 2014 (please refer to Note No. 8.2 Disposal Group in 2014).

### Licences

As of 31 December 2015, licences consist primarily of the licences listed below:

In May 1997, Telefónica Germany GmbH & Co. OHG acquired a GSM Licence (Global System for Wireless Communications) (2G). In connection with the E-Plus Group acquisition on 1 October 2014, another GSM Licence was acquired by the Telefónica Deutschland Group. As of 31 December 2015, the carrying amount of the GSM Licences was EUR 76 million (2014: EUR 156 million). The GSM Licences expire on 31 December 2016. The remaining amortisation period is one year.

In August 2000, Telefónica Germany GmbH & Co. OHG acquired a UMTS licence (3G) that expires on 31 December 2020. In May 2010, Telefónica Germany GmbH & Co. OHG acquired frequency usage rights in the UMTS band that expire in December 2025 or December 2020. As part of the E-Plus Group acquisition on 1 October 2014, another UMTS licence that expires on 31 December 2020 was acquired as well as additional frequency usage rights in the UMTS band that expire in December 2025. The carrying amount as of 31 December 2015 was EUR 1,060 million (2014: EUR 1,267 million). The remaining amortisation periods are five and ten years respectively.

In May 2010, Telefónica Germany GmbH & Co. OHG also acquired frequency usage rights used for LTE (4G), among others, that likewise 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 2015 was EUR 1,540 million (2014: EUR 1,695 million). The remaining amortisation period is ten years.

### Customer bases

The customer bases of EUR 2,541 million (2014: EUR 2,898 million) resulted primarily from the acquisition of E-Plus Group by Telefónica Deutschland. The customer bases acquired in the E-Plus acquisition on 1 October 2014 are amortised over a remaining period of eight to nine years.

### Software

Software mainly includes licences for office and IT applications. The carrying amount as of 31 December 2015 was EUR 538 million (2014: EUR 477 million). The software is amortised on a straight-line basis over its useful life, which is generally estimated to be between two to five years. In the financial years 2015 and 2014 there were no significant individual additions to software. The software disposals primarily relate to application software that reached the end of its useful life. According to the processing integration of E-Plus in 2015 network-related software amounting to EUR 62 million were reclassified in order to achieve harmonisation of disclosures.

### Brand names

The brand names acquired in the E-Plus Group acquisition on 1 October 2014 had a carrying amount of EUR 81 million as of 31 December 2015 (2014: EUR 99 million). The brand names are amortised over a remaining period of two or 19 years.

### Construction in progress/prepayments on intangible assets

In the financial year 2015, the Telefónica Deutschland Group acquired additional frequencies for a total of EUR 1,198 million that are 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 from 1 January 2017. The use of the acquired frequencies at 700 MHz is expected from the date they are vacated by the broadcasting companies. For further information, please refer to Note No. 2 Significant Events and Transactions in the Reporting Period.

In the year under review, borrowing costs were capitalised as a component of the acquired frequencies. Capitalised borrowing costs amounted to EUR 3.1 million as of 31 December 2015 and related to the acquisition of frequencies on 26 June 2015.

The Telefónica Deutschland Group based the capitalisation on a borrowing cost rate averaging 1.41 %.

The changes in the group structure in the previous year resulted from the acquisition of E-Plus (for further information see Note No. 7 Business Combinations).

### 5.3. Property, plant and equipment

Property, plant and equipment was composed as follows as of 31 December 2015 and 2014:

| (Euros in millions)                       | Land and buildings | Plant and machinery | Furniture, tools and other items | PP&E in progress | Property, plant and equipment |
|---|--------------------|---------------------|----------------------------------|------------------|-------------------------------|
| <b>Gross cost</b>                         |                    |                     |                                  |                  |                               |
| <b>As of 1 January 2014<sup>1</sup></b>   | <b>681</b>         | <b>5,761</b>        | <b>262</b>                       | <b>69</b>        | <b>6,772</b>                  |
| Additions                                 | 14                 | 550                 | 27                               | 65               | 656                           |
| Disposals                                 | (12)               | (348)               | (56)                             | (0)              | (416)                         |
| Reclassifications                         | (0)                | 76                  | 2                                | (79)             | (0)                           |
| Change in group structure <sup>1</sup>    | 43                 | 1,528               | 8                                | 164              | 1,742                         |
| Others                                    | 28                 | 215                 | –                                | –                | 243                           |
| <b>As of 31 December 2014<sup>1</sup></b> | <b>753</b>         | <b>7,781</b>        | <b>243</b>                       | <b>219</b>       | <b>8,996</b>                  |
| <b>As of 1 January 2015</b>               | <b>753</b>         | <b>7,781</b>        | <b>243</b>                       | <b>219</b>       | <b>8,996</b>                  |
| Additions                                 | 11                 | 698                 | 47                               | (17)             | 739                           |
| Disposals                                 | (35)               | (289)               | (60)                             | (0)              | (384)                         |
| Reclassifications                         | 0                  | 71                  | 2                                | (134)            | (62)                          |
| Other                                     | 8                  | (45)                | –                                | –                | (37)                          |
| <b>As of 31 December 2015</b>             | <b>738</b>         | <b>8,216</b>        | <b>231</b>                       | <b>68</b>        | <b>9,252</b>                  |
| <b>Accumulated amortisation</b>           |                    |                     |                                  |                  |                               |
| <b>As of 1 January 2014<sup>1</sup></b>   | <b>(431)</b>       | <b>(3,239)</b>      | <b>(207)</b>                     | <b>–</b>         | <b>(3,877)</b>                |
| Additions                                 | (64)               | (601)               | (29)                             | –                | (694)                         |
| Disposals                                 | 12                 | 348                 | 56                               | –                | 416                           |
| Reclassifications                         | 1                  | (1)                 | 0                                | –                | (0)                           |
| <b>As of 31 December 2014<sup>1</sup></b> | <b>(482)</b>       | <b>(3,494)</b>      | <b>(179)</b>                     | <b>–</b>         | <b>(4,154)</b>                |
| <b>As of 1 January 2015</b>               | <b>(482)</b>       | <b>(3,494)</b>      | <b>(179)</b>                     | <b>–</b>         | <b>(4,154)</b>                |
| Additions                                 | (79)               | (869)               | (28)                             | –                | (977)                         |
| Disposals                                 | 32                 | 289                 | 60                               | –                | 381                           |
| Reclassifications                         | 3                  | 2                   | 0                                | –                | 5                             |
| <b>As of 31 December 2015</b>             | <b>(526)</b>       | <b>(4,071)</b>      | <b>(147)</b>                     | <b>–</b>         | <b>(4,745)</b>                |
| <b>Net book value</b>                     |                    |                     |                                  |                  |                               |
| <b>As of 31 December 2014<sup>1</sup></b> | <b>272</b>         | <b>4,287</b>        | <b>63</b>                        | <b>219</b>       | <b>4,842</b>                  |
| <b>As of 31 December 2015</b>             | <b>212</b>         | <b>4,144</b>        | <b>84</b>                        | <b>68</b>        | <b>4,507</b>                  |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

The additions to property, plant and equipment in 2015 in the amount of EUR 739 million related mainly to investments in faster network expansion, including by optimising UMTS (3G), the increased LTE expansion, the expansion of IP technologies and the expansion of the mobile data services with even faster download speeds.

Within property, plant and equipment assets connected to decommissioning, dismantling and shutdown obligations decreased by EUR 37 million due to changes in prices. Caused by changes in the measurement of the maturity and the higher prices, assets increased in the prior year by EUR 243 million.

The changes in the group structure in the previous year resulted from the acquisition of E-Plus (for further information see Note No. 7 Business Combinations).

Property, plant and equipment deriving from finance leases amounted to EUR 224 million as of 31 December 2015 and EUR 64 million as of 31 December 2014. The increase resulted primarily out of the transfer of mobile sites to the Deutsche Telekom in course of the network integration (see Note No 8.1, Discounted operations). 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 No. 5.10 Interest-Bearing Debt (finance leases).

The PP&E in progress resulted mainly from the expansion of the network.

#### 5.4. Trade and other receivables

The breakdown of this item in the Consolidated Statement of Financial Position is as follows:

| (Euros in millions)  | As of 31 December |              |                   |              |
|--|-------------------|--------------|-------------------|--------------|
|  | 2015              |              | 2014 <sup>1</sup> |              |
|  | Non-current       | Current      | Non-current       | Current      |
| Trade receivables  | 169               | 1,648        | 252               | 1,702        |
| Receivables from related parties (Note No. 13 Related Parties) | –                 | 37           | –                 | 83           |
| Other receivables  | –                 | 29           | –                 | 21           |
| Provisions for bad debts                                       | (13)              | (194)        | (16)              | (261)        |
| <b>Trade and other receivables</b>                             | <b>157</b>        | <b>1,520</b> | <b>236</b>        | <b>1,545</b> |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

The trade receivables include receivables from finance leases. For further information refer to Note No. 5.10 Interest-Bearing Debt (finance leases).

The breakdown of trade receivables is as follows:

| (Euros in millions)        | As of 31 December |              |             |              |
|----------------------------|-------------------|--------------|-------------|--------------|
|                            | 2015              |              | 2014        |              |
|                            | Non-current       | Current      | Non-current | Current      |
| Trade receivables billed   | 76                | 819          | 153         | 994          |
| Trade receivables unbilled | 93                | 829          | 99          | 708          |
| <b>Trade receivables</b>   | <b>169</b>        | <b>1,648</b> | <b>252</b>  | <b>1,702</b> |

The following table shows the development of the allowances for the years ending as of 31 December 2015 and 2014.

| (Euros in millions)   | Non-current | Current      |
|---|-------------|--------------|
| <b>Allowances as of 31 December 2015</b>                              | <b>(13)</b> | <b>(194)</b> |
| Additions   | –           | (94)         |
| Release   | –           | –            |
| Utilisation   | 3           | 161          |
| <b>Allowances as of 31 December 2014</b>                              | <b>(16)</b> | <b>(261)</b> |
| Additions   | (8)         | (80)         |
| Release   | 2           | –            |
| Utilisation   | –           | 73           |
| Reclassifications <sup>1</sup>  | 3           | 16           |
| Change in group structure (refer to Note No. 7 Business Combinations) | (11)        | (153)        |
| <b>Allowances as of 1 January 2014</b>                                | <b>(2)</b>  | <b>(118)</b> |

1 The transfers in 2014 mainly relate to assets from yourfone GmbH, classified as assets held for sale as of 31 December 2014 (please refer to Note No. 8.2 Disposal Groups in 2014).

In 2015 and 2014, the Telefónica Deutschland Group sold “O<sub>2</sub> My Handy” receivables in order to optimise the working capital and to access an alternative source of funding. The nominal value of the receivables transferred in 2015 was EUR 738 million (2014: EUR 302 million) and the carrying amount was EUR 725 million (2014: EUR 294 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 previous year, a small portion of less than 5% of the receivables sold was not derecognised at the time of the sale due the continuing involvement. The carrying amount of these assets, which the Telefónica Deutschland Group continues to recognise, was EUR 8 million as of 31 December 2015 and EUR 24 million as of 31 December 2014. A liability was recognised in the same amount. The continuing involvement that was recognised was the maximum risk remaining with the Telefónica Deutschland Group and essentially results from a possible default of the receivables. Between now and the end of 2017, the Group could be obligated to repurchase EUR 28 million if customers should default on their respective debts. The actual defaults are compared to the originally expected ones every month 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 (2014: EUR 2 million).

The total loss on the date of the receivables transfer in 2015 was EUR 3 million (2014: EUR 1 million).

As in the previous year, the impact on profit and loss from continuing involvement following the completion of the transactions comprised a profit of EUR < 1 million.

## 5.5. Other financial assets

As of 31 December 2015 and in the previous year, the other financial assets comprised the following:

| (Euros in millions)           | As of 31 December |           |             |           |
|-------------------------------|-------------------|-----------|-------------|-----------|
|                               | 2015              |           | 2014        |           |
|                               | Non-current       | Current   | Non-current | Current   |
| Investments in start-ups      | 18                | –         | 13          | –         |
| Interest rate swaps           | 12                | 2         | 12          | 2         |
| Reimbursement rights          | 9                 | –         | 12          | –         |
| Silent factoring deposit      | 22                | 8         | 9           | 16        |
| Deposits                      | 1                 | –         | 1           | –         |
| Loans                         | 1                 | 1         | 1           | 1         |
| <b>Other financial assets</b> | <b>63</b>         | <b>10</b> | <b>49</b>   | <b>19</b> |

The other non-current financial assets primarily comprise:

- Investments in start-ups of EUR 18 million (2014: EUR 13 million)
- Interest rate swaps of EUR 12 million (2014: EUR 12 million) belonging to the two issued bonds (for further information see Note No. 5.10 Interest-Bearing Debt)
- Reimbursement rights of EUR 9 million (2014: EUR 12 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 22 million (2014: EUR 9 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 for the deposit

Other current financial assets primarily include the current portion of the security deposit for silent factoring of EUR 8 million (2014: EUR 16 million).

#### 5.6. Other non-financial assets and other non-financial liabilities

The other non-financial assets as of 31 December 2015 were composed as follows:

| (Euros in millions)               | As of 31 December |           |             |           |
|-----------------------------------|-------------------|-----------|-------------|-----------|
|                                   | 2015              |           | 2014        |           |
|                                   | Non-current       | Current   | Non-current | Current   |
| Prepayments                       | 160               | 46        | 142         | 54        |
| Prepayments to related parties    | –                 | 0         | –           | 1         |
| Other tax receivables             | –                 | 15        | –           | 16        |
| <b>Other non-financial assets</b> | <b>160</b>        | <b>61</b> | <b>142</b>  | <b>71</b> |

The non-financial assets primarily relate to prepayments for leased lines.

