2012
Annual Report

of Telefónica Deutschland Holding AG
for the financial year ended December 31, 2012

Telefónica
Deutschland

Management Report of Telefónica Deutschland Holding AG

(formerly Telefónica Germany Verwaltungs GmbH), Munich
for the financial year ended December 31, 2012

Overview of the financial year 2012

- Initial public offering in October
- Change of legal form from a limited liability company into a German stock corporation
- Appointment of the management board and supervisory board
- Revenues: Reimbursement of the management services from subsidiaries
- Distribution of a pre-IPO dividend to O2 (Europe) Limited amounting to EUR 7,186m, thereof:
  Cash payment of EUR 4,300m
  Offsetting of claims relating to capital commitments into the free capital reserves: EUR 2,886m

The figures were subject to rounding adjustments that were carried out according to established commercial standards. As a result, the figures stated in a table may not exactly add up to the total values that may also be stated in the table.

1. Business and operating environment

1.1. Economic and legal environment

Telefónica Deutschland Holding AG (formerly Telefónica Germany Verwaltungs GmbH; hereafter "Telefónica Deutschland") acts as a management holding company and additionally as a service provider responsible for the management and the strategic orientation of the Telefónica Deutschland Group and its operating business activities (the legal structure of Telefónica Deustchland Group is presented in section 1.2.1.). By the investments in its subsidiaries, the financial and performance positions of Telefónica Deutschland are influenced by the development of the subsidiaries. The following explanations concerning the economic and legal environment are thus indirectly relevant to Telefónica Deutschland.

1.1.1. Economic environment

German macro environment
Germany is Europe's largest economy and has been relatively resilient throughout the recent economic crisis, experiencing consistent GDP growth over the last few years. Real GDP growth in 2011 was 3.0% compared to 1.4% across the EU. In 2012, real GDP growth slowed down to 0.7% for Germany, still significantly higher than the EU average of minus 0.4% in 2012. Germany is one of the wealthiest countries in the EU with GDP per capita at EUR 31,662 in 2011 rising to EUR 32,584 in 2012, higher than the EU average of EUR 28,537 in 2011 and EUR 29,039 for 2012.

(Source: Federal Statistical Office, FocusEconomics Consensus Forecast Euro Area, February 2013; German Federal Bank Monthly Report, January 2013)

Real GDP growth

	2010	2011	2012
Germany	4.2	3.0	0.7
EU Average	2.0	1.4	(0.4)

General trend in the German telecommunications market
The German telecommunications sector is experiencing a number of clear trends which are set to extend into the future. First, there is a strong movement towards convergence. Second, there is a strong push by all four mobile network operators to monetize wireless data. The symbiotic growth in wireless data usage and smartphone penetration presents upside opportunities for mobile network operators. Third, it is expected that there will be a move to cloud services, where services such as Customer Relationship Management systems and e-mail are hosted remotely rather than on dedicated servers within enterprises. Finally, the market for machine-to-machine (M2M) communication is growing.

(Source: Yankee Group Research, Global ConnectedView Forecast, December 2012)

German wireless market
Germany is the EU's largest wireless market by number of subscribers slightly growing from 114.1 million accesses in 2011 to 114.2 million accesses (i.e. SIM cards) as of September 2012.

The penetration rate compared to 2011 remained stable at 140% as of September 2012. In 2012, market customer growth was mainly driven by postpaid, with postpaid customers representing 46% of total accesses at the end of September 2012 up from 44% end of 2011.

(Source: Company data. Yankee Group Research, Global ConnectedView Forecasts, December 2012)

The German wireless market was very competitive in 2012 driven by a strong push of smartphones and smartphone tariffs. According to Yankee Group Research, smartphone penetration increased from the end of 2011 by more than 11 percentage points to 45.7% at the end of 2012.

Wireless service revenue growth on the German market continued in 2012, up around 2% compared to 2011. This increase in wireless services revenues is mainly driven by an increased penetration of smartphones and small screen devices such as tablets, as well as consumption of wireless data services.

The German wireless market is well developed, with four wireless network operators. Telefónica Deutschland Group recorded 19.1 million accesses, giving it a market share of 16.7% as of September 30, 2012 compared to a market share of 16.2% as of September 30, 2011 counting 18.1 million accesses.

(Source: Company data. Yankee Group Research, Global ConnectedView Forecasts, December 2012)

German wireline market
The wireline broadband services market in Germany remained competitive. Market customer base grew around 1.5% compared to 2011 and reached a customer base of approximately 26.3 million at the end of September 2012. The major DSL service provider in Germany is Deutsche Telekom AG in Bonn, the incumbent telecommunications service provider. Other major competitors in the broadband internet market rent the unbundled local loop (ULL) from Deutsche Telekom AG, as does Telefónica Deutschland Group.

(Source: Global Comms Database German broadband 2012)

Economic environment of the segment Global Services
Growth in Europe and Latin America is particularly relevant for the Global Services segment due to its geographic focus. Latin America's and the Carribean's GDP growth rates for 2011 were 4.5% and for 2012 growth was solid as well, coming in at 3.0%. However, there are some signs of a slowdown in economic growth. This is mainly due to the weaker economic outlook of the major economies and the slowdown in growth in China. The variance between the individual countries is very large. Growth scenarios in countries such as Chile, Colombia, Peru and Venezuela are evaluated as satisfactory to positive while other countries are facing a difficult situation (Brazil, Argentina, Mexico). The Global Services segment was sold on October 1, 2012 and is reported under discontinued

operations in the Consolidated Financial Statements for the year ended December 31, 2012.

(Source: International Monetary Fund, Overview of the World Economic Outlook Projections, January 2013)

1.1.2. Regulatory influences on Telefónica Deutschland Group

Telecommunications services and the operation of telecommunication networks are subject to the regulatory regime of the German Telecommunications Act (Telekommunikationsgesetz) of June 22, 2004 as amended on May 3, 2012 and certain regulations that supplement the Telecommunications Act.

The Telecommunications Act implements the European Regulatory Framework for Electronic Communications Networks and Services which was amended in November 2009 (the “Framework”). The Framework consists of, amongst other provisions, the Framework Directive (2002/21/EC), the Authorization Directive (2002/20/EC), the Access Directive (2002/19/EC), the Universal Service Directive (2002/22/EC) and the Directive on Privacy and Electronic Communications (2002/58/EC).