The other non-financial liabilities as of 31 December 2015 were composed as follows:

| (Euros in millions)                     | As of 31 December |           |
|---|-------------------|-----------|
|   | 2015              | 2014      |
|   | Current           | Current   |
| Payroll taxes and social security       | 11                | 13        |
| Current tax payables for indirect taxes | 34                | 0         |
| Other current taxes                     | 2                 | 5         |
| <b>Other non-financial liabilities</b>  | <b>48</b>         | <b>18</b> |

## 5.7. Inventories

As of 31 December 2015, inventories amounted to EUR 123 million (2014: EUR 104 million) and mainly comprised smartphones and accessories.

| (Euros in millions) | As of 31 December |            |
|---------------------|-------------------|------------|
|                     | 2015              | 2014       |
| Merchandise         | 130               | 109        |
| Allowances          | (6)               | (5)        |
| <b>Inventories</b>  | <b>123</b>        | <b>104</b> |

The total cost of inventories recognised as an expense in the Consolidated Income Statement in the financial year 2015 was EUR 1,271 million (2014: EUR 919 million).

As is typical for the industry, the suppliers of the inventories hold title retention to the inventories.

## 5.8. Cash and cash equivalents

The cash and cash equivalents line item 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.

| (Euros in millions)              | As of 31 December |              |
|----------------------------------|-------------------|--------------|
|                                  | 2015              | 2014         |
| Cash at bank and in hand         | 11                | 30           |
| Cash pooling                     | 522               | 1,673        |
| <b>Cash and cash equivalents</b> | <b>533</b>        | <b>1,702</b> |

## 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 2015, 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 have no right to securitise shares. Each non-par share in general grants one vote at the Annual General Meeting. The shares are freely transferable.

In the previous year, Telefónica Deutschland's share capital was increased by EUR 1,117 million by way of a capital increase for cash, entered in the commercial register on 18 September 2014 and by EUR 741 million by way of a capital increase for contributions in kind, entered in the commercial register on 7 October 2014, to a total of EUR 2,975 million.

**Authorised capital**

As of 31 December 2015, Telefónica Deutschland Holding AG had authorised capital 2012/I of EUR 293 million.

**Conditional capital**

The share capital of Telefónica Deutschland Holding AG was contingently increased by up to EUR 558 million by issuing up to 558,472,700 registered shares (contingent capital 2014/I).

The conditional capital 2014/I was resolved by the Annual General Meeting on 11 February 2014, suspending the contingent capital 2012/I.

**Additional paid-in capital**

As a result of the capital increases for cash and for contributions in kind implemented in the financial year 2014 in connection with the acquisition of 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 in the previous year to EUR 4,800 million as of 31 December 2014.

The increase in additional paid-in capital resulted from the total exercise price of the shares from the capital increases for cash and contributions in kind of EUR 6,690 million, less the contributions to share capital of EUR 1,858 million and less the costs of the capital increases of EUR 33 million.

**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 (2014: EUR 0.014 million).

**Proposed dividend for financial year 2015 to be paid in 2016**

On 5 November 2015, the Management Board of Telefónica Deutschland announced its intention to propose a cash dividend of EUR 0.24 per share to the next Annual General Meeting, which is scheduled for 19 May 2016.

**Annual General Meeting 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.

**Annual General Meeting and dividend distribution in 2014**

The Annual General Meeting of Telefónica Deutschland took place on 20 May 2014. Besides the discharge of the Supervisory Board and Management Board and the election of Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its registered office in Stuttgart, branch office Munich, as auditor for the 2014 Consolidated Financial Statements and Financial Statements of Telefónica Deutschland Holding AG, the Annual General Meeting resolved to distribute a dividend of EUR 0.47 per dividend-entitled share, a total EUR 525 million.

## 5.10. Interest-bearing debt

| (Euros in millions)                       | As of 31 December |            |                   |            |
|---|-------------------|------------|-------------------|------------|
|   | 2015              |            | 2014 <sup>1</sup> |            |
|   | Non-current       | Current    | Non-current       | Current    |
| Bonds                                     | 1,105             | 12         | 1,103             | 12         |
| Promissory notes and registered bonds     | 299               | 4          | –                 | –          |
| Loan liabilities                          | 250               | 251        | 500               | 226        |
| Finance leases                            | 32                | 180        | 204               | 382        |
| Contribution and compensation obligations | –                 | 3          | –                 | 3          |
| Other financial liabilities               | –                 | 119        | –                 | –          |
| <b>Interest-bearing debt</b>              | <b>1,686</b>      | <b>568</b> | <b>1,808</b>      | <b>622</b> |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

### Bonds

This item contains two bonds with a carrying amount of EUR 1,117 million as of 31 December 2015 (2014: EUR 1,115 million), of which EUR 1,105 million (2014: EUR 1,103 million) is classified as non-current and EUR 12 million (2014: 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 No. 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 corporate 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 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 1.268 % on the same amount in return.

In 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 corporate purposes. In connection with this, an interest rate swap was concluded for a partial amount of EUR 200 million of the bond's nominal value. 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 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 13 million cumulative loss in 2014 and EUR 1 million profit in 2015), while the corresponding clean prices of the interest rate swaps result in a cumulative profit of EUR 12 million (EUR 13 million cumulative profit in 2014 and EUR 1 million loss in 2015). 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 % (2014: 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 2015 (2014: 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.

#### **Loan liabilities**

This item includes a loan with an original total value of EUR 1,250 million, which was borrowed by Telefónica Germany GmbH & Co. OHG from Telfisa Global B.V. on 12 September 2012 (see Note No. 13 Related Parties). Repayments of EUR 225 million were made in 2015.

Of the EUR 501 million of the loan remaining as of 31 December 2015 (2014: EUR 726 million), EUR 250 million (2014: EUR 500 million) is classified as non-current and EUR 251 million (2014: EUR 226 million) as current. The current portion also includes accrued interest for the aforementioned non-current loan liabilities.

#### **Finance leases**

This item contains finance lease liabilities of EUR 212 million as of 31 December 2015 (2014: EUR 586 million), of which EUR 32 million (2014: EUR 204 million) is classified as non-current and EUR 180 million (2014: EUR 382 million) as current.

The obligations from finance leases result mainly from agreements for mobile phones and network elements concluded under sale and leaseback transactions and classified as finance leases in accordance with their form.

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 2015 and in the previous year (for further information see Note No. 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 2015    |  |                              |   |
|---------------------------|--|------------------------------|---|
| (Euros in millions)       | Minimum future lease payments obligation | Unamortised interest expense | Present value of future minimum lease payments obligation |
| 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   |
| <b>Total</b>              | <b>216</b>                               | <b>4</b>                     | <b>212</b>  |

| As of 31 December 2014 <sup>1</sup> |  |                              |   |
|-------------------------------------|--|------------------------------|---|
| (Euros in millions)                 | Minimum future lease payments obligation | Unamortised interest expense | Present value of future minimum lease payments obligation |
| Due within one year                 | 386                                      | 4                            | 382   |
| Due between 1 and 5 years           | 212                                      | 8                            | 204   |
| Due in more than 5 years            | –  | –                            | –   |
| <b>Total</b>                        | <b>598</b>                               | <b>12</b>                    | <b>586</b>  |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

#### 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 contracts concluded with the customers comprise fixed lease payments over a term of two years. Until the end of the financial year 2014, this business model was refinanced entirely under sale and lease back agreements.

The following table shows the expected minimum lease payments by end customers:

| As of 31 December 2015                   |                               |                            |   |
|--|-------------------------------|----------------------------|---|
| (Euros in millions)                      | Minimum future lease payments | Unrealised interest income | Present value of outstanding minimum lease payments |
| Due within one year                      | 224                           | 2                          | 222   |
| Due between 1 and 5 years                | 94                            | 0                          | 94  |
| Due in more than 5 years                 | –                             | –                          | –   |
| <b>Total</b>                             | <b>319</b>                    | <b>2</b>                   | <b>316</b>  |
| Accumulated allowance                    |                               |                            | (31)  |
| <b>Total after accumulated allowance</b> |                               |                            | <b>286</b>  |

| (Euros in millions)                      | As of 31 December 2014        |                            |   |
|--|-------------------------------|----------------------------|---|
|  | Minimum future lease payments | Unrealised interest income | Present value of outstanding minimum lease payments |
| Due within one year                      | 226                           | 3                          | 224   |
| Due between 1 and 5 years                | 100                           | 1                          | 99  |
| Due in more than 5 years                 | –                             | –                          | –   |
| <b>Total</b>                             | <b>326</b>                    | <b>3</b>                   | <b>323</b>  |
| Accumulated allowance                    |                               |                            | (36)  |
| <b>Total after accumulated allowance</b> |                               |                            | <b>286</b>  |

The impairment of receivables from finance leases is recognised as an expense. The credit risk is determined on the basis of past empirical values.

Extension 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 No. 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 has reached agreements with certain commercial suppliers, especially devices suppliers to extend payment periods. All postponements will result in payment of interests expressly agreed. This has entailed a change in the nature of debt in 2015 in the case of invoices affected by the deferral, from being operative to be financial debt. The accrual of interest agreed for the delay in the payment of the debt has been registered as financial expense.

### 5.11. Trade and other payables and deferred income

The composition of trade and other payables and deferred income is as follows:

| (Euros in millions)   | As of December 31 |              |             |              |
|---|-------------------|--------------|-------------|--------------|
|   | 2015              |              | 2014        |              |
|   | Non-current       | Current      | Non-current | Current      |
| Trade payables against third parties                            | 109               | 573          | –           | 860          |
| Accruals  | 19                | 1,105        | 16          | 977          |
| Payables to related parties (Note No. 13 Related Parties)       | –                 | 298          | –           | 254          |
| <b>Trade payables</b>   | <b>128</b>        | <b>1,975</b> | <b>16</b>   | <b>2,092</b> |
| Other creditors non-trade                                       | 2                 | 69           | 3           | 80           |
| Other payables to related parties (Note No. 13 Related Parties) | –                 | 53           | –           | 42           |
| Other payables  | 23                | 175          | –           | 70           |
| <b>Other payables</b>   | <b>25</b>         | <b>296</b>   | <b>3</b>    | <b>191</b>   |
| <b>Trade and other payables</b>                                 | <b>154</b>        | <b>2,272</b> | <b>19</b>   | <b>2,283</b> |
| <b>Deferred income</b>  | <b>424</b>        | <b>471</b>   | <b>305</b>  | <b>400</b>   |

Trade payables against third parties include the outstanding payment obligations from the mobile phone frequency auction (non-current portion: EUR 109 million; current portion: EUR 111 million) (Note No. 2 Significant Events and Transactions in the Reporting Period).

Accruals mainly relate to outstanding invoices for goods and services and for non-current assets.

Other creditors non-trade mainly consist of liabilities due to personnel.

Other payables mainly include payables from obligations with regards to mobile network sites being transferred to Deutsche Telekom amounting to EUR 123 million in the course of net integration as well as debtors with credit balances (non-current portion: EUR 23 million; current portion: EUR 100 million). These include asset retirement obligations and rental obligations from terminated idle rental contracts (Note No. 2 Significant Events and Transactions in the Reporting Period).

For the maturity profile of the listed liabilities, see Note No. 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 MBA MVNO agreement (Note No. 2 Significant Events and Transactions in the Reporting Period).

The 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:

| (Euros in millions) | As of 31 December |            |             |            |
|---------------------|-------------------|------------|-------------|------------|
|                     | 2015              |            | 2014        |            |
|                     | Non-current       | Current    | Non-current | Current    |
| Pension obligations | 76                | –          | 89          | –          |
| Other provisions    | 440               | 196        | 698         | 241        |
| <b>Provisions</b>   | <b>516</b>        | <b>196</b> | <b>787</b>  | <b>241</b> |

### 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 2015, the employer's share of the statutory pension insurance amounted to EUR 43 million (2014: EUR 32 million).

Telefónica Deutschland Group has additional defined contribution plans. The expense for defined contribution plans recognised for the period amounted to EUR 3 million (2014: EUR 1 million).

The following table contains the key data for the defined benefit plans:

| (Euros in millions)                            | As of 31 December |              |
|--|-------------------|--------------|
|  | 2015              | 2014         |
| Defined benefit obligation from funded plans   | (143)             | (143)        |
| Defined benefit obligation from unfunded plans | (55)              | (58)         |
| <b>Present value of defined benefit</b>        | <b>(198)</b>      | <b>(201)</b> |
| Plan assets                                    | 122               | 111          |
| <b>Surplus/(deficit)</b>                       | <b>(76)</b>       | <b>(89)</b>  |
| Effect of the asset ceiling                    | –                 | –            |
| <b>Net defined benefit liability</b>           | <b>(76)</b>       | <b>(89)</b>  |
| <b>Reimbursement rights</b>                    | <b>8</b>          | <b>10</b>    |

The development in the present value of the defined benefit obligation in 2015 and 2014 is as follows:

| (Euros in millions)  | 2015         | 2014         |
|--|--------------|--------------|
| <b>Defined benefit obligation as of 1 January</b>  | <b>(201)</b> | <b>(93)</b>  |
| Current service costs (personnel expenses)   | (7)          | (4)          |
| Interest income (expense) (financial result)   | (4)          | (4)          |
| Remeasurement of defined benefit obligation  | 12           | (47)         |
| <i>thereof: actuarial gains (losses) arising from changes in demographic assumptions</i> | –            | 0            |
| <i>thereof: actuarial gains (losses) arising from changes in financial assumptions</i>   | 11           | (47)         |
| <i>thereof: experience adjustments</i>   | 1            | 0            |
| Benefits paid  | 2            | 2            |
| Change in group structure (refer to Note No. 7 Business Combinations)                    | –            | (55)         |
| Others   | –            | (0)          |
| <b>Defined benefit obligation as of 31 December</b>                                      | <b>(198)</b> | <b>(201)</b> |

The restructuring measures taken in the previous year (see other provisions) resulted in a curtailment as per IAS 19 with regard to the pension entitlements of departing employees that have not yet vested on the date of departure. However, the effects on the defined benefit obligation as of 31 December 2015 are immaterial.

The present value of the defined benefit obligation is distributed as follows across the individual groups of those entitled to pensions:

| (Euros in millions)               | 2015         | As of 31 December 2014 |
|-----------------------------------|--------------|------------------------|
| Amounts owing to active members   | (79)         | (83)                   |
| Amounts owing to deferred members | (86)         | (81)                   |
| Amounts owing to retirees         | (33)         | (36)                   |
| <b>Defined benefit obligation</b> | <b>(198)</b> | <b>(201)</b>           |

The fair value of the plan assets developed as follows in 2015 and 2014:

| (Euros in millions)   | 2015       | 2014       |
|---|------------|------------|
| <b>Fair value of plan assets as of 1 January</b>                              | <b>111</b> | <b>91</b>  |
| Return on plan assets excluding amounts included in interest income (expense) | (1)        | (2)        |
| Interest income (net financial income (expense))                              | 3          | 4          |
| Employer contributions  | 9          | 9          |
| Benefits paid   | (1)        | (2)        |
| Change in group structure (refer to Note No. 7 Business Combinations)         | –          | 11         |
| Others  | 2          | –          |
| <b>Fair value of plan assets as of 31 December</b>                            | <b>122</b> | <b>111</b> |

The effect of the asset ceiling developed as follows in 2015 and 2014:

| (Euros in millions)                                  | 2015 | 2014 |
|--|------|------|
| <b>Effect of the asset ceiling as of 1 January</b>   | -    | 3    |
| Change of the effect of asset ceiling                | -    | (3)  |
| <b>Effect of the asset ceiling as of 31 December</b> | -    | -    |

The fair value of the reimbursement rights from insurance contracts developed in 2015 and 2014 as follows:

| (Euros in millions)  | 2015 | 2014 |
|--|------|------|
| <b>Fair value of reimbursement rights as of 1 January</b>                    | 10   | 6    |
| Return on reimbursement rights excluding amounts included in interest income | 0    | 0    |
| Interest income  | 0    | 0    |
| Employer contributions   | 0    | 2    |
| Benefits paid  | (0)  | (0)  |
| Change in group structure (refer to Note No. 7 Business Combinations)        | -    | 2    |
| Others   | (2)  | -    |
| <b>Fair value of reimbursement rights as of 31 December</b>                  | 8    | 10   |

The net pension expense recognised in the Income Statement is comprised as follows:

| (Euros in millions)                                      | 2015 | 2014 |
|--|------|------|
| Current service costs (personnel expenses)               | 7    | 4    |
| Interest expense (income) (net financial income/expense) | 2    | 0    |
| <b>Total amount of expense</b>                           | 9    | 4    |

The actual returns from plan assets were EUR 1 million for the financial year ending 31 December 2015 and EUR 2 million for 2014.

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 (information in the form of average factors).

|  | As of 31 December |            |
|--|-------------------|------------|
|  | 2015              | 2014       |
| Discount rate                            | 2.47%             | 2.25%      |
| Nominal rate of pension payment increase | 2.00%             | 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).

| (In years)   | As of 31 December |      |
|--|-------------------|------|
|  | 2015              | 2014 |
| 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 2015:

| (Euros in millions)  | Increase in parameters | Decrease in parameters |
|--|------------------------|------------------------|
| Discount rate (+0.25 %/–0.25 %)                            | (11)                   | 12                     |
| Nominal rate of pension payment increase (+0.50 %/–0.50 %) | 9                      | (8)                    |
| Fluctuation 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 level of effect on the determination of the DBO due to the interest 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 2015 |
|--|-------------------------------|
| 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 years and 10 years | 22                            |

The average of the expected term of the defined benefit obligation is 24 years.

The best estimate of the contributions that will be paid into the plans in the financial year ending 31 December 2015 amounts to EUR 9 million.

### Other provisions

Other provisions include provisions for restructuring, dismantling, onerous contracts and others. The movement is as follows:

| (Euros in millions)  | Restructuring | Dismantling | Onerous contract | Others    | Total      |
|--|---------------|-------------|------------------|-----------|------------|
| <b>As of 1 January 2015</b>  | <b>399</b>    | <b>501</b>  | <b>22</b>        | <b>17</b> | <b>939</b> |
| Additions  | 73            | 4           | –                | –         | 77         |
| Utilisation  | (253)         | (76)        | (3)              | (12)      | (344)      |
| Release  | –             | –           | –                | (3)       | (3)        |
| Reclassifications  | –             | –           | 1                | (1)       | –          |
| Others   | –             | (37)        | –                | –         | (37)       |
| Unwinding of discount  | 1             | 2           | –                | –         | 3          |
| <b>As of 31 December 2015</b>  | <b>220</b>    | <b>394</b>  | <b>20</b>        | <b>1</b>  | <b>635</b> |
| <i>thereof non-current</i>   | <i>51</i>     | <i>372</i>  | <i>15</i>        | <i>1</i>  | <i>440</i> |
| <i>thereof current</i>   | <i>169</i>    | <i>22</i>   | <i>5</i>         | <i>0</i>  | <i>196</i> |
| <b>As of 1 January 2014</b>  | <b>–</b>      | <b>80</b>   | <b>23</b>        | <b>0</b>  | <b>103</b> |
| Additions  | 409           | 7           | 1                | 0         | 416        |
| Utilisation  | (13)          | (7)         | (4)              | (11)      | (36)       |
| Release  | –             | –           | –                | (1)       | (1)        |
| Others   | –             | 243         | –                | –         | 243        |
| Unwinding of discount  | –             | 2           | 0                | –         | 2          |
| Change in group structure<br>(refer to Note No. 7 Business Combinations) | 3             | 176         | 2                | 28        | 210        |
| <b>As of 31 December 2014</b>  | <b>399</b>    | <b>501</b>  | <b>22</b>        | <b>17</b> | <b>939</b> |
| <i>thereof non-current</i>   | <i>179</i>    | <i>492</i>  | <i>18</i>        | <i>9</i>  | <i>698</i> |
| <i>thereof current</i>   | <i>220</i>    | <i>9</i>    | <i>3</i>         | <i>8</i>  | <i>241</i> |

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 220 million as of 31 December 2015 (2014: EUR 399 million) is allocated to personnel adjustments, the suspension of contracts with sales representatives and other measures.

The majority of the provision amount recognised as of 31 December 2015 is attributable to severance payments in connection with personnel adjustments.

The provisions for dismantling 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 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 others item primarily includes obligations from litigation and partial retirement agreements.

As of 31 December 2015, changes in the composition of other provisions of the Telefónica Deutschland Group compared to 31 December 2014 resulted in particular from restructuring. Some of the provisions in place at the end of the year were used as planned, while some of the non-current provisions were reclassified as current (EUR 128 million). Restructuring provisions of EUR 73 million were added in the financial year 2015. Of this figure, EUR 53 million related to the transfer of mobile network sites.

The additions of EUR 73 million for restructuring is recognised in other expenses and in personnel expenses in the financial year 2015 (for further information see Note No. 6.3 Personnel Expenses and 6.4 Other Expenses).

## 6. Selected Explanatory Notes to the Consolidated Income Statement

### 6.1. Revenues

Revenues are comprised as follows:

| (Euros in millions)   | 1 January to 31 December |              |
|-----------------------|--------------------------|--------------|
|                       | 2015                     | 2014         |
| Rendering of services | 6,576                    | 4,718        |
| Other sales           | 1,312                    | 803          |
| <b>Revenues</b>       | <b>7,888</b>             | <b>5,522</b> |

Revenues from the rendering of services include mobile service revenues as well as revenues from fixed business. The other sales include handset revenues and other revenues.

None of the Telefónica Deutschland Group's customers account for more than 10% of total revenues.

The breakdown of revenues according to mobile business and fixed business is shown in the following table:

| (Euros in millions)     | 1 January to 31 December |              |
|-------------------------|--------------------------|--------------|
|                         | 2015                     | 2014         |
| Mobile business         | 6,832                    | 4,375        |
| Mobile service revenues | 5,532                    | 3,580        |
| Handset revenues        | 1,300                    | 795          |
| Fixed business          | 1,043                    | 1,138        |
| Other revenues          | 12                       | 8            |
| <b>Revenues</b>         | <b>7,888</b>             | <b>5,522</b> |

#### 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 inter-connection 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<sub>2</sub> 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<sub>2</sub> 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<sub>2</sub> 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 business

Fixed business revenues mainly comprise 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 called 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<sub>2</sub> More Local” mobile location-based services or the “mpass” mobile payment system.

### 6.2. Other income

Other income comprised the following in 2015 and 2014:

| (Euros in millions)                                | 1 January to 31 December |            |
|--|--------------------------|------------|
|  | 2015                     | 2014       |
| Own work capitalised and ancillary income          | 146                      | 105        |
| Gain on disposal of assets                         | 15                       | 1          |
| Income from final purchase price adjustment E-Plus | 104                      | –          |
| <b>Other income</b>                                | <b>265</b>               | <b>106</b> |

The 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 related to the sale of yourfone GmbH. For further information, see Note No. 8.2 Disposal Groups in 2014.

The income of EUR 104 million resulted from the agreement on the final purchase price for the acquisition of the E-Plus Group. For further information, see Note No. 7 Business Combinations.

### 6.3. Personnel expenses

In the financial year 2015, personnel expenses amounted to EUR 655 million (2014: EUR 828 million). Personnel expenses from share-based payments is presented in Note No. 15 Share-Based Payments; personnel expenses relating to pension plans are presented in Note No. 5.12 Provisions.

In addition, restructuring expenses of EUR 4 million (2014: EUR 322 million) are recognised in personnel expenses. For further information, see Note No. 5.12 Provisions.

#### 6.4. Other expenses

The other expenses mainly comprise of costs 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 2015 include restructuring expenses of EUR 69 million (2014: EUR 87 million; for further information see Note No. 5.12 Provisions).

#### 6.5. Net financial income/expense

For the current financial year, the Telefónica Deutschland Group's net financial income (expense) amounts to EUR –48 million (2014: EUR –34 million).

The breakdown of net financial income/(expense) is as follows:

| (Euros in millions)                           | 1 January to 31 December |                   |
|---|--------------------------|-------------------|
|   | 2015                     | 2014 <sup>1</sup> |
| Interest income from financial assets         | 10                       | 10                |
| Interest expenses from financial liabilities  | (53)                     | (43)              |
| Accretion of provisions and other liabilities | (3)                      | (0)               |
| Other exchange gains/(losses)                 | (1)                      | (1)               |
| <b>Net financial income/(expense)</b>         | <b>(48)</b>              | <b>(34)</b>       |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

The interest income from financial assets mainly comprises the interest income in connection with "O<sub>2</sub> My Handy" receivables and receivables from finance leases.

The interest expenses from financial liabilities in the amount of 2015 mainly include the interest for the loan borrowed from Telfisa Global B.V. in September 2012, for the bonds issued in November 2013 and February 2014 and for the initial placement of promissory notes and registered bonds in March 2015. Interest from the finance lease obligation is also included.

#### 6.6. Income tax

##### Consolidated income tax group

As of 31 December 2015, the consolidated income tax group of the Telefónica Deutschland Group consisted of 24 companies.

The integration of the E-Plus Group into the consolidated income tax group of the Telefónica Deutschland Group with retrospective tax effect from 1 January 2015 was anticipated in the prior-year financial statements. The consolidated income tax group of the Telefónica Deutschland Group (in its structure before the acquisition of E-Plus on 1 October 2014), which comprised six entities, and the consolidated income tax group of the E-Plus Group (in its structure as acquired on 1 October 2014), which comprised 17 entities, continued to exist as of 31 December 2014.

### Current and deferred taxes

The income taxes recorded in the Consolidated Income Statement essentially comprise deferred taxes. The reported prior-year current taxes relate to adjustments of tax assessments:

| (Euros in millions)         | 1 January to 31 December |             |
|-----------------------------|--------------------------|-------------|
|                             | 2015                     | 2014        |
| Current tax (expense)       | –                        | (1)         |
| Deferred tax expense        | (72)                     | (33)        |
| <b>Income tax (expense)</b> | <b>(72)</b>              | <b>(34)</b> |

The movements in deferred taxes are as follows:

| (Euros in millions)  | 2015       | 2014       |
|--|------------|------------|
| <b>As of 1 January</b>   | <b>581</b> | <b>584</b> |
| Deferred tax expense   | (72)       | (33)       |
| Movement in deferred taxes recognised directly in equity as shown in the Consolidated Statement of Comprehensive Income                  | (3)        | 15         |
| Amount for deferred taxes directly recorded within assets and liabilities held for sale (refer to Note No. 8.2. Disposal Groups in 2014) | –          | 16         |
| <b>As of 31 December</b>   | <b>505</b> | <b>581</b> |

### Tax loss carry forwards and temporary differences

Tax losses carried forward for which no deferred tax assets are reported as of 31 December 2015 amounted to EUR 13,437 million for corporate income tax and EUR 13,246 million for trade tax (2014: EUR 12,060 million and EUR 11,632 million).

In the previous year, for temporary differences of EUR 277 million no deferred tax assets were recognised.