The Telecommunications Act contains provisions regarding, among other things: (i) the establishment and powers of the regulatory body; (ii) notification requirements; (iii) the granting of rights of way; (iv) the allocation of frequencies; (v) access obligations; (vi) the regulation of rates; (vii) abusive behavior; (viii) consumer protection; and (ix) data protection and public safety. Some of these obligations only apply to providers that have significant market power in their respective markets. Other obligations apply or might be imposed by the German Federal Network Agency (FNA) even if those operators do not have significant market strength.

In November 2009, the European Parliament, following a proposal by the European Commission, passed legislation amending certain directives within the framework in order to strengthen competition and consumer rights in Europe’s telecom markets and to facilitate access to high-speed broadband internet connections. The changes to the existing framework came into effect on December 19, 2009, and had to be transposed into national law. This led to an amendment of the Telecommunications Act which entered into force in May 2012.

While most of the new regulations entered into force in May 2012, transition periods existed for some of them. Worth mentioning are the rules concerning the free-of-charge-waiting-loop and some of the rules concerning the change of the provider.

Telekom Deutschland GmbH Contingent Model for VDSL
In April 2012, the Federal Network Agency (FNA) rejected Telekom Deutschland GmbH’s application for a “contingent model”. Telekom Deutschland GmbH had planned to grant its competitors bitstream access via the VDSL access product on the basis of agreed contingent accesses. After Telekom Deutschland GmbH managed to allay FNA’s concerns, FNA approved the contingent model in July 2012 and forwarded it to the European Commission for review. The changes addressed the ability to migrate the accesses to alternative infrastructures, lower minimum commitments and higher monthly fees.

FNA expects that implementing the contingent model will boost the distribution of high-end broadband accesses and that it will incentivize the roll-out of new infrastructure (e.g. through expanded alliances).

Telefónica Germany GmbH & Co. OHG signed such a contingent model agreement with Telekom Deutschland GmbH in December 2012 and promotes VDSL accesses on this basis. Telefónica Deutschland Group gains access to about 11million households through VDSL and thus promotes another form of competitive wireline infrastructure.

Roaming III
On May 30, 2012, the Council of the European Union adopted a new, revised roaming regulation, which replaced the 2009 regulation (“Roaming III”). This new roaming regulation entered into force on July 1, 2012 and will apply until June 30, 2022. Under Roaming III, the current retail price caps on voice calls and SMS have again been reduced and a new retail cap on data services has been introduced. Wholesale price caps will also be progressively reduced and new structural measures are being introduced with the aim of improving competition amongst operators. From July 1, 2014, customers will be able to buy their domestic and roaming services separately from different operators, while keeping the same phone number. In addition, since July 1, 2012 mobile virtual network operators (MVNO) have the right to access other operators’ networks at wholesale prices in order to provide roaming services.

The regulation also lays down rules aimed at increasing price transparency and improving the provision of information on charges to roaming customers.

With respect to retail prices, the new rules pursuant to Roaming III which entered into force on July 1, 2012 are, among others, as follows:

- 29 cents per minute to make a call;
- 8 cents per minute to receive a call;
- 9 cents to send a text message; and
- 70 cents per megabyte (MB) to download data or browse the internet while travelling abroad (charged per kilobyte used).

Decisions concerning mobile and fixed termination rates (MTR/FTR)

MTR
Telefónica Deutschland Group's most recently approved MTRs (EUR 0.0339/min) expired on November 30, 2012. On November 16, 2012, the FNA reached a preliminary decision on new MTRs as follows: EUR 0.0185/min as of December 1, 2012, and at EUR 0.0179/min as of December 1, 2013.

The European Commission has been notified of the preliminary decision. Telefónica Germany GmbH & Co. OHG filed an objection to the decision on December 19, 2012, with the aim of increasing termination rates.

FTR
On November 30, 2012 the FNA released its preliminary decision on the fixed termination rate (FTR) for Telekom Deutschland GmbH. The local FTR will decrease by about 20%. Because of regulatory obligations, the Telekom Deutschland GmbH's FTR will also have an impact on the FTR for traffic exchanged with alternative network operators. The final decision is expected in the first or second quarter of 2013.

The FNA drafted a decision for the ex-ante regulation of the alternative network operators' FTR in 2012. The current ex-post regulation will be in effect until approval of the draft decision has been received from the EU, which is expected in the first or second quarter of 2013.

Future development of GSM licenses
The GSM licenses that grant the right to use the 900 MHz and 1,800 MHz band of the frequency spectrum expire at the end of 2016. The FNA is currently deciding on the future of these frequencies. In November 2012 the FNA published a paper containing four potential scenarios regarding the future of the spectrum. The scenarios range from prolongation over an isolated awarding scenario of the GSM licenses to scenarios that contain the allocation of the GSM spectrum together with an additional spectrum that is expected to be available within the next few years. The scenario paper is open for discussion. Input is called for until January 31, 2013. The FNA stated that it plans to publish a draft decision based on the input on the scenario paper.

1.2. Organization, business activities and strategy

1.2.1. Structure of Telefónica Deutschland Holding AG and Telefónica Deutschland Group

Telefónica Deutschland Holding AG ("Telefónica Deutschland") is a German stock corporation (Aktiengesellschaft) organized and operating under German law. The company's change of legal form from a German limited liability company (Gesellschaft mit beschränkter Haftung) into a German stock corporation was approved by a resolution at the general shareholders' meeting of September 18, 2012 and was registered in the commercial register on September 26, 2012. Ever since, the company has been a German stock corporation.

The legal and business name (Firma) is "Telefónica Deutschland Holding AG". The registered office (Satzungssitz) is in Munich, Germany. Telefónica Deutschland Holding AG is registered in the commercial register (Handelsregister) of the local court (Amtsgericht) in Munich under registration number HRB 201055. The company has its business address at Georg-Brauchle-Ring 23–25, 80992 Munich, Germany (telephone number: +49 (0) 89 2442–0; www.telefonica.de). Its financial year is the calendar year (January 1 through December 31). Telefónica Deutschland Holding AG was established for an unlimited period of time.

The initial public offering on the regulated market of the Frankfurt Stock Exchange was successfully concluded on the first day of trading on October 30, 2012 at an initial share price of EUR 5.60. The WKN is A1J5RX; the ISIN DE000A1J5RX9. The registered share capital of Telefónica Deutschland Holding AG amounts to EUR 1,116,945,400. It is divided into 1,116,945,400 registered shares with no-par value each representing a notional amount of EUR 1.00 in the registered share capital. While 23.17% of the shares are in free float, the remaining 76.83% are held by Telefónica Germany Holdings Limited. Each share confers one vote at the company's general shareholders' meeting. There are no restrictions on voting rights. The major shareholder, Telefónica Germany Holdings Limited, does not have any alternate voting rights.