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:

| (Euros in millions)                      | As of 31 December   |                          |                     |                          |
|--|---------------------|--------------------------|---------------------|--------------------------|
|  | 2015                |                          | 2014                |                          |
|  | Deferred tax assets | Deferred tax liabilities | Deferred tax assets | Deferred tax liabilities |
| Goodwill and other intangible assets     | 771                 | (266)                    | 642                 | (311)                    |
| Tangible assets                          | 47                  | (378)                    | 1                   | (478)                    |
| Trade and other receivables              | 32                  | (69)                     | 85                  | (90)                     |
| Other current financial assets           | 29                  | (13)                     | 351                 | (29)                     |
| Debt, trade and other payables           | 7                   | (10)                     | 171                 | (454)                    |
| Provisions including pension provisions  | 198                 | (17)                     | 210                 | (0)                      |
| Other current financial liabilities      | 101                 | –                        | 2                   | (13)                     |
| Tax loss carry forwards                  | 73                  | –                        | 494                 | –                        |
| <b>Deferred tax assets (liabilities)</b> | <b>1,258</b>        | <b>(753)</b>             | <b>1,956</b>        | <b>(1,375)</b>           |
| Set off                                  | (753)               | 753                      | (1,375)             | 1,375                    |
| <b>Deferred tax assets (liabilities)</b> | <b>505</b>          | <b>–</b>                 | <b>581</b>          | <b>(0)</b>               |

### Reconciliation of profit before tax to income tax expense recognised

The reconciliation between profit before tax and the reported income tax for 2015 and 2014 is as follows:

| (Euros in millions)  | 1 January to 31 December |                   |
|--|--------------------------|-------------------|
|  | 2015                     | 2014 <sup>1</sup> |
| <b>Profit/(loss) before tax</b>  | <b>(311)</b>             | <b>(655)</b>      |
| Tax expense at prevailing statutory rate (32%)                           | 99                       | 210               |
| Non-deductible expenses  | (22)                     | (17)              |
| Tax free income  | 5                        | –                 |
| Change in unrecognised temporary differences and tax loss carry forwards | (157)                    | (210)             |
| Other  | 3                        | (17)              |
| <b>Income tax</b>  | <b>(72)</b>              | <b>(34)</b>       |
| Current tax (expense)  | –                        | (1)               |
| Deferred tax expense   | (72)                     | (33)              |
| <b>Income tax (expense)</b>  | <b>(72)</b>              | <b>(34)</b>       |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

## 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 overall by EUR 134 million. EUR 30 million of this figure was taken directly to goodwill within the twelve-month period. 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 remaining payment received in the amount of EUR 104 million less expenses to reach the agreement in the amount of EUR 2 million is reported in the cash flow from operating activities. The remaining amount of EUR 30 million is reported in the cash flow from investing activities because they were recognised within the twelve-month period and therefore don't have an 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)        |
| Custom Base  | 2,718                                       | 2,857                                 | 139          |
| Others   | 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                                   | –            |
| <b>Net assets</b>  | <b>5,777</b>                                | <b>5,420</b>                          | <b>(357)</b> |
| Goodwill   | 928   | 1,256                                 | 328          |
| <b>Purchase price according to IFRS 3.45</b>                         | <b>6,706</b>                                | <b>6,676</b>                          | <b>(30)</b>  |
| Purchase price adjustments outside measurement period acc. IFRS 3.45 |   | (104)                                 | (104)        |
| <b>Final purchase price</b>  |   | <b>6,572</b>                          | <b>(134)</b> |

The changes are primarily reflected in intangible assets and property, plant and equipment. The adjustments 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.

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 will lead to a reduction of depreciation and amortisation and interest expenses in subsequent periods. This means an improvement in the profit for 2014 of EUR 32 million, resulting in an increase in retained earnings. Depreciation and amortisation decreased retrospectively by EUR 26 million in the first quarter of 2015 and EUR 28 million in the second quarter of 2015.

## 8.

### Discontinued Operations and Disposal Groups

#### 8.1. Disposal group during the financial year 2015

##### Sale of Telefónica Germany Shoptransfer AG

On 29 June 2015, Telefónica Germany GmbH & Co. OHG and yourfone GmbH entered into an agreement regarding the sale of Telefónica Germany Shoptransfer AG. Telefónica Germany Shoptransfer AG and its subsidiary Telefónica Germany Retail Ausgliederungs GmbH were founded in connection with the spin-off to transfer shops and associated assets, liabilities, personnel and contractual relationships. The companies' purpose mainly extends to sales activities in connection with mobile telecommunications contracts.

On 29 June 2015, the shares in Telefónica Germany Shoptransfer AG were transferred to yourfone GmbH. Through the sale of yourfone GmbH in February 2015 to Drillisch and the sale of Telefónica Germany Shoptransfer AG, the Telefónica Deutschland Group met further European Commission requirements that were set in connection with the acquisition of the E-Plus Group.

The sale of Telefónica Germany Shoptransfer AG had the following impact on the Group's net assets and financial position as of 30 June 2015:

| (Euros in millions)                   | As of 31 December 2015 |
|---------------------------------------|------------------------|
| Property, plant and equipment         | 1.6                    |
| Trade and other receivables           | 0.1                    |
| Cash and cash equivalents             | 1.9                    |
| Prepaid expenses                      | 0.1                    |
| Provisions                            | (3.8)                  |
| <b>Net assets and liabilities</b>     | <b>(0.0)</b>           |
| Net consideration received            | 0.0                    |
| Cash and cash equivalents disposed of | (1.9)                  |
| <b>Net cash outflow</b>               | <b>(1.9)</b>           |

##### Sale of the Omega companies

On 17 July 2015, Telefónica Germany GmbH & Co. OHG, E-Plus Mobilfunk GmbH and DFMG Deutsche Funkturm GmbH entered into an agreement on the sale of OmegaTowers 1 Funkdienste GmbH & Co. KG, OmegaTowers 1 Funkdienste Komplementär GmbH, OmegaTowers 2 Funkdienste GmbH & Co. KG, OmegaTowers 2 Funkdienste Komplementär GmbH and OmegaTowers 3 Funkdienste GmbH. Die OmegaTowers 1 Funkdienste GmbH & Co. KG, its general partner OmegaTowers 1 Funkdienste Komplementär GmbH, OmegaTowers 2 Funkdienste GmbH & Co. KG and its general partner OmegaTowers 2

Funkdienste Komplementär GmbH were founded in connection with the spin-off to transfer certain mobile communications installations to locations and the associated contractual relationships. OmegaTowers 3 Funkdienste GmbH was founded in connection with the sale of certain mobile communications installations to locations and the associated contractual relationships. The purpose of the companies is to perform preliminary infrastructure services for the operation of mobile communications networks.

On 1 October 2015, the shares in the Omega companies were transferred to DFMG Deutsche Funkturm GmbH. As planned, the Telefónica Deutschland Group is using the transaction to realise part of the announced synergies from network integration. The Telefónica Deutschland Group can continue to use these sites without restriction until they are no longer needed in the course of the integration of the O<sub>2</sub> and E-Plus networks.

In connection with the sale, the Telefónica Deutschland Group transferred dismantling obligations and lease obligations amounting to EUR 123 million by assuming an obligation to the Omega companies. The technical equipment that was legally transferred with the transaction are from an economic perspective attributable to Telefónica group and therefore further recognised in fixed assets. Obligations from the service agreements with the Omega entities do not include direct rental obligations for this technical equipment. Therefore, a liability for rental obligations was not recognised. The sale of the Omega companies in 2015 did not result in any further material effects on the net assets and financial position of the Group. The transaction resulted in a small loss on disposal that was reported in other income in the Consolidated Income Statement.

## 8.2. Disposal groups in 2014

### Disposal of yourfone GmbH

On 11 December 2014, E-Plus Mobilfunk GmbH & Co. KG, Düsseldorf, and Drillisch AG, Maintal, concluded an agreement on the sale of yourfone GmbH. yourfone GmbH, with its registered office in Hamburg and almost 210,000 active customers as of 31 December 2014, operates as a provider in the field of mobile communications and offers bill-based all-network flat-rate products. The company mainly focuses on young and modern users of smartphones.

The major assets and liabilities of yourfone GmbH, taking into account the retrospective adjustments in accordance with IFRS 3, which were held for sale as of 31 December 2014, comprise the following:

| (Euros in millions)               | As of 31 December 2014 <sup>1</sup> |
|-----------------------------------|-------------------------------------|
| Goodwill                          | 7                                   |
| Other intangible assets           | 52                                  |
| Property, plant and equipment     | –                                   |
| Other financial assets            | 3                                   |
| Trade and other receivables       | 12                                  |
| Cash and cash equivalents         | 16                                  |
| Interest-bearing debt             | (19)                                |
| Trade and other payables          | (5)                                 |
| Provisions                        | –                                   |
| Deferred tax liabilities          | (17)                                |
| <b>Net assets and liabilities</b> | <b>49</b>                           |

<sup>1</sup> The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

On 31 December 2014, the cash and cash equivalents in the assets and liabilities held for sale include restricted cash of EUR 15 million from the Telefónica Deutschland Group's perspective.

The Telefónica Deutschland Group reported net inflows of disposals of enterprises amounting to EUR 57 million in the financial year 2015, and generated a gain on disposal of EUR 15 million, which was reported in other income in the Consolidated Income Statement.

## 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:

| (Euros in millions)   | 1 January to 31 December |                   |
|---|--------------------------|-------------------|
|   | 2015                     | 2014 <sup>1</sup> |
| Total profit (loss) attributable to equity holders of the parent for basic earnings   | (383)                    | (689)             |
| Dilutive effects of the conversion of potential ordinary shares                       | –                        | –                 |
| Total profit (loss) attributable to equity holders of the parent for diluted earnings | (383)                    | (689)             |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

There were no dilutive equity instruments outstanding in the reporting periods shown.

In addition, the share capital of Telefónica Deutschland Holding AG was contingently increased (see Note No. 1 Reporting Entity). Shares from the contingent capital of a stock corporation are not part of the calculation of the earnings per share as they can be contingently issued.

| (Number of shares in millions)  | As of 31 December |       |
|---|-------------------|-------|
|   | 2015              | 2014  |
| Weighted average number of ordinary shares for basic earnings per share   | 2,975             | 1,620 |
| Weighted average number of ordinary shares for diluted earnings per share | 2,975             | 1,620 |

In the previous year, the share capital of the company was increased from EUR 1,117 million to EUR 2,975 million by issuing new shares. The number of shares increased by 1,116,945,400 effective 18 September 2014 as a result of the cash capital increase, and to 740,664,193 effective as of 1 October 2014 as a result of the capital increase for contributions in kind. Because of the increase, the weighted average number of ordinary shares outstanding in the reporting period 2014 changed.

Basic and diluted earnings per share attributable to the ordinary shareholders of the parent company amount to:

| (Earnings per share)              | 1 January to 31 December |                   |
|-----------------------------------|--------------------------|-------------------|
|                                   | 2015                     | 2014 <sup>1</sup> |
| Basic earnings per share in EUR   | (0.13)                   | (0.43)            |
| from continuing operations        | (0.13)                   | (0.43)            |
| from discontinued operations      | –                        | –                 |
| Diluted earnings per share in EUR | (0.13)                   | (0.43)            |
| from continuing operations        | (0.13)                   | (0.43)            |
| from discontinued operations      | –                        | –                 |

<sup>1</sup> The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

## 10.

### Measurement Categories of Financial Assets and Financial Liabilities

In the following tables, the fair value 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 2015, 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

| As of 31 December 2015                                 |   |                                     |                                   |                       |                        |   |  |                       |                  |                            |
|--|---|-------------------------------------|-----------------------------------|-----------------------|------------------------|---|--|-----------------------|------------------|----------------------------|
| Financial assets                                       |   |                                     |                                   |                       |                        |   |  |                       |                  |                            |
| Measurement hierarchy                                  |   |                                     |                                   |                       |                        |   |  |                       |                  |                            |
| (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 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 |
| Non-current trade and other receivables (Note No. 5.4) | –   | –                                   | –                                 | 157                   | –                      | –   | –  | 157                   | 157              | –                          |
| Other non-current financial assets (Note No. 5.5)      | 12  | 18                                  | –                                 | 23                    | –                      | 12  | 18   | 53                    | 53               | 9                          |
| Current trade and other receivables (Note No. 5.4)     | –   | –                                   | –                                 | 1,519                 | –                      | –   | –  | 1,519                 | 1,519            | 1                          |
| Other current financial assets (Note No. 5.5)          | 2   | –                                   | –                                 | 8                     | –                      | 2   | –  | 10                    | 10               | –                          |
| Cash and cash equivalents (Note No. 5.8)               | –   | –                                   | –                                 | 533                   | –                      | –   | –  | 533                   | 533              | –                          |
| <b>Total</b>   | <b>14</b>   | <b>18</b>                           | <b>–</b>                          | <b>2,240</b>          | <b>–</b>               | <b>14</b>   | <b>18</b>  | <b>2,272</b>          | <b>2,272</b>     | <b>11</b>                  |

| As of 31 December 2014 <sup>1</sup>                    |   |                                     |                                   |                       |                        |   |  |                       |                  |                            |
|--|---|-------------------------------------|-----------------------------------|-----------------------|------------------------|---|--|-----------------------|------------------|----------------------------|
| Financial assets                                       |   |                                     |                                   |                       |                        |   |  |                       |                  |                            |
| Measurement hierarchy                                  |   |                                     |                                   |                       |                        |   |  |                       |                  |                            |
| (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 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 |
| Non-current trade and other receivables (Note No. 5.4) | –   | –                                   | –                                 | 236                   | –                      | –   | –  | 236                   | 236              | –                          |
| Other non-current financial assets (Note No. 5.5)      | 12  | 13                                  | –                                 | 11                    | –                      | 12  | 13   | 37                    | 37               | 12                         |
| Current trade and other receivables (Note No. 5.4)     | –   | –                                   | –                                 | 1,545                 | –                      | –   | –  | 1,545                 | 1,545            | –                          |
| Other current financial assets (Note No. 5.5)          | 2   | –                                   | –                                 | 17                    | –                      | 2   | –  | 19                    | 19               | –                          |
| Cash and cash equivalents (Note No. 5.8)               | –   | –                                   | –                                 | 1,702                 | –                      | –   | –  | 1,702                 | 1,702            | –                          |
| <b>Total</b>   | <b>14</b>   | <b>13</b>                           | <b>–</b>                          | <b>3,511</b>          | <b>–</b>               | <b>14</b>   | <b>13</b>  | <b>3,539</b>          | <b>3,539</b>     | <b>12</b>                  |

1 The previous-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

As of 31 December 2015, 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 concluded in connection with the bond issue (for further information, see Note No. 5.5 Other Financial Assets).

In addition, EUR 18 million of the other non-current financial assets (see Note No. 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 No. 5.5 Other Financial Assets). These assets were measured according to level 3 as reliable measurement using a market price is not possible. These entities generate a start-up loss, 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 5 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 2015 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:

| (Euros in millions)            | As of 31 December |           |
|--------------------------------|-------------------|-----------|
|                                | 2015              | 2014      |
| Overdue for 1–90 days          | 38                | 46        |
| Overdue for 91–180 days        | 1                 | 3         |
| Overdue for more than 180 days | 14                | 12        |
| <b>Total</b>                   | <b>53</b>         | <b>61</b> |

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.

| (Euros in millions)                                  | As of December 31, 2015                                    |                                |                |   |  |          |                       |                  |                        |
|--|--|--------------------------------|----------------|---|--|----------|-----------------------|------------------|------------------------|
|  | Financial liabilities                                      |                                |                |   |  |          |                       |                  |                        |
|  | Financial liabilities at fair value through profit or loss | Liabilities at amortised costs | Finance Leases | Measurement hierarchy                             |  |          | Total carrying amount | Total fair value | Not in scope of IFRS 7 |
| Level 1 (Quoted prices)                              |  |                                |                | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) |          |                       |                  |                        |
| Non-current interest-bearing debt (Note No. 5.10)    | 360  | 1,294                          | 32             | –   | 360  | –        | 1,686                 | 1,733            | –                      |
| Non-current trade and other payables (Note No. 5.11) | –  | 151                            | –              | –   | –  | –        | 151                   | 151              | 2                      |
| Current interest-bearing debt (Note No. 5.10)        | –  | 388                            | 180            | –   | –  | –        | 568                   | 568              | –                      |
| Current trade and other payables (Note No. 5.11)     | –  | 2,203                          | –              | –   | –  | –        | 2,203                 | 2,203            | 69                     |
| <b>Total</b>   | <b>360</b>   | <b>4,036</b>                   | <b>212</b>     | <b>–</b>  | <b>360</b>   | <b>–</b> | <b>4,608</b>          | <b>4,655</b>     | <b>71</b>              |

| As of December 31, 2014 <sup>1</sup>                 |  |                                |                |                         |   |  |                       |                  |                        |
|--|--|--------------------------------|----------------|-------------------------|---|--|-----------------------|------------------|------------------------|
| Financial liabilities                                |  |                                |                |                         |   |  |                       |                  |                        |
| (Euros in millions)                                  | Measurement hierarchy                                      |                                |                |                         |   |  | Total carrying amount | Total fair value | Not in scope of IFRS 7 |
|  | Financial liabilities at fair value through profit or loss | Liabilities at amortised costs | Finance Leases | Level 1 (Quoted prices) | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) |                       |                  |                        |
| Non-current interest-bearing debt (Note No. 5.10)    | 360  | 1,244                          | 204            | –                       | 360   | –  | 1,808                 | 1,873            | –                      |
| Non-current trade and other payables (Note No. 5.11) | –  | 19                             | –              | –                       | –   | –  | 19                    | 19               | –                      |
| Current interest-bearing debt (Note No. 5.10)        | 3  | 237                            | 382            | –                       | –   | 3  | 622                   | 622              | –                      |
| Current trade and other payables (Note No. 5.11)     | –  | 2,283                          | –              | –                       | –   | –  | 2,283                 | 2,283            | –                      |
| <b>Total</b>   | <b>363</b>   | <b>3,783</b>                   | <b>586</b>     | <b>–</b>                | <b>360</b>  | <b>3</b>   | <b>4,732</b>          | <b>4,798</b>     | <b>–</b>               |

1 The previous-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

As of 31 December 2015, EUR 360 million of other 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 No. 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 2015.

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<br>31 December 2015 |
|--|----------------|---------------------|--------------------------------------|
| <b>Parent company</b>  |                |                     |                                      |
| Telefónica Deutschland Holding AG, Munich  | Germany        | n/a                 | n/a                                  |
| <b>Subsidiaries</b>  |                |                     |                                      |
| Telefónica Germany Management GmbH, Munich   | Germany        | Full financial year | 100 %                                |
| Telefónica Germany GmbH & Co. OHG, Munich <sup>1</sup>                                     | Germany        | Full financial year | 100 %                                |
| Telefónica Germany 1. Beteiligungsgesellschaft mbH, Munich                                 | Germany        | Full financial year | 100 %                                |
| Telefónica Germany Customer Services GmbH, Munich  | Germany        | Full financial year | 100 %                                |
| Wayra Deutschland GmbH, Munich   | Germany        | Full financial year | 100 %                                |
| Fonic GmbH, Munich   | Germany        | Full financial year | 100 %                                |
| O2 Telefónica Deutschland Finanzierungs GmbH, Munich                                       | Germany        | Full financial year | 100 %                                |
| TGCS Bremen Contact Center GmbH, Munich  | Germany        | From October 2015   | 100 %                                |
| TGCS Hamburg Contact Center GmbH, Munich   | Germany        | From October 2015   | 100 %                                |
| TGCS Nürnberg Contact Center GmbH, Munich  | Germany        | From October 2015   | 100 %                                |
| E-Plus 2. Beteiligungsgesellschaft mbH, Munich   | Germany        | From November 2015  | 100 %                                |
| E-Plus Mobilfunk GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| E-Plus Services Treuhand GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| E-Plus Service GmbH & Co. KG, Potsdam <sup>1</sup>   | Germany        | Full financial year | 100 %                                |
| E-Plus Customer Operations GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| E-Plus Customer Support GmbH, Potsdam  | Germany        | Full financial year | 100 %                                |
| E-Plus Retail GmbH, Düsseldorf   | Germany        | Full financial year | 100 %                                |
| Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH, Düsseldorf                       | Germany        | Full financial year | 100 %                                |
| WiMee-Plus GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| WiMee-Connect GmbH, Düsseldorf   | Germany        | Full financial year | 100 %                                |
| AY YILDIZ Communications GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| Cash & Phone GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| Gettings GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| Ortel Mobile GmbH, Düsseldorf  | Germany        | Full financial year | 100 %                                |
| Go Clever GmbH, Düsseldorf   | Germany        | Full financial year | 100 %                                |
| E-Plus Financial Services GmbH, Potsdam  | Germany        | Full financial year | 100 %                                |
| Shortcut I GmbH & Co. KG, Hamburg  | Germany        | Full financial year | 90 %                                 |
| <b>Joint operations</b>  |                |                     |                                      |
| TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg  | Germany        | Full financial year | 50 %                                 |
| TCHIBO Mobilfunk GmbH & Co. KG, Hamburg  | Germany        | Full financial year | 50 %                                 |
| <sup>1</sup> The entities are using the exemption provisions pursuant to section 264b HGB. |                |                     |                                      |
| <b>Other investments</b>   |                |                     |                                      |
| MNP GbR, Cologne   | Germany        | Full financial year | 50 %                                 |
| Mediakraft Networks GmbH, Munich   | Germany        | Full financial year | 18 %                                 |
| tado GmbH, Munich  | Germany        | Full financial year | 18 %                                 |
| Yuilop S.L., Barcelona   | Spain          | Full financial year | 18 %                                 |
| Sum Up Holdings Ltd, Grand Cayman  | Cayman Islands | Full financial year | 7 %                                  |
| Zen Guard GmbH, Berlin   | Germany        | Full financial year | 5 %                                  |
| So1 GmbH, Berlin   | Germany        | From August 2015    | 5 %                                  |

## 12.

## Joint Operations

Telefónica Germany GmbH & Co. OHG jointly controls TCHIBO Mobilfunk Beteiligungs GmbH, Hamburg, and TCHIBO Mobilfunk GmbH & Co. KG, Hamburg. In application of IFRS 11.17 and the respective application guidelines, the companies were classified as joint operations considering other facts and circumstances.

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.

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 amounting to up to EUR 6 million, if needed. As of 31 December 2015, 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 2015 and 2014 are comprised as follows:

| TCHIBO Mobilfunk GmbH & Co. KG<br>(Euros in millions) | 2015 | 2014                     |
|---|------|--------------------------|
|   |      | As of 31 December        |
| <b>Financial position</b>                             |      |                          |
| Current assets  | 13   | 14                       |
| <i>thereof cash and cash equivalents</i>              | 6    | 2                        |
| Non-current assets                                    | 0    | 0                        |
| Current liabilities                                   | (7)  | (9)                      |
| Non-current liabilities                               | –    | –                        |
| <b>Income Statement</b>                               |      | 1 January to 31 December |
| Revenues and other income                             | 30   | 30                       |
| Expenses  | (30) | (29)                     |
| <i>thereof amortisation and depreciation</i>          | (0)  | (0)                      |
| Operating income                                      | 0    | 0                        |
| Net financial income/(expense)                        | 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 as well as, from 1 October 2014 to 12 November 2015, between the Telefónica Deutschland Group and the KPN Group, as KPN held a share of more than 20% between the conclusion of the E-Plus transaction and the latter date.

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 No. 11 provides an overview of the companies making up the Telefónica Deutschland Group. In 2014 and 2015, 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 No. 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 No. 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 No. 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 No. 14 Transactions with the Management Board and Supervisory Board)
- Joint ventures (see Note No. 13.3 Transactions with Joint Operations)

The extent of the transactions conducted with the Telefónica, S.A. Group, the KPN Group and other related parties can be seen in the overviews below.

Intercompany charges are based on cost-plus or other 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:

| (Euros in millions)   | As of 31 December |              |
|---|-------------------|--------------|
|   | 2015              | 2014         |
| <b>Receivables from the Telefónica, S.A. Group</b>  | <b>558</b>        | <b>1,726</b> |
| that are recognised in the following items in the Consolidated Statement of Financial Position: |                   |              |
| Cash and cash equivalents (cash pooling)  | 522               | 1,673        |
| Trade and other receivables   | 37                | 54           |
| <b>Liabilities to the Telefónica, S.A. Group</b>  | <b>851</b>        | <b>1,022</b> |
| that are recognised in the following items in the Consolidated Statement of Financial Position: |                   |              |
| Trade and other payables  | 351               | 296          |
| Interest-bearing debt   | 501               | 726          |

#### 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, services e.g. roaming and insurance services, and 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 9 million in 2015 and of EUR 7 million in 2014.

#### Trade and other payables

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 10 million in 2015 (2014: EUR 6 million).

#### Interest-bearing debt

The interest-bearing debt relates to the loan agreement with Telfisa Global B.V.

#### 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:

| (Euros in millions)    | Revenues, other income and interest income |      | Expenses                 |       |
|------------------------|--|------|--------------------------|-------|
|                        | 1 January to 31 December                   |      | 1 January to 31 December |       |
|                        | 2015                                       | 2014 | 2015                     | 2014  |
| Telefónica, S.A. Group | 15   | 29   | (129)                    | (104) |

Revenues are generated primarily from the sale of goods and services e.g. roaming, mobile phone insurance, wholesale voice etc. The figure also includes interest income from cash pooling amounting to EUR 0 million (2014: EUR 2 million).

Expenses include group fees totalling EUR 54 million in 2015 and EUR 53 million in 2014, 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. insurances 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 2015, KPN held 15.46% of the shares of the Telefónica Deutschland Group.

#### Receivables from and liabilities to the KPN Group

As of 31 December 2014, the Telefónica Deutschland Group reported the following receivables from and liabilities to the companies belonging to the KPN Group:

| (Euros in millions)   | As of 31 December 2014 <sup>1</sup> |
|---|-------------------------------------|
| <b>Receivables from KPN Group</b>   | <b>44</b>                           |
| that are recognised in the following items in the Consolidated Statement of Financial Position: |                                     |
| Trade and other receivables   | 44                                  |
| <b>Liabilities to KPN Group</b>   | <b>7</b>                            |
| that are recognised in the following items in the Consolidated Statement of Financial Position: |                                     |
| Trade payables  | 7                                   |

1 The previous-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

#### 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 2015 to 12 November 2015 and 1 October 2014 to 31 December 2014:

| (Euros in millions) | Revenues and other income           |                                     | Expenses                            |                                     |
|---------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
|                     | 1 January to<br>12 November<br>2015 | 1 October to<br>31 December<br>2014 | 1 January to<br>12 November<br>2015 | 1 October to<br>31 December<br>2014 |
| KPN Group           | 3                                   | 2                                   | (31)                                | (27)                                |

Revenues are generated primarily from the performance of services.

The expenses are incurred inter alia 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:

| (Euros in millions)                             | As of 31 December |      |
|---|-------------------|------|
|   | 2015              | 2014 |
| Receivables from TCHIBO Mobilfunk GmbH & Co. KG | 0                 | 0    |
| Liabilities to TCHIBO Mobilfunk GmbH & Co. KG   | 3                 | 6    |

| (Euros in millions)            | Revenues and other income |      | Expenses                 |      |
|--------------------------------|---------------------------|------|--------------------------|------|
|                                | 1 January to 31 December  |      | 1 January to 31 December |      |
|                                | 2015                      | 2014 | 2015                     | 2014 |
| TCHIBO Mobilfunk GmbH & Co. KG | 8                         | 7    | 24                       | 22   |

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 2015, the members of key management personnel comprised the following members of the Management Board:

- Thorsten Dirks (CEO),
- Rachel Empey (CFO),
- Markus Haas (COO).

In the financial year 2014, Rene Schuster (CEO) was a member of the Management Board until 31 January 2014.

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 No. 14 Transactions with Management Board and Supervisory Board.

#### b) Salaries and other benefits paid to the Management Board in 2015 and 2014

Salaries and other benefits according to IAS 24.17 that were granted to active Management Board members are composed as follows:

| (Euros in thousands)              | January 1 to December 31 |              |
|-----------------------------------|--------------------------|--------------|
|                                   | 2015                     | 2014         |
| <b>Total remuneration</b>         | <b>5,497</b>             | <b>6,873</b> |
| thereof:                          |                          |              |
| Short-term employee benefits      | 4,322                    | 3,684        |
| Other long-term employee benefits | 404                      | 164          |
| Termination benefits              | –                        | 2,671        |
| Share-based payments              | 540                      | 287          |
| Defined benefit obligation        | 231                      | 67           |

The defined benefit pension obligation for Management Board members totalled EUR 3,161 thousand in the financial year 2015 and EUR 3,074 thousand in 2014. For further details of the pension obligations of the Telefónica Deutschland Group, please refer to Note No. 5.12 Provisions.