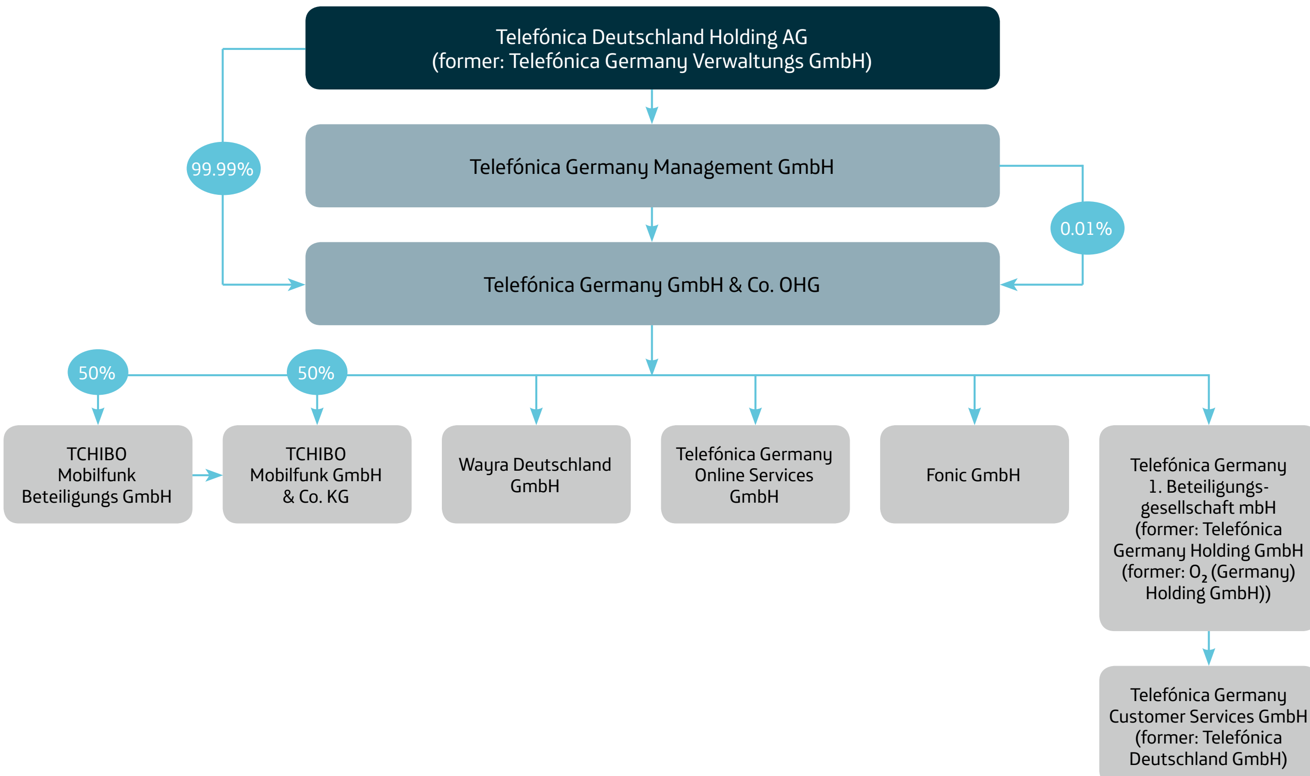
Telefónica Deutschland Holding AG has authorized capital allowing the management board of the company (subject to approval by the supervisory board) to increase the registered share capital until September 17, 2017 by a total amount of up to EUR 558,472,700 by issuing new non-par value registered shares. Furthermore, Telefónica Deutschland Holding AG's registered share capital is conditionally increased for granting stock upon the exercise of option or conversion rights or for the fulfillment of conversion obligations.

Telefónica Deutschland Holding AG is the holding company of Telefónica Deutschland Group which is incorporated in the Consolidated Financial Statements of its ultimate parent, Telefónica S.A., Madrid, Spain as of December 31, 2012.

The legal structure of Telefónica Deutschland Holding AG as of December 31, 2012 is shown on the next page.

Until October 1, 2012 Group 3G UMTS Holding GmbH, Quam GmbH and Telefónica Global Services GmbH, together with its subsidiaries Telefónica Global Roaming GmbH, Telefónica Compras Electronicas S.L. and the indirectly held 40% interest in Adquira España S.A., were part of Telefónica Deutschland Group.

All shares of these companies were held by Telefónica Global Activities Holdings B.V. (former Telefónica Chile Holding B.V.). Prior to the IPO, Telefónica Deutschland Holding AG sold all shares in Telefónica Global Activities Holdings B.V. to Telfisa Global B.V., a Telefónica Group entity. After the sale, Telefónica Global Activities



Holdings B.V. and all of the aforementioned entities ceased to be members of the group.

Telefónica Global Services GmbH, Telefónica Global Roaming GmbH, Telefónica Compras Electronicas S.L. and Adquira España S.A. together formed the segment Global Services. As of December 31, 2012, Telefónica Deutschland Group comprises one segment (telecommunications).

Management and governing bodies
The company's governing bodies are the management board, the supervisory board and the general shareholders' meeting. The power of these governing bodies is determined by the German Stock Corporation Act (AktG), the company's articles of association and the by-laws of both the management board and the supervisory board.

Management board
Members of the management board are appointed by the supervisory board for a maximum term of five years and may be re-appointed an unlimited number of times, in each case for a maximum of five years. The supervisory board may revoke the appointment of a management board member prior to the expiration of his or her term for good reason, such as for gross breach of fiduciary duties or if the general shareholders' meeting adopts a no-confidence resolution in relation to the management board member in question. The supervisory board may appoint one management board member as chairperson or spokesman and another member as deputy chairperson or spokesman. The members of the management board of the company have been appointed until September 17, 2015.

The management board of the company currently comprises three members:
- René Schuster CEO (Chief Executive Officer)
- Rachel Empey CFO (Chief Financial Officer)
- Markus Haas CSO (Chief Strategy Officer)

Supervisory board
In accordance with the company's articles of association sections 95 and 96 of the German Stock Corporation Act and section 7 of the German Co-Determination Act (Mitbestimmungsgesetz – MitbestG), the supervisory board consists of twelve members, six of which are shareholder representatives and – upon completion of the election process already initiated within Telefónica Deutschland Holding AG – six of which are employee representatives. Unless the general shareholders' meeting has set a shorter term, the term of each supervisory board member, as well as the term of each substitute member, if elected, expires at the end of the general shareholders' meeting discharging the members of the supervisory board for the fourth fiscal year following the commencement of the member's term of office, not including the fiscal year in which the term commences. All members of the supervisory board of the company have been appointed until the end of the ordinary general shareholders' meeting held in 2017 for the year ending December 31, 2016.