### c) Share options held by members of the Management Board in 2015 and 2014

The following changes have occurred in the Telefónica, S.A. share options for the Management Board members (for further information see Note No. 15 Share-Based Payments):

| (In units)                                      | 2015           | 2014     |
|---|----------------|----------|
| <b>Share options as of January 1</b>            | <b>212,636</b> | 159,292  |
| Forfeited share options                         | (3,399)        | (48,344) |
| Share options issued under the capital increase | 2,518          | –        |
| Addition of share options                       | 88,375         | 168,340  |
| Change in key management                        | –              | (66,652) |
| Vested shares                                   | (33,469)       | –        |
| <b>Share options as of December 31</b>          | <b>266,661</b> | 212,636  |

## 14.

### Transactions with Management Board and Supervisory Board

#### 1. Management Board

According to the shareholders' resolution 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 current employment contracts of the members of the Management Board of Telefónica Deutschland Holding AG were concluded on 2 July 2014 and came into force on 1 October 2014. The employment contract of one of the Management Board members was amended by way of an amendment agreement on 22 January 2015. As a matter of principle, the employment contracts of the Management Board members expire on 30 September 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 2015 amounted to EUR 5,225 thousand. The total remuneration includes share-based payments for 88,375 share options with a fair value of EUR 571 thousand at the grant date.

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 2014 amounted to EUR 5,468 thousand. The total remuneration included share-based payments for 168,340 share options with a fair value of EUR 1,680 thousand at the grant date.

In the financial years 2015 and 2014, the total remuneration expenses for former directors and their surviving dependants was EUR 424 thousand in 2015 and EUR 222 thousand in 2014.

As of 31 December 2015 and 2014, the pension obligations for former directors and their surviving dependants were EUR 11,554 thousand and EUR 12,172 thousand respectively<sup>2</sup>.

<sup>2</sup> In order to ensure consistency, the disclosure only refers to the members of management of the former Telefónica Germany Verwaltungs GmbH, Munich.

For more details of the pension obligations of the Telefónica Deutschland Group, please refer to Note No. 5.12 Provisions.

## 2. Supervisory Board

| Name                              | Member of the Supervisory Board  |
|-----------------------------------|----------------------------------|
| Eva Castillo Sanz                 | since 5 October 2012             |
| María Pilar López Álvarez         | 18 September 2012 to 12 May 2015 |
| Laura Abasolo García de Baquedano | since 12 May 2015                |
| Angel Vilá Boix                   | since 18 September 2012          |
| Patricia Cobián González          | since 18 September 2012          |
| Michael Hoffmann                  | since 5 October 2012             |
| Enrique Medina Malo               | since 18 September 2012          |
| Sally Anne Ashford                | since 18 September 2014          |
| Antonio Manuel Ledesma Santiago   | since 18 September 2014          |
| Imke Blumenthal                   | since 3 June 2013                |
| Thomas Pfeil                      | since 3 June 2013                |
| Dr Jan-Erik Walter                | since 3 June 2013                |
| Marcus Thurand                    | since 3 June 2013                |
| Christoph Heil                    | since 3 June 2013                |
| Claudia Weber                     | since 3 June 2013                |
| Joachim Rieger                    | since 31 October 2014            |
| Jürgen Thierfelder                | since 31 October 2014            |

The members received remuneration for their activities of EUR 342 thousand in 2015 and EUR 231 thousand in 2014.

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 2015 |
|------------------------------|-------------------------------|
| <b>Remuneration</b>          | <b>856</b>                    |
| thereof:                     |                               |
| Short-term employee benefits | 821                           |
| Share-based payments         | 16                            |
| Service cost                 | 19                            |

As of 31 December 2015, the Telefónica Deutschland Group has not granted the members of their Supervisory Board any securities or loans and has not assumed any guarantees for them.

## 15.

## Share-Based Payments

As of 31 December 2015, 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 will end 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 will begin on 1 October 2016 and end on 30 September 2019. 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 allocation of share options under the 2011 plan took place on 1 July 2012 and ended on 30 June 2015. The total shareholder return of Telefónica, S.A. during this period was higher than the median for the comparison group, resulting in a partial allocation of 77 % of the share options to a weighted average price on the exercise date amounting to EUR 12,98:

| Phase                            | Maximum number of share options still to be granted | Fair value per unit when granted | End date      |
|----------------------------------|---|----------------------------------|---------------|
| 2nd phase Plan 2011: 1 July 2012 | 132,799   | 8.28                             | June 30, 2015 |

| Phase                            | No. of shares co-investment | End date      |
|----------------------------------|-----------------------------|---------------|
| 2nd phase Plan 2011: 1 July 2012 | 15,252                      | June 30, 2015 |

| Phase                            | Total   | End date      |
|----------------------------------|---------|---------------|
| 2nd phase Plan 2011: 1 July 2012 | 148,051 | June 30, 2015 |

The last allocation of share options of Telefónica, S.A. shares as part of the 2011 plan took place on 1 July 2013. As of 31 December 2015, the maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was:

| Phase                            | Maximum number of share options still to be granted | Fair value per unit when granted | End date      |
|----------------------------------|---|----------------------------------|---------------|
| 3rd phase Plan 2011: 1 July 2013 | 135,848   | 6.40                             | June 30, 2016 |

| Phase                            | No. of shares co-investment | End date      |
|----------------------------------|-----------------------------|---------------|
| 3rd phase Plan 2011: 1 July 2013 | 17,264                      | June 30, 2016 |

| Phase                            | Total   | End date      |
|----------------------------------|---------|---------------|
| 3rd phase Plan 2011: 1 July 2013 | 153,112 | June 30, 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 2015, the maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was:

| Phase                               | Maximum number of share options still to be granted | Fair value per unit when granted | End date           |
|-------------------------------------|---|----------------------------------|--------------------|
| 1st phase Plan 2014: 1 October 2014 | 313,407   | 8.60                             | September 30, 2017 |

| Phase                               | No. of shares co-investment | End date           |
|-------------------------------------|-----------------------------|--------------------|
| 1st phase Plan 2014: 1 October 2014 | 41,511                      | September 30, 2017 |

| Phase                               | Total   | End date           |
|-------------------------------------|---------|--------------------|
| 1st phase Plan 2014: 1 October 2014 | 354,918 | September 30, 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 2015, the maximum number of shares of Telefónica, S.A. assigned (including the amount of co-investment) under the plan was:

| Phase                                  | Maximum number of share options still to be granted | Fair value per unit when granted | End date          |
|--|---|----------------------------------|-------------------|
| 2nd phase of 2014 plan: 1 October 2015 | 248,180   | 6.46                             | 30 September 2018 |

| Phase                                  | No. of shares (co-investment) | End date          |
|--|-------------------------------|-------------------|
| 2nd phase of 2014 plan: 1 October 2015 | 62,059                        | 30 September 2018 |

| Phase                                  | Total   | End date          |
|--|---------|-------------------|
| 2nd phase of 2014 plan: 1 October 2015 | 310,239 | 30 September 2018 |

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)                                    | 2015           | 2014           |
|---|----------------|----------------|
| <b>Share options as of 1 January</b>          | <b>809,453</b> | <b>528,074</b> |
| Addition of share options                     | 310,239        | 393,571        |
| Share options granted due to capital increase | 11,603         | –              |
| Change in employees                           | (164,976)      | (23,268)       |
| Exercise of share options                     | (113,999)      | –              |
| Forfeited share options                       | (34,052)       | (88,924)       |
| <b>Share options as of 31 December</b>        | <b>818,268</b> | <b>809,453</b> |

#### "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 will begin on 1 October 2016, and will end on 30 September 2019.

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 share options to be granted <sup>1</sup> | Fair value per unit when granted | End date          |
|---------------------------|--|----------------------------------|-------------------|
| 1st phase: 1 October 2014 | 45,000   | 8.60                             | 30 September 2017 |
| 2nd 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)                                    | 2015          | 2014          |
|---|---------------|---------------|
| <b>Share options as of 1 January</b>          | <b>45,000</b> | –             |
| Addition of share options                     | 60,000        | 45,000        |
| Share options granted due to capital increase | 395           | –             |
| Change in employees                           | (7,000)       | –             |
| <b>Share options as of 31 December</b>        | <b>98,395</b> | <b>45,000</b> |

#### “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 can be granted under the plan only between 2011 and 2015. Within the Telefónica Deutschland Group, only one member of the Managing Board of Telefónica Deutschland Holding AG is 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 (if applicable, for each of the tranches).

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 share options to be granted | Fair value per unit when granted | End date          |
|----------------|---|----------------------------------|-------------------|
| 1 October 2014 | 65,990  | 12.12                            |                   |
| 1st tranche    | 21,997  |                                  | 30 September 2015 |
| 2nd tranche    | 22,248  |                                  | 31 January 2016   |
| 3rd tranche    | 22,248  |                                  | 31 January 2017   |

| (In units)                                    | 2015          | 2014          |
|---|---------------|---------------|
| <b>Share options as of 1 January</b>          | <b>65,990</b> | –             |
| Addition of share options                     | –             | 65,990        |
| Share options granted due to capital increase | 502           | –             |
| Share options granted                         | (21,997)      | –             |
| <b>Share options as of 31 December</b>        | <b>44,495</b> | <b>65,990</b> |

**Bonus II – “Deferred Bonus Plan” (cash-settled)**

Bonus II (deferred bonus) exists in order to avoid an excessive incentive effect through the PIP and thus too strong an incentive for the pursuit of corporate goals. Here, the Management Board members are provided 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. 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 peer 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 peer group. If the total shareholder return of Telefónica Deutschland Holding AG lies between the upper quartile and the median, Bonus II is calculated linear proportionally. If Telefónica Deutschland Holding AG lies below the median, there is no entitlement to payments.

For detailed information regarding Bonus II – “Deferred Bonus Plan” (cash-settled) please refer to Note No. 13.4 Transactions with other related persons.

**“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 to 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 will end on 31 July 2016. The vesting period will end twelve months after the end of the subscription period on 31 July 2016. The participating employees had acquired the following number of shares as of 31 December 2015:

| As of 31 December | No. of shares delivered | Weighted average of grant date fair value per unit |
|-------------------|-------------------------|--|
| 2015              | 117,252                 | 12.58  |

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 is 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.

There is a recharge agreement in place between Telefónica, S.A. and the Telefónica Deutschland Group in relation to the shares that will be delivered to employees in Germany. This recharge is recognised with a reduction in equity and a corresponding liability to Telefónica, S.A.

| (In units)                             | 2015           | 2014           |
|--|----------------|----------------|
| <b>Share options as of 1 January</b>   | –              | <b>150,417</b> |
| Addition of share options              | 117,252        | –              |
| Change in employees                    | –              | (6,145)        |
| Share options granted                  | –              | (144,272)      |
| <b>Share options as of 31 December</b> | <b>117,252</b> | –              |

#### 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:

| (Euros in millions)   | 2015     | As of 31 December 2014 |
|---|----------|------------------------|
| <b>Personnel expenses arising from share-based payment transactions</b> | <b>2</b> | <b>2</b>               |
| <i>thereof from cash-settled plans</i>                                  | –        | 0                      |
| <i>thereof from equity-settled plans</i>                                | 2        | 2                      |

#### Liabilities arising from share-based payment transactions

As of 31 December 2015 liabilities arising from share-based payment amounted EUR 2 million (2014: EUR 1 million).

## 16.

### Information Regarding Employees

The following table presents the breakdown of the Telefónica Deutschland Group's average headcount in 2015 and 2014 grouped with respect to their status under labour law:

| Average headcount <sup>1</sup> | 2015          | 2014         |
|--------------------------------|---------------|--------------|
| Office staff                   | 9,483         | 6,609        |
| thereof from joint operations  | 11            | 10           |
| Temporary staff                | 597           | 613          |
| <b>Total</b>                   | <b>10,080</b> | <b>7,222</b> |

<sup>1</sup> The employees of the E-Plus Group are contained from 1 October 2014.

## 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 self-generated cash in Euros as well as Euro-denominated equity and debt, there is 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 2015 and 2014 would have been as follows:

|                     | 1 January to 31 December |       |               |       |
|---------------------|--------------------------|-------|---------------|-------|
|                     | 2015                     |       | 2014          |       |
| (Euros in millions) | Risk position            | + 10% | Risk position | + 10% |
| USD                 | (9.1)                    | 1.2   | (14.1)        | 1.3   |
| GBP                 | (3.3)                    | 0.8   | 0.2           | 0.0   |

Because the Telefónica Deutschland Group did not use cash flow hedge accounting, the effect of the sensitivities would only have affected the Consolidated Income Statement.

### Interest rate risk

Interest risks primarily arise from the variable-interest cash pooling accounts of the Telefónica Deutschland Group with Telfisa Global B.V., Netherlands, as well as from variable-interest loan agreements as borrower and interest swaps. In November 2013 and February 2014, interest rate swaps were signed in each case in connection with the issue of bonds for a partial amount of the bonds' nominal values. On the basis of these interest swaps contract, 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. At the start of each hedge relationship, both the relationship between the hedge instrument and the underlying transaction as well as the goal and strategy of the hedge were documented. A specific allocation of the hedging instrument to the corresponding liability took place and an estimate of the degree of effectiveness of the hedging relationship was made. The existing hedging relationship is continuously monitored for effectiveness.

The net risk position for variable interest for the Telefónica Deutschland Group as of the reporting dates 31 December 2015 and 2014 was minus EUR 388 million and EUR 643 million respectively; these figures are primarily attributable to the loan, the interest swap and the cash and cash equivalents deposited with Telfisa Global B.V.

The Telefónica Deutschland Group concluded two interest rate swaps as a hedging instrument in the financial years 2013 and 2014 (see Interest rate risk management below).

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 2015 and 2014 are shown below. There is no impact recognised directly in equity. This analysis assumes that all other variables remain unchanged.

| (Euros in millions) | 1 January to 31 December |      |
|---------------------|--------------------------|------|
|                     | 2015                     | 2014 |
| + 100bp             | (4)                      | 6    |
| - 100bp             | 5                        | 5    |

### Credit risk

Credit risk describes the risk of financial losses from the inability of contractual partners to repay or service debts in accordance with the contract. The Telefónica Deutschland Group's maximum credit risk corresponds with the carrying amount of the financial assets (without considering 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 the credit risk, the Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and only reports adjustments for 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 558 million as of 31 December 2015, and EUR 1,726 million as of 31 December 2014. Financial assets in respect of the KPN Group amounted to EUR 44 million as of 31 December 2014.<sup>3</sup>

### 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.

In August and September 2012, Telefónica Germany GmbH & Co. OHG concluded agreements with various banks for revolving credit facilities. As a result, Telefónica Germany GmbH & Co. OHG has undrawn committed credit lines in the total amount of EUR 710 million with a maturity beyond one year and an operating credit line in the amount of EUR 40 million with a maturity within one year as of the reporting date 31 December 2015. In all agreements, the interest corresponds to the sum of the margin plus Euribor. In the course of the cash-pooling and deposit agreements with Telfisa Global B.V., Netherlands another short-term credit line is provided.

Cash and cash equivalents amounted to EUR 533 million as of 31 December 2015 and to EUR 1,702 million as of 31 December 2014.

The following table shows the maturity profile of the financial liabilities of the Telefónica Deutschland Group on the basis of the contractual undiscounted payments:

| As of 31 December 2015               |                       |                    |                |              |            |
|--------------------------------------|-----------------------|--------------------|----------------|--------------|------------|
| (Euros in millions)                  | Total carrying amount | Gross cash outflow | remaining term |              |            |
|                                      |                       |                    | < 1 years      | 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          | –            | –          |
| <b>Financial liabilities</b>         | <b>4,679</b>          | <b>4,849</b>       | <b>2,866</b>   | <b>1,246</b> | <b>737</b> |

<sup>3</sup> The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

| (Euros in millions)                  | Total carrying amount | Gross cash outflow | As of 31 December 2014 <sup>1</sup> |              |            |
|--------------------------------------|-----------------------|--------------------|-------------------------------------|--------------|------------|
|                                      |                       |                    | remaining term                      |              |            |
|                                      |                       |                    | < 1 years                           | 1–5 years    | > 5 years  |
| Non-current interest-bearing debt    | 1,808                 | 1,960              | 26                                  | 1,410        | 524        |
| Non-current trade and other payables | 19                    | 19                 | –                                   | 18           | 1          |
| Current interest-bearing debt        | 622                   | 627                | 627                                 | –            | –          |
| Current trade and other payables     | 2,283                 | 2,283              | 2,283                               | –            | –          |
| <b>Financial liabilities</b>         | <b>4,732</b>          | <b>4,889</b>       | <b>2,936</b>                        | <b>1,428</b> | <b>525</b> |

1 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

### 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 2015, the equity ratio amounted to 62.0% compared with 63.6%<sup>4</sup> in 2014. OIBDA from continuing operations amounted to EUR 1,804 million in 2015 and EUR 679 million in 2014.

### Interest rate risk management

The interest rate risk results from the sensitivity of financial assets and liabilities in relation to changes on the market interest rates. The corporation strives to limit such risks by using interest rate swaps.

### Fair value hedge for fixed interest financial liabilities

In November 2013 and February 2014, interest swaps of EUR 200 million and EUR 150 million were signed in connection with the issue of one bond in each case. On the basis of the existing interest swap contracts, the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and in return receives a fixed interest rate on the same amount as consideration. The interest swaps compensate for the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities. The Telefónica Deutschland Group reports the interest swaps in the Consolidated Statement of Financial Position at fair value. The company recognises the corresponding portion of the fixed-interest financial liabilities that are thereby hedged as the sum of their carrying amount and a value adjustment. The value adjustment corresponds to the change in the fair value of the financial liabilities on the basis of the relevant hedged interest risk. Changes in the fair value of the interest swaps as well as the changes in the adjustment to the carrying amount of the hedged portion of the fixed-interest financial liabilities are recognised in the financial income/(loss) in the Consolidated Income Statement.

## 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

4 The prior-year figures as of 31 December 2014 were retrospectively adjusted in accordance with IFRS 3. For detailed information regarding the change in the published figures, please refer to Note No. 7 Business Combinations.

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.

In the context of an ongoing tax audit, it was announced that the tax authorities' assessment with regard to the VAT treatment of prepaid contracts is different to the assessment of the Telefónica Deutschland Group. The focus of the assessment is on whether VAT needs to be paid on erased credit balances of customers that were erased due to inactivity. The potential surplus amount is not material and will subsequently trigger interests.

The Telefónica Deutschland Group is, as part of its ordinary business, involved in various proceedings both in court and out of court. The possible effects are of minor significance for the Group's net assets, financial position and results 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)                      | 2015              | 2014         |
| Less than 1 year                         | 513               | 549          |
| 1 to 5 years                             | 1,164             | 1,396        |
| Over 5 years                             | 817               | 1,031        |
| <b>Total operating lease obligations</b> | <b>2,494</b>      | <b>2,976</b> |

| (Euros in millions)                                     | As of 31 December |              |
|---|-------------------|--------------|
|   | 2015              | 2014         |
| Less than 1 year  | 1,561             | 710          |
| 1 to 5 years  | 267               | 265          |
| Over 5 years  | 701               | 710          |
| <b>Total purchase and other contractual obligations</b> | <b>2,529</b>      | <b>1,685</b> |

Purchase and other contractual obligations increased during the reporting period compared to the Consolidated Financial Statements for the year ended 31 December 2014 mainly due to new long-term purchase contracts with suppliers (Note No.2 Significant Events and Transactions in the Financial Year).

The following amounts are recognised in the Consolidated Income Statement:

| (Euros in millions)   | 1 January to 31 December |      |
|-----------------------|--------------------------|------|
|                       | 2015                     | 2014 |
| Operate lease expense | 584                      | 418  |

The expenses for operating leases include essentially rental expenses (i.e. office building and shops), antenna sites, cars and network equipment (i.e. leased lines and cell sites).

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 74 million as of 31 December 2015 compared with EUR 66 million in 2014.

## 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:

| (Euros in millions)          | 1 January to 31 December |            |
|------------------------------|--------------------------|------------|
|                              | 2015                     | 2014       |
| Less than 1 year             | 31                       | 35         |
| 1 to 5 years                 | 75                       | 86         |
| Over 5 years                 | 46                       | 50         |
| <b>Total sublease income</b> | <b>153</b>               | <b>171</b> |

The following amounts are recognised in the Consolidated Income Statement:

| (Euros in millions)   | 1 January to 31 December |      |
|-----------------------|--------------------------|------|
|                       | 2015                     | 2014 |
| Total sublease income | 35                       | 28   |

## 20. Total Auditor's Fees

The services listed below performed by the Group's auditor, Ernst & Young GmbH, were recognised in the Consolidated Income Statement in the financial years 2015 and 2014.

Because the Telefónica Deutschland Group conducts all of its business in Germany, the entire amount is incurred in Germany.

| (Euros in millions)          | 1 January to 31 December |          |
|------------------------------|--------------------------|----------|
|                              | 2015                     | 2014     |
| <b>Type of fees:</b>         |                          |          |
| Auditor's fees               | 3                        | 3        |
| Other audit-related services | 0                        | 1        |
| <b>Total fees</b>            | <b>3</b>                 | <b>4</b> |

The auditor's fees include especially the fees for auditing the Consolidated Financial Statements of Telefónica Deutschland Holding AG and fees for auditing separate financial statements. Other audit-related services were performed in the financial year 2015 only in minor extend.

## 21. Events after the Reporting Period

There were no significant events after the end of the financial year 2015.

## 22. Declaration of Compliance with the German Corporate Governance Code

On 13/14 October 2015 the Management Board and Supervisory Board of Telefónica Deutschland Holding AG issued the latest declaration of compliance in accordance with section 161 of the German Stock Corporation Act (AktG) that is made available for the shareholders on the company's website.

[WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN/CORPORATE-GOVERNANCE/DECLARATION-OF-COMPLIANCE.HTML](http://WWW.TELEFONICA.DE/INVESTOR-RELATIONS-EN/CORPORATE-GOVERNANCE/DECLARATION-OF-COMPLIANCE.HTML)

Munich, 5 February 2016

Telefónica Deutschland Holding AG

The Management Board



Thorsten Dirks



Rachel Empey



Markus Haas



Further  
Informa-  
tion\_

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## 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 Group Management Report, which has been combined with the Management Report for Telefónica Deutschland Holding AG, 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, 5 February 2016

Telefónica Deutschland Holding AG

The Management Board



Thorsten Dirks



Rachel Empey



Markus Haas

## 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 2015 to 31 December 2015. 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 Sec. 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 Sec. 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 Sec. 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 and as a whole provides a suitable view of the Group’s position and suitably presents the opportunities and risks of future development.

Munich, 19 February 2016

Ernst & Young GmbH  
Wirtschaftsprüfungsgesellschaft

Dahmen  
Wirtschaftsprüfer  
[German public auditor]

Vogel  
Wirtschaftsprüferin  
[German public auditor]

# Supervisory Board Report for the 2015 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 concerns – not least in connection with the transformation and integration activities since the acquisition of E-Plus Group. 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 2015 financial year, the Supervisory Board consisted of 16 members, being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Angel Vilá Boix, María Pilar López Álvarez, 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 12 May 2015 María Pilar López Álvarez resigned as member of the Supervisory Board. Following the proposition of the nomination committee the Annual General Meeting elected Laura Abasolo García de Baquedano as new member of the Subervisory Board for the shareholder representatives. Her term of office began with the end of the Annual General Meeting on 12 May 2015.

The German Stock Corporation Act determines for listed companies that at least one independent member of the Supervisory Board must have expertise in the areas of accounting or auditing. In the Supervisory Board of Telefónica Deutschland Holding AG, Michael Hoffmann performs the function of the independent financial expert within the

meaning of section 100 para. 5 German Stock Corporation Act (AktG).

### Composition of the Management Board

The Management Board comprises three members: Alongside Thorsten Dirks as CEO, Markus Haas is 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.

All board members are appointed for the period until the end of 30 September 2017.

### 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 the integration and transformation measures following the E-Plus acquisition. 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 2015, five ordinary meetings of the Supervisory Board took place, namely on 19 February, 23 March (meeting on the financial statements for the 2014 financial year; "Bilanzsitzung"), 30 April, 24 July, 4 November 2015. Meetings of the Audit Committee were also held on these days. In addition, there were three extraordinary meetings of the Supervisory Board (one of which by telephone) and further resolutions of the Supervisory Board outside of meetings.

So far there has been one Supervisory Board meeting in 2016: on 19 February 2016 (meeting on the financial statements for the 2015 financial year; "Bilanzsitzung").

### Fundamental issues dealt with by the Supervisory Board

The first ordinary meeting of the Supervisory Board in the 2015 financial year on 19 February 2015 was held among others to prepare the meeting regarding the financial statements ("Bilanzsitzung") held on 23 March 2015. Furthermore, especially the transformation and integration of the E-Plus Group – in particular the corporate structure – and the annual general meeting 2015 were treated.

The meeting regarding the financial statements for the 2014 financial year ("Bilanzsitzung") was held on 23. March 2015. In addition to the items associated therewith, such as the approval of the financial statements and management reports (Group and of the corporation) for the 2014 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 12 May 2015 were agreed and issues of Corporate Governance and Management Board compensation were dealt with. Another important issue in this and the previous Supervisory Board meetings was the upcoming auction of mobile phone frequencies. In addition, individual projects (including shop transfers to Drillisch) were discussed.

In addition to the first quarter results 2015 the agenda of the ordinary meeting on 30 April 2015 included amongst others the upcoming frequency auction again as well as intra-group mergers, the subsequent purchase price adjustment process regarding the E-plus acquisition as well as corporate culture. Furthermore, the Supervisory Board decided to dissolve the Capital Increase Committee after complete fulfilment of its tasks. At the same time, the Supervisory Board established a new Committee, the so-called Spectrum Committee, to perform the functions of the Supervisory Board during the frequency auction.

The ordinary meeting on 24 July 2015 covered amongst others the half-year financial results 2015, company financing and restructuring measures, compliance and the efficiency of the Supervisory Board. Additionally, the Spectrum Committee and the Board of Directors reported on the process and the final results of the frequency auction. The Spectrum Committee was then dissolved as it had completed its task.

The ordinary meeting of 4 November 2015 was inter alia concerned with financial topics (in particular Q3 results and operational investments). The Supervisory Boards also

discussed again the efficiency of the Supervisory Board. Additionally the date for the Annual General Meeting which should be held on 19 May 2016, was resolved.

At extraordinary meetings (sometimes by telephone, sometimes in presence meetings), the Supervisory Board covered the minimum gender diversity quota for the Supervisory Board and the Management Board, financial issues and discussed the new organisational structure, the operational plan and approved the budget for the 2016 financial year.

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, the synergy reports and the market positioning and the telecommunications business were examined and discussed.

All Supervisory Board members in office for the entire 2015 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 resolutions on the new Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG) 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. During the reporting period, another committee existed until 30 April 2015, the so called Capital Increase Committee., as well as from 30 April 2015 until 24 July 2015 the so called Spectrum 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 (since 21 May 2015)
- Thomas Pfeil and
- Christoph Heil.

María Pilar López Álvarez resigned from the Audit Committee as of 12 May 2015.

In 2015, the Audit Committee met five times. In addition to the regular topics financial results, auditing, risk management and compliance, it dealt in particular with valuation issues as well as financing measures and peculiarities of accounting matters in connection with the acquisition and the integration of the E-Plus Group.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:

- Eva Castillo Sanz (Chairperson)
- Imke Blumenthal
- Angel Vilá Boix and
- Marcus Thurand.