1.2.2. Business activities

Telefónica Deutschland Holding AG acts as a management and holding company and additionally as a service provider responsible for the management and the strategic orientation of the Telefónica Deutschland Group and its operating business activities, which concentrate on rendering telecommunication services and the distribution of hardware. Telefónica Deutschland Holding AG generates its revenues by the compensation of costs in regard of services rendered by the Telefónica Deutschland Holding AG for its subsidiaries. Services contain management services provided by the management board for sectors, such as group strategy, corporate communication, controlling, new business and innovation.

Before its change into a German stock corporation Telefónica Deutschland solely acted as holding company without any ordinary business activities. The management board, therefore, received no renumeration from Telefónica Deutschland.

The Telefónica Deutschland Group operates the following business activities:

Telecommunications
Telefónica Deutschland Group offers wireless and wireline services providing voice, data and value-added services to consumer and business customers. In addition, we are one of the leading wholesale providers in Germany, offering our wholesale partners access to our infrastructure and service capabilities.

We operate a nationwide mobile network with GSM coverage exceeding 99% of the German population, and a nationwide wireline network with DSL access covering approximately 67% of German households. Our mobile network operates on the technology standards GSM, UMTS, and, more recently, LTE.

We market our products under a multi-brand strategy, offering the majority of our postpaid and prepaid wireless and wireline products and converged services through our core premium O_2 brand. We constantly seek to improve the positioning of O_2 to attract premium consumers and businesses. Our aspiration is to be one of the most popular brands with the most satisfied customers in the German telecommunications market.

Through our "O_2 My Handy" model launched in May 2009, we sell handsets and other hardware to our customers for a fixed price either for immediate payment of the total purchase price or for an up-front payment of part of the total purchase price and 12 or 24 subsequent monthly installments. This provides the customer with price transparency with respect to the costs of the handset and the costs of the wireless services. Customers are able to acquire a wide range of mobile phones, including premium handsets, based on attractive payment terms. Our main suppliers of handsets are Samsung, Apple, Nokia, HTC and Sony Mobile Communications. Our focus for the "O_2 My Handy" model has been and continues to be on smartphones, which comprise more than 90% of the handsets we sold in the financial year ended December 31, 2012. The "O_2 My Handy" model is also used for our secondary brands, especially for a portfolio of low-budget smartphones, in order to meet the increasing demand for data services in these customer segments as well as, in part, for our wholesale partners.

We access additional customer groups through our secondary and partner brands as well as our wholesale channels. Secondary brands are fully-controlled brands, such as FONIC and netzclub or brands held through joint ventures and strategic partnerships, such as Tchibo mobil and Türk Telekom Mobile. We market high-speed internet access and wireline telephony via DSL. Our multi-brand approach enables us to target a broad range of consumers and to maximize our sales reach through tailored product offerings, marketing and distribution. We also provide wholesale wireless, wireline network and value-added services to customers such as 1&1, mobilcom/debitel, Drillisch and the two major German cable operators. We provide our wireline wholesale partners with a range of ULL services, including wireline telephony and high-speed internet access, as well as other add-on services, such as billing, the management of phone numbers and SIP-accounts. The extensive portfolio we offer to our wholesale partners which enables them to service their end-customers allows us to increase our reach and leverage scale.

We target our small and home offices (SoHos), small and medium-sized enterprises (SMEs) customers, and large, national companies through our O_2 brand and multinational corporations with our "Telefónica Multinational Solutions". We offer our products through a diversified distribution platform, including both direct sales channels, comprising our nationwide network of self-operated and franchised O_2 shops and premium partner shops, online and telesales, and indirect sales channels, such as retail/e-retail partnerships and dealers/cooperations.

Global Services
All global procurement activities of the operating units of Telefónica Group including the activities of Telefónica Deutschland Group are coordinated and managed by the Global Services segment. Global Services acts as a central contact point for the suppliers of the whole Telefónica Group by consolidating the needs of the individual companies and negotiating with suppliers on a global scale in order to achieve economies of scale for Telefónica Group.

Global Services also acts as an agent in negotiating integrated wireline, wireless and IT services to Telefónica Group with the objective of optimizing these services for Telefónica Group and achieving economies of scale. Telefónica Global Roaming, on behalf of Telefónica Europe's operating businesses, negotiates discount agreements with Telefónica's international roaming partners, both to achieve favorable cost positions and secure inbound roaming revenues.

1.2.3. Group strategy

Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its business activities, including the development of the group strategy for Telefónica Deutschland Group.

We aim to leverage our existing assets to capture market share in the wireless services market and drive growth through the following strategic priorities:

Capitalize on multi-brand portfolio and superior customer satisfaction
We aim to use our core O_2 brand and our strong portfolio of secondary brands and partner brands to build on our position in the German telecommunications market. We also intend to continuously explore strategic partnerships to add brands that target specific niches or consumer segments.

The aim of our customer service, retention and satisfaction programs is to continue to provide our customers with consistently high-quality service and maintain transparency, thereby earning our customers' trust. We believe that our high levels of customer satisfaction decrease churn and increase the rate at which our current customers recommend us to new potential customers. We intend to increase the use of direct distribution channels to optimize our acquisition process and costs.

Monetize data opportunities through innovative products and digital services
We aim to leverage the current strength of our core O_2 brand and to monetize the rise in data usage and smartphone users, especially through the ongoing roll-out of our LTE network and through increased convergence.

Expand our convergence strategy to increase share of customer spending and reduce churn
We intend to continue to focus on converged wireless and wireline service bundles in order to increase our share of customer spending, reduce wireless churn and reduce subscriber acquisition costs. One of our strategic aims is to cross-sell products and services to customers who currently use only wireless or wireline services, because this increases our share of customers' spending. We believe it also reduces our risk of churn. In addition, cross-selling allows for the acquisition of new accesses at comparatively low customer acquisition costs. To utilize the cross-selling potential in our customer base, we offer discounts to customers who purchase both wireless and wireline services.

(Source: Convergence study)*

* The company commissioned mm customer strategy GmbH to regularly produce a market study of our business and market position ("Convergence Study"), the key findings of which were published on September 19, 2012 at www.mm-strategy.com, and which we also cite in this Management Report. All statistics and market data in this study are derived from third-party sources or are produced by mm customer strategy GmbH. We did not verify or modify any of the third-party statistics or other statistics provided by mm customer strategy GmbH.

Seize the opportunity in the SoHo, SME and wholesale markets

We target small, medium-sized and large national business customers with our core O_2 brand and larger international companies with our "Telefónica Multinational Solutions" in partnership with Telefónica Group. We intend to raise customers' perception of our core O_2 brand as a business brand. We aim to increase our market share by differentiating ourselves from our competitors by providing good value for money, tailored propositions and bundled benefits and focusing on customer service.

We aim to use innovation to improve services, profitability and competitiveness in our wholesale business to maintain and increase our market share.

Maintain competitive 3G and LTE networks
We believe demand for LTE technology in Germany will increase significantly in 2013 and 2014. During the initial roll-out, the German regulator FNA required certain towns and districts with little or no broadband coverage (also known as "white spots") to be prioritized. This requirement has been fulfilled in all of the 16 federal states. As a result, we are now able to develop our LTE network strategy based primarily on commercial considerations.

Drive profitable growth and efficiency to generate enhanced cash flow
We intend to drive profitable growth by maximizing operating efficiencies. This will entail actively managing our customer base and our ARPU levels, with a focus on data usage, including increasing our share of direct distribution channels, online and digital customer care. Efficiency initiatives to optimize processes, realize network efficiencies, and streamline our IT systems are also on the agenda.

1.2.4. Management of the group

The management of Telefónica Deutschland Group is carried out centrally by the members of the management board of the Telefónica Deutschland Holding AG with the objective to achieve profitable growth for the company.

Clear end-to-end profit and loss responsibilities have been defined to reward entrepreneurial behavior, which is one of the company's key maxims. Management is passionate about increasing shareholder value and strongly believes that delivering superior customer and employee experiences is the key to achieving this objective.

Telefónica Deutschland Group's management has implemented a comprehensive internal management system to steer the group, primarily consisting of the following elements:

- A strategic setting process
- An integrated budgeting and planning system
- Key financial and operational performance indicators
- Monthly reporting to the management board and supervisory board

- Ongoing risk and opportunity management
- Management by objectives at all levels of the company

1.2.4.1. Strategic setting process

Telefónica Deutschland Group's management board reviews corporate strategy based on its vision for the company using an annually recurring planning process. This process entails developing the long-term strategic targets for the company's German market share and usually a three-year financial plan. Decisions are based on current market and competition analyses, market forecasts, the company's vision and long-term strategic goals.

New growth opportunities are systematically identified and investment decisions made accordingly. The overall corporate strategy and goals are then broken down into business unit strategies in close cooperation with each business unit. This step includes implementing an operational model of the strategy at the business unit level by defining specific financial targets, key performance indicators (KPI) to measure the degree of success implementing the strategy and establishing levers to achieve the targets. A detailed budget planning round for the next fiscal year is conducted based on the agreed three-year targets and short term strategic priorities are defined in parallel.

1.2.4.2. Management system and value management

We have defined performance figures to steer our strategic and operational targets so that we reach our goals. The following KPIs are an integral part of Telefónica Deutschland Group's management system and value management and reflect the interests of our different stakeholders.

Profitability
Revenue growth is a key indicator of the success of our business. The OIBDA and the OIBDA margins facilitate operating performance comparisons from period to period and company to company by eliminating potential differences caused by variations in tax positions (such as the impact of changes in effective tax rates or deferred taxes on periods or companies), depreciation and amortization and certain other items. OIBDA and the OIBDA margin are commonly used in terms to compare the operating activities of telecommunications operators. However, because other companies may not calculate OIBDA and the OIBDA margin exactly as we do, our presentation of OIBDA and the OIBDA margin may not be comparable to that of other companies.

Financial planning
We are driving enhanced Free Cash Flow generation to meet our capital expenditure needs. Main focus is on the investments in growth as well as the ability to pay a dividend.

Furthermore, the company's leverage ratio (calculated by dividing net financial debt by OIBDA) is managed at the Telefónica Deutschland Group level.

Capital management
We are monitoring cost of capital and the equity ratio with a goal of optimizing capital structure.

Shareholder remuneration
In line with its shareholder remuneration policy, the company intends to pay a dividend.

The payment of dividends, if any, and the amounts and timing thereof, depend on a number of factors, including future revenues, profits, financial conditions, general economic and business conditions, the company's future prospects, applicable legal and regulatory requirements and such other factors as the management board may deem relevant.

The company aims to remain solvent by refraining from paying dividends, distributing capital or capital reserves in cash or buying back shares, if the ratio of net financial debt/OIBDA materially and consistently exceeds the target leverage, and restricting the use of new debt to pay dividends, allowing it only if the ratio of net financial debt/OIBDA complies with the target leverage (as defined below in chapter 2.3.1. Principles and objectives of financial management).

Customer satisfaction
Customer satisfaction is a key priority for our company and we continuously seek to improve the positioning of O_2, our core premium brand, to attract premium consumer and business customers for postpaid wireless, wireline and converged services. Our aspiration is to be the most popular brand with the most satisfied customers in the German telecommunications market. This includes offering customer insight driven propositions and providing outstanding service through all customer touch points. We believe our high levels of customer satisfaction decrease churn and increase the rate at which our current customers recommend us to new potential customers.

Customer satisfaction is measured regularly, and the impact of all decisions on customer satisfaction is taken into account.

Employee satisfaction
A company cannot be successful without its employees. Our employees contributed substantially to our success. Their confidence, dedication and commitment make us what we are today.

We measure the satisfaction of our employees regularly and take their feedback seriously to further improve the company.

1.2.4.3. Budgeting and planning system

The integrated planning system is based on a combination of strategic and operational targets. Telefónica Deutschland Group defines internal targets for the company and the group for all relevant key performance indicators, as described in chapter 1.2.4.2. Both the expected market development and internal expectations for growth and efficiency evolution are discussed once a year to generate a long-term plan for the next three years. The first year is ultimately broken down into a monthly plan to reflect the detailed budget for the first year. For control purposes, the budget is updated twice a year taking into account as is results as analyzed in conjunction with the monthly reporting process, an update on market trends and currently recognized additional opportunities or risks. The revised forecast is then used to make operational corrections or to seize new opportunities for the company and group.

1.3. Product development and innovations

Product development
We are building a solid basis for sustainable growth in revenues and earnings with our range of flexible, competitive and customer-oriented products, which we continually improve and expand. For example, we added various data flat rates to our portfolio of "O_2 Blue" packages in early 2012. These are specifically tailored to address the way our customers' use of the internet has changed due to the ever-increasing spread of smartphones. They serve our customers' need for an integrated voice telephony and data transmission service perfectly. Telefónica Deutschland Group has been offering LTE for smartphones since July 2012. Apart from the mobile rates, our portfolio includes a great variety of state-of-the-art smartphones by almost all quality manufacturers. With our "O_2 My Handy" plan, the devices can also be bought without a mobile phone contract.

Our portfolio also comprises new offers for our DSL customers. "Speed", an additional VDSL option for the O_2 DSL offerings has been available since late 2012. It allows our customers to surf the internet up to three times faster than with a traditional DSL connection. In recent years, Telekom Deutschland GmbH in particular has invested heavily in VDSL infrastructure, a network that so far has grown to cover about 11 million households in 48 towns and cities across Germany. The long-term partnership with Telekom Deutschland GmbH, which we entered into in late 2012, enables us to use the VDSL contingent model, which gives us the opportunity to offer an extremely competitive high-speed DSL product in addition to our successful wireless solutions.

The different ways our customers now use mobile telephones and new technological developments are allowing us to tap new business areas. One example is mobile payment, an area in which the Telefónica Deutschland Group developed various products and services in 2012. Our customers can now pay for digital purchases such as games, digital currencies or apps with their mobile phone bill using "direct to bill". Our "mpass" payment service lets customers use their phones for payment: They can pay online and, thanks to NFC (near field communication), offline in many retail outlets. Our alliance with MasterCard makes easy, secure and contact-free payment possible at all outlets that have installed the PayPass infrastructure. Finally, we added the O_2 credit card to our financial services portfolio in November 2012. The O_2 credit card is issued by our partner Barclaycard and is accepted at more than 30 million outlets that accept Visa.

New rates and products for business customers
Over the course of 2012 we restructured the "O_2 on Business" offering. The new rates vary by volume of data allowed to be transferred at maximum speed, the abroad call time included and the number of text messages included. An option for LTE-compatible devices is also available.

In addition, Telefónica Deutschland Group has been offering all freelancers, self-employed customers and small businesses a discount when they combine their wireless and wireline connections and book a DSL contract in addition to their mobile phone contract.

Apart from attractive rates, we offer our business customers a great variety of services. For example, we have been offering a comprehensive cloud-based solution for business telephony as part of our product portfolio since October 2012: The Office Voice Cloud connects wireline and wireless systems so that the functions of the wireline can also be used from the mobile phone while on the go. Telefónica Deutschland Group offers this product in cooperation with nfon AG, one of the leading providers of off-premises telephone exchanges (IP Centrex) in Germany.

The portfolio of M2M products for business customers was also expanded in 2012. For example, a new solution package for fleet monitoring has been available since March 2012: The O_2 Fleet Store is offered in cooperation with Masternaut, the leading telematics services provider. Medium-sized or large companies and multinationals use it to more efficiently manage their fleets, reduce costs and improve customer satisfaction. The O_2 Fleet Store's core component is a tiny GPS box. It can be installed in any vehicle and connects to the Masternaut servers via the O_2 mobile communications network. While moving, it continually transmits vehicle data such as location, direction of movement, speed and the temperature in the cargo space. The movements of individual commercial vehicles can be tracked on a map featured on a password-protected website, which provides additional information about any available vehicle.

Innovation management
A crucial success factor for further growth is our ability to identify trends and new technological developments early on, to turn them into customer-driven products and bring them to market quickly. In doing so, we draw on the global innovation network of Telefónica Group, refine the respective global products and also develop strategically specific services for the German market. Our innovation management always follows the principle of "open innovation" in order to tap the maximum innovation potential for our company. This means that we involve employees as well as customers, start-ups, business partners and other drivers of innovation in our innovation activities.

We apply "smartidee", our employee suggestion scheme, as a platform for staff to share their ideas and, consequently, to help take our company to the next level. Since its inauguration in 2003, more than 13,000 suggestions have generated a financial benefit for our company accounting to over EUR 15m.

Launched in 2010, the "O_2 Ideenforum" gives customers a chance to send their suggestions regarding new products and services to the Telefónica Deutschland Group; submitted ideas are then discussed and prioritized by other customers on the o2.de portal. About 150,000 registered customers have participated in the process already. By implementing selected ideas, we both improve our products and give credible proof of our supreme customer orientation.

Stepping up our customers' involvement in product development and reducing time-to-market are our top priorities. This is why we launched the "O_2 Ideenlabor" in November 2011. This initiative ensures a full innovation cycle where concepts developed in-house via an online survey are presented to customers who provide us with their instant feedback. As of today, a panel of about 1,500 customers and other interested users are registered for the ideas lab, enabling us to collect hundreds of data points within only a few hours in a highly cost-efficient way.

We also maintain close ties with leading research institutes and are actively involved in an exchange of ideas on innovation through symposia, panel discussions and the annual DLD (Digital-Life-Design) Conference in Munich, which brings together the pioneers of the IT and telecommunications industries.

2. Analysis of the business performance

2.1. Statement of the board of management on business development

The management board is satisfied with the preceding financial year 2012 of Telefónica Deutschland Holding AG. Telefónica Deutschland Holding AG successfully went public with the official listing of its shares at the end of October 2012. As a result, a transformation of the legal form of a limited liability company into a stock corporation as well as the appointment of members of the management board and supervisory board took place. In the course of the initial public offer, non-core business subsidiaries (Group 3G UMTS Holding GmbH, Quam GmbH and Telefónica Global Services GmbH including its subsidiaries Telefónica Global Roaming GmbH, Telefónica Compras Electronicas S.L. and the 40% interest in Adquira España S.A.) have been sold at the beginning of October 2012. Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its business activities. Due to that management services provided and recharge of IPO costs, revenues of kEUR 1,676 were generated in the financial year 2012.

Prior to the IPO the shareholder's meeting of Telefónica Deutschland declared a dividend to O2 (Europe) Limited amounting to EUR 7,186m, of which EUR 4,300m have been considered as cash payments and the remaining EUR 2,886m were offset against claims from a pledge for payment into the free capital reserves of Telefónica Deutschland.

Concernig the Telefónica Deutschland Group, the following should be noted:

The management board is pleased with the development of its telecommunications' business as Telefónica Deutschland Group extended its positive financial and operating performance trend throughout the year outperforming the market with trading momentum in the postpaid sector and successfully monetizing wireless data. After the initial public offering in 2012, we are convinced that we have further raised our profile and will continue the successful Telefónica Deutschland Group growth story in the long run. Wireless data has stimulated growth, as reflected in our continuous, strong financial performance in the financial year of 2012. Total revenue growth of 3.5% was especially driven by wireless service revenues due to a strong increase in accesses and a stable ARPU. Data revenues benefitted from increased smartphone penetration to improve by 16.1%. Additionally, the significant OIBDA growth of 11.3% resulted in an OIBDA margin of 24.5% in 2012 (2011: 22.8%), leveraging wireless data growth and increased efficiencies. Increased investments in the network, improving 3G data capacity and accelerating the LTE network rollout will give essential support to our wireless service revenue growth.

We are also pleased with the development of the Global Services segment, whose companies were part of Telefónica Deutschland Group until September 30, 2012. We succeeded in reinforcing the business model and obtaining general acceptance among suppliers. Recently the focus shifted to improving operational procedures and the extending the scope of activities. The adjusted OIBDA margin remained stable for the prior financial year.

We are pleased with our first "BBB" rating from FitchRatings and the associated positive signal to the capital market. The rating reflects our strong position in a highly competitive market and the financial stability of Telefónica Deutschland Group.

The business development of Telefóncia Deutschland Holding AG is discussed in more detail in the following sections.

2.2. Results of operations and earnings position

Revenues
Revenues were recorded for the first time and amounted to kEUR 1,676 for the financial year ended December 31, 2012. Revenues comprise the costs for rendered management services (kEUR 1,000), as described in 1.2.2., provided by the members of the management board to Telefónica Deutschland Group. In 2012, these comprise also IPO related costs (kEUR 676). In 2011, the Telefónica Deutschland Holding AG recorded no revenues.

Other operating income
Other operating income decreased from kEUR 4,747,455 in 2011 to kEUR 207 as of December 31, 2012. The amount in 2012 comprises the reversal of liabilities to affiliated companies in 2012. In the previous year other operating income mainly comprised income from the write-up of the carrying value of the interest in Telefónica Germany GmbH & Co. OHG.

Personnel expenses
The personnel expenses as of December 31, 2012 amount to kEUR 932 (prior year: kEUR 0) and include the remuneration of the management board.

Other operating expenses
Other operating expenses increased from kEUR 27 as of December 31, 2011 to kEUR 703 as of December 31, 2012. The increase is mainly based on expenses in connection with the initial public offering of Telefónica Deutschland Holding AG in 2012.

Net financial result
The net financial result of the period 2012 amounts to kEUR 20. Hence, compared to previous year (kEUR 67) a decrease of kEUR 47 is recorded. This was due to lower cash pooling balances and interests.

Profit for the period
The profit of the period for Telefónica Deutschland declined compared to previous year by kEUR 4,747,206 to kEUR 282. Essential relating to this development is the substantial decrease in other operating income. These included in the previous year income from the write-up of the carrying value of the Telefónica Germany GmbH & Co. OHG amounting to kEUR 4,747,455.

2.3. Financial position

2.3.1. Principles and objectives of financial management

Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its business activities. Thus, Telefónica Deutschland is essentially financed from charging these management services to Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. In addition, Telefónica Deutschland Holding AG is integrated in Telefónica Deutschland Group's overall financial management.

Risk control and centralized management are key principles underpinning Telefónica Deutschland Group's financial management. The company aims to remain solvent by (a) refraining from paying dividends and buying back shares and neither paying back capital nor capital reserves and (b) restricting the use of new debt to pay dividends, allowing it only if the ratio of net financial debt/OIBDA complies with the target leverage.

The management board and supervisory board intend to maintain the company's leverage ratio (calculated by dividing net financial debt by OIBDA) below 1.0 over the medium term (the "target leverage").

2.3.2. Financing

Long-term financing arrangements
Telefónica Deutschland Holding AG is integrated in Telefónica Deutschland Group's overall financial management. As part of the Group's financial management Telefónica Germany GmbH & Co. OHG entered into a loan agreement dated September 12, 2012 with the Telefónica Group entity Telfisa Global B.V. (TGB.V.) as lender, pursuant to which TGB.V. has agreed to provide a loan facility (the "Facility") of EUR 1.25bn bearing interest at the rate of the 3-month EURIBOR plus a margin of 120 basis points, increasing by 40 basis points per year, accruing on a daily basis after drawdown of funds on the basis of a 360 day year. The Facility has a repayment schedule of 20% per year until 2017.

Telefónica Germany GmbH & Co. OHG has the right to prepay the Facility, in whole or in part in a minimum amount of EUR 100,000, on any interest payment date or subject to payment of a market-based breakage fee. The Facility is also subject to a mandatory prepayment in the event Telefónica Germany GmbH & Co. OHG obtains financing that matures after September 13, 2017 in the amount of 25% of the proceeds received from such financing which will be applied as a prepayment of the Facility. Default interest of an additional 2 percentage points on top of the applicable interest rate will apply in the event Telefónica Germany GmbH & Co. OHG fails to comply with any of its payment obligations under the loan agreement for any reason. The loan agreement contains certain restrictive covenants, including with respect to disposals of assets, creation of liens, and mergers and consolidations. In the event of default, the Facility will be accelerated and all amounts owed under the Facility will become immediately due for repayment. Events of default under the loan agreement include, among others, breach of the loan agreement, in particular a payment breach, an insolvency or similar event, a breach of payment obligations with respect to other indebtedness, and if Telefónica Germany GmbH & Co. OHG experiences a change of control.

As of December 31, 2012, the principal future payment obligations from our long-term financing arrangements, after giving effect to the EUR 1.25bn loan granted by TGB.V. on September 12, 2012 are as follows:

Long term financing arrangements – Telefónica Deutschland Group

Euros in millions

	Payment due by period				
	2013	2014	2015	2016	2017
Senior credit facilities	250	250	250	250	250
Debt relating to finance leases	4	2	2	1	–
Total	**254**	**252**	**252**	**251**	**250**

Revolving credit facilities
In August and September 2012, Telefónica Germany GmbH & Co. OHG, as borrower, entered into revolving credit facility agreements with several banks. As a result, Telefónica Germany GmbH & Co. OHG has undrawn committed credit lines with maturity beyond one year in a total amount of EUR 710m.

Every agreement's calculation of interest is the percentage rate which is the aggregate of the margin and EURIBOR.

Cash pooling
In the future, Telefónica Deutschland Holding AG as well as Telefónica Deutschland Group will remain member and participate in the cash management system used by Telefónica Group. In this regard certain deposit and cash management agreements with TGB.V. were determined. Cash throughout the Telefónica Group is centralized through these arrangements, allowing us to benefit from the economies of scale from the overall Telefónica Group as well as, among other things, from the in-house liquidation of payables and receivables between us and the participating members of Telefónica Group. Under the cash pooling arrangements, the entire cash surplus available in our bank accounts included in the cash pool is automatically transferred on a daily basis to master bank accounts held by TGB.V. In addition, we are also able to use other ways to deposit funds to the cash pool account and settle receivables from, and payables to, Telefónica Group companies and third parties via the cash pool. We are able to draw from this pooled account certain amounts exceeding the amount of our cash contributions up to a maximum amount of EUR 40m, which helps us to satisfy our working capital requirements. The amount that may be included in the cash pool is capped at an amount equal to our 18-month free cash flow. In addition, we are entitled to make cash deposits for periods of between one and up to 12 months in separate accounts. For positive balances in the cash pool account, we are paid a rate of interest set by a reference rate (LIBOR or EURIBOR, depending on the relevant currency), plus/less a margin based on market prices. For deposits made in separate accounts for a period of between one and up to 12 months, we agree with Telefónica Group on the applicable interest rate in each individual case. Similarly, we will be charged interest when we borrow money from the pool exceeding our contributed cash amounts. The interest rate for borrowings is based on a reference rate (LIBOR or EURIBOR, depending on the relevant currency), plus a margin based on market prices. The deposit and cash management agreements are automatically renewed every calendar year unless terminated by either party prior to the end of a contractual year upon 30 business days' notice or immediately in certain circumstances, such as failure to make payments requested under the agreement or if we reasonably believe that our repayment claims under the arrangements are not fully recoverable. Subject only to the general legal rules for the set-off of claims, any claims for the repayment of deposits made under the deposit and cash management agreement can be offset against liabilities under loans granted to us by TGB.V., including, in the case of Telefónica Germany GmbH & Co. OHG, the existing loan facility of EUR 1.25bn granted by TGB.V. on September 12, 2012. In addition, we have significant information rights under the deposit and cash management agreements with regard to the financial condition of Telefónica Group and TGB.V.

This helps us to determine whether we may continue participating in the cash pooling or whether any termination rights have been triggered and should be exercised. Telefónica S.A. has guaranteed TGB.V.'s obligations under cash pool arrangements.

As of Decemebr 31, 2012 the deposits of Telefónica Deutschland Group in connection with cash pooling agreements amounted to EUR 308.2 million.

2.4. Analysis of assets and capital structure

Balance Sheet

Euros in thousands

	As of December 31,			
	2012	2011	Amount	% Change
Financial assets	5,758,877	10,375,942	(4,617,064)	(44.5)
Receivables from shareholders	–	2,885,896	(2,885,896)	(100.0)
Receivables from affiliated companies and other receivables	5,954	4,213	1,741	41.3
Other assets	–	25	(25)	(100.0)
Cash and cash equivalents	3,100	3,100	–	–
Total assets = total equity and liabilities	**5,767,931**	**13,269,177**	**(7,501,245)**	**(57)**
Provisions	1,028	11	1,017	>100
Trade and other payables	704	317,782	(317,078)	(99.8)
Equity	5,766,199	12,951,383	(7,185,185)	(55.5)

Financial assets
Financial assets concern interests in Telefónica Germany GmbH & Co. OHG and interests in Telefónica Germany Management GmbH. At December 31, 2012 the carrying amount of the interests amount to kEUR 5,758,877 (2011: kEUR 10,375,942). The reduction of the interests in Telefónica Germany GmbH & Co. OHG is mainly driven by the withdrawal from the reserves of Telefónica Germany GmbH & Co. OHG amounting to kEUR 4,300,000 and the offset of an existing capital promise in the amount of kEUR 317,495.

Receivables from shareholders
On March 28, 2003 and April 30, 2004 O2 (Europe) Limited issued a declaration of obligation to Telefónica Deutschland Holding AG (former "Telefónica Germany Verwaltungs GmbH"; former "O2 Germany Verwaltungs GmbH") under which O2 (Europe) Limited obliged itself to provide Telefónica Deutschland Holding AG by way of voluntary shareholder's contribution with an amount of kEUR 4,650,000 and kEUR 500,000, respectively. These amounts were to be remitted on first demand of Telefónica Deutschland Holding AG and obligations have been unlimited in time.
As of December 31, 2011 O2 (Europe) Limited contributed kEUR 2,264,104 of cash under the declarations of obligation. The remaining obligations relating to the declaration were offset against the dividend payment of Telefónica Deutschland Holding AG.

Receivables from affiliated companies and other receivables
Receivables from affiliated companies and other receivables, including also the cash pooling receivables from Telfisa Global B.V., amount to kEUR 5,954. The receivables from affiliated companies for management services of members of the management board and the charge of other costs and other claims amount to kEUR 2,698 as of December 31, 2012. Furthermore, the receivables from cash pooling as of December 31, 2012 amount to kEUR 3,256 (2011: kEUR 4,213)

Cash and cash equivalents
Cash and cash equivalents in the amount of kEUR 3,100 have not changed since December 31, 2011.

Provisions
As of December 31, 2012 provisions amount to kEUR 1,028. Hence, provisions increased by kEUR 1,017 compared to previous year. The change reflects the first-time consideration of a provision for the compensation of the management board.

Trade and other payables
Trade and other payables declined by kEUR 317,078 from kEUR 317,782 as of December 31, 2011 to kEUR 704 as of December 31, 2012. The change was driven by the offset of an existing capital promise against Telefónica Germany GmbH & Co. OHG in the amount of kEUR 317,495. This result was only to a minor part offset by trade payables for IPO related expenses in the amount of kEUR 306 and other payables in connection with value added taxes and taxes on wages in the amount of kEUR 365.

Equity
The change in equity of kEUR 7,185,184 is primarily due to the pre-IPO dividend transferred to O2 (Europe) Limited., which was based on a shareholders resolution dated September 13, 2012. A part of the didvidend has been fulfilled by a cash dividend amounting to kEUR 4,300,000 and the outstanding amount of

kEUR 2,885,896 by the offsetting against claims from a pledge for payment against O2 (Europe) Limited.

On September 18, 2012 O2 (Europe) Limited has increased the share capital of Telefónica Deutschland Holding AG from EUR 1,116,945,300 by EUR 100 to EUR 1,116,945,400 in return for a contribution in kind.

3. Employees