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 (prior to her María Pilar López Álvarez) and Enrique Medina Malo. The Nomination Committee prepared the election proposal for the Annual General Meeting on 12 May 2015, at which Laura Abasolo García de Baquedano was elected as successor of María Pilar López Álvarez.

The Capital Increase Committee which was formed in connection with the E-Plus transaction whose members were:

- Patricia Cobián González (Chairperson)
- María Pilar López Álvarez
- Marcus Thurand
- Thomas Pfeil.

was dissolved in the Supervisory Board Meeting on 30 April 2015.

This committee dealt in particular with the specific implementation of the cash capital increase and the capital increase against contribution in kind in connection with the closing of the E-Plus transaction.

The so-called Spectrum Committee performed tasks of the Supervisory Board and under the authorization granted instead of the Supervisory Board at the frequency auction. It consisted of:

- Eva Castillo Sanz (Chairperson)
- Patricia Cobián González
- Marcus Thurand und
- Christoph Heil.

## 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 in accordance with section 289a German Commercial Code in the Annual Report and on the company's website at [WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION](http://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](http://WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT).

On 13/14 October 5 the Management Board and the Supervisory Board approved a new Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG). The Declaration of Compliance was published on 14 October 2015. You can find them in the Annual Report or at the company's website at [WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE](http://WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE). Earlier versions thereof can be also found at this website.

Six of the now 16 members of the Supervisory Board held positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies in 2015. 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.

In September 2015 the Supervisory Board adjusted its concrete objectives for its composition and set a gender diversity quota of at least 30% in accordance with section 96 par. 2 AktG. The Supervisory Board exceeds this quota in the financial year 2015 (37.5% female members).

In September 2015, the Supervisory Board also decided on a minimum gender diversity quota of 20% for members of the Management Board of the company. This quota is fulfilled since the existence of the company as a public limited company. Currently the Management Board consists of one third female members.

## Review of the Financial Statements 2015

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 2015 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 19 February 2016 ("Bilanzsitzung"). The Audit Committee and the Supervisory Board in its entirety thoroughly examined the reports and discussed them in detail together with the auditor on 19 February 2016. The Supervisory Board acknowledged and approved the auditor's findings in the audit reports and had no objections.

At its meeting on 19 February 2016, 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 2015 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

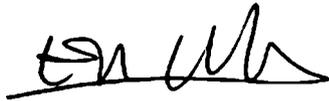
1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,
3. there are no circumstances that would require a materially different assessment of the measures listed in the report 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 Super-

visory 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.

Munich, 19 February 2016

On behalf of the Supervisory Board



Eva Castillo Sanz  
Chairperson of the Supervisory Board of  
Telefónica Deutschland Holding AG

The Supervisory Board thanks the members of the Management Board 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 the integration of E-Plus Group, they have contributed considerably to the success of the company.

# 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 Holding AG inform about Corporate Governance as follows. This Corporate Governance Report is also published together with the Management Declaration in accordance with section 289a German Commercial Code (HGB) on our website at [WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT](http://WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT).

## Declaration of compliance

The Management Board and Supervisory Board of Telefónica Deutschland Holding AG feel committed to the principles of transparent corporate governance and regularly consider the principles of the German Corporate Governance Code. On 13/14 October 2015 they last stated a declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG). The full text of the compliance declaration may also be viewed on the company's website at [WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE](http://WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE).

## The company's governing bodies

As a German stock corporation, Telefónica Deutschland Holding AG 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.

### 1 — 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 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 289a of the German Commercial Code (HGB) (Erklärung zur Unternehmensführung) in the Annual Report or on the Telefónica Deutschland website under [WWW.TELEFONICA.DE/ERKLAERUNG-ZUR-UNTERNEHMENSFUEHRUNG](http://WWW.TELEFONICA.DE/ERKLAERUNG-ZUR-UNTERNEHMENSFUEHRUNG).

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 which it adjusted in the financial year 2015 to the stipulations of section 96 paragraph 2 German Stock Corporation Act (AktG):

- The Supervisory Board has at least one independent member within the meaning of section 100 paragraph 5 of German Stock Corporation Act (AktG) 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 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](http://WWW.TELEFONICA.DE/INVESTOR-RELATIONS)), especially the financial calendar. Furthermore, analyst conferences 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).

#### Compliance

Telefónica Deutschland is committed to comply with all laws, regulations, processes, rules and enactments applicable to its business activity. Therefore, the company has a group-wide compliance organisation that is continuously improved. 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 company has a compliance department that is concerned with the implementation and optimisation of the compliance organization within the company, the coordination of compliance activities and advises employees on their questions. The existing Compliance Management System is continuously developed further to adjust it to the changing legal and economic conditions. The Management Board is informed regularly on compliance activities.

In this overall context, the company of course also maintains insider lists wherein any persons who act for the company and have authorised access to insider information are registered (following respective instructions regarding their duties by insider law).

The Management Board – as well as the Supervisory Board – regularly discusses the topic "compliance".

#### Transparency and communication

Telefónica Deutschland shareholders can receive information on the company on its 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 2015, 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 directors' dealings.

As per 31 December 2015, 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 directors' dealings.

### Directors' Dealings

According to section 15a of the German Securities Trading Act (WpHG), members of the Management and Supervisory Boards and related parties are obliged to disclose directors' dealings in Telefónica Deutschland shares if the value of these transactions reaches EUR 5,000 within a calendar year.

Further information can be found on the Telefónica Deutschland website at [WWW.TELEFONICA.DE/DIRECTORSDEALINGS](http://WWW.TELEFONICA.DE/DIRECTORSDEALINGS).

### Accounting and auditing

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with seat in Stuttgart, branch Munich, has been appointed auditor and group auditor for the financial year 2015 by resolution of the annual General Meeting on 12 May 2015.

# 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)

Persuant 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 October 2015, the Management Board and Supervisory Board of Telefónica Deutschland Holding AG ("Company") issued a declaration of compliance pursuant to section 161 paragraph 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 sec. 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 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 to, the Super-

visory 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 board member service agreements do not provide for the exact amount of the Company's pension expenses. The Company has assumed the respective pension commitments from the 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 sec. 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, 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 companies' 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.

This and previous declarations of compliance are available on the company's website at [WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE](http://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/GESCHAFTSGRUNDSAETZE](http://WWW.TELEFONICA.DE/GESCHAFTSGRUNDSAETZE).

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](http://WWW.TELEFONICA.DE/OMBUDSMANN)), competition law and ethically appropriate behavior. The company's data protection officer 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](http://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 reporting period, there were three members on the Telefónica Deutschland Holding AG Management Board (Thorsten Dirks, Rachel Empey and Markus Haas).

In the Supervisory Board Meeting on 21 September 2015 and in accordance with section 111 paragraph 5 German Stock Corporation Act (AktG) the Supervisory Board set a gender

diversity quota of at least 20% for the Management Board. Since then this quota is effective and was exceeded in the financial year 2015 (1/3 female members).

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 is responsible for corporate strategy, coordinating this regularly with the Supervisory Board, and also ensures its implementation.

Each Management Board member is responsible for managing the area of business assigned 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 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. After the resignation of María Pilar López Álvarez at the close of the Annual General Meeting of 12 May 2015, Laura Abasolo García de Baquedano was elected by the Annual General Meeting as new member of the Supervisory Board.

The current members of Supervisory Board are: Chairperson Eva Castillo Sanz, Deputy Chairperson Imke Blumenthal and the Supervisory Board Members Laura Abasolo García de Baquedano, Ángel Vilá Boix, Patricia Cobián González, Enrique Medina Malo, Michael Hoffmann, Sally Anne Ashford, Antonio Manuel Ledesma Santiago, Marcus Thurand, Thomas Pfeil, Christoph Heil, Claudia Weber, Dr. Jan-Erik Walter, Joachim Rieger and Jürgen Thierfelder.

During the reporting period the Supervisory Board consisted of six female and ten male (members i.e. of 37,5 % female and 62,5 % of male participants). Therewith it fulfilled the requirements of section 96 para. 2 German Stock Corporation Act (AktG) (30 % minimum gender diversity quota) also determined by the Supervisory Board for itself.

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 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.

María Pilar López Álvarez belonged to the Audit Committee until 12 May 2015.

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 (since 7 March 2015) and Enrique Medina Malo. María Pilar López Álvarez belonged to the Nomination Committee until 6 March 2015.

The Mediation Committee with the responsibilities as defined in section 31 Co-Determination Act (MitbestG) consists of the following members:

- Eva Castillo Sanz (Chairperson)
- Imke Blumenthal
- Angel Vilá Boix and
- Marcus Thurand.

The so-called Capital Increase Committee which was established in the financial year 2014 and consisted of:

- Patricia Cobián González (Chairperson)
- María Pilar López Álvarez
- Marcus Thurand and
- Thomas Pfeil

was dissolved with resolution of the Supervisory Board as of 30 April 2015.

Within the same meeting on 30 April 2015, the Supervisory Board decided to establish a further committee, the so-called Spectrum Committee. The Spectrum Committee performed tasks instead of the Supervisory Board and under the authorization granted of the Supervisory Board with regard to the frequency auction. Members of the Spectrum Committee were:

- 
- Eva Castillo Sanz (Vorsitzende)
  - Patricia Cobián González
  - Marcus Thurand and
  - Christoph Heil.

With resolution of the Supervisory Board in its meeting on 24 July 2015 the committee was dissolved after the end of the frequency auction.

4/5 February 2016

### Management Board

Thorsten Dirks (CEO)

Rachel Empey (CFO)

Markus Haas (COO)

### Supervisory Board

#### Shareholder representatives

Eva Castillo Sanz  
(Chairperson of the Supervisory Board and Chairperson of the Mediation Committee)

Laura Abasolo Garcia de Baquedano

Ángel 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 Ashford

Antonio Ledesma

#### Employee representatives

Imke Blumenthal  
(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 | 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   |
| Bitkom                  | Bundesverband Informationswirtschaft, Telekommunikation und neue Medien e. V., Berlin  |
| BKartA                  | Bundeskartellamt (Federal Cartel Office)   |
| BNetzA                  | Bundesnetzagentur (German Federal Network Agency)  |
| bp                      | Basis points   |
| Broadband               | Refers to telecommunication in which a wide band of frequencies is available to transmit information   |
| 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  |
| CH <sub>4</sub>         | Methane  |
| Cloud Service           | Cloud services are dynamic infrastructure, software or platform services provided online   |
| CO <sub>2</sub>         | Carbon dioxid  |
| CR                      | Corporate Responsibility   |
| DLD                     | Digital-Life-Design  |
| 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 cash flow   |
| FNA                     | Federal Network Agency   |
| FTR                     | Fixed network Termination Rates  |
| FY                      | Financial Year   |
| GDP                     | Gross Domestic Product   |
| GfK                     | Gesellschaft für Konsumforschung (Consumer research association)   |
| GHG                     | Greenhouse Gas   |

|                         |   |
|-------------------------|---|
| GSM                     | Global System for Mobile Communications: this is the global standard for digital mobile communications  |
| GWh                     | Gigawatt hours  |
| HGB                     | Handelsgesetzbuch (German Commercial Code)  |
| HSPA                    | High-Speed Package Access   |
| Hosting                 | Providing storage capacity via the internet   |
| IFRS                    | International Financial Reporting Standards   |
| Internet                | Worldwide network of computers on the basis of an IP (Internet Protocol) without any central network management                               |
| IoT                     | Internet of Things  |
| IPO                     | Initial public offering   |
| 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 Program          | Severance payment program for the planned downsizing in the context of the merger of E-Plus   |
| Libor                   | London Interbank Offered Rate   |
| 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   |
| mpass                   | Mobile payment service  |
| MSR                     | Mobile Service Revenues   |
| MTR                     | Mobile termination rates  |
| Multi-brand strategy    | Enables Telefónica Deutschland to provide customers in all segments offers that suit their exact needs through various own and partner brands |
| MVNO                    | Mobile Virtual Network Operator   |
| N <sub>2</sub> O        | Nitrous Oxid  |
| Net Adds                | New customers for the period less those customers leaving are designated as net additional customers  |
| NFC                     | Near Field Communication: a short-range wireless connectivity standard  |
| O2 (Europe) Limited     | O2 (Europe) Limited, Slough, United Kingdom   |
| O <sub>2</sub> My Handy | Monthly payment model for mobile phones and other devices   |
| OIBDA                   | Operating Income before Depreciation and Amortisation   |
| OpCF                    | Operating cash flow   |
| Opex                    | Operating expenses  |

|                              |   |
|------------------------------|---|
| OTT                          | Over The Top  |
| 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  |
| 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  |
| t                            | tons  |
| Tablet                       | A wireless, portable personal computer with a touch screen interface  |
| Telefónica, S.A.             | Telefónica, S.A., Madrid/Spain  |
| Telefónica Deutschland       | Telefónica Deutschland Holding AG, Munich   |
| Telefónica Deutschland Group | The companies included in the Consolidated Financial Statements of Telefónica Deutschland   |
| 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 multimedia and telematics service under the frequency spectrum of 2GHz.                 |
| VAT                          | Value Added Tax   |
| VDSL                         | Very High Data Rate Digital Subscriber Line (see DSL)   |
| VoLTE                        | Voice over LTE  |
| VPN                          | Virtual Private Network   |
| 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  |

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Georg-Brauchle-Ring 23–25  
80992 Munich, Germany  
Phone: +49 89 2442 0  
[www.telefonica.de](http://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](mailto:shareholder-deutschland@telefonica.com)  
E-mail institutional investors: [ir-deutschland@telefonica.com](mailto:ir-deutschland@telefonica.com)  
[www.telefonica.de/investor-relations](http://www.telefonica.de/investor-relations)

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Telefónica Deutschland Holding AG  
Georg-Brauchle-Ring 23–25  
80992 Munich, Germany  
Tel.: +49 89 2442 0  
[www.telefonica.de](http://www.telefonica.de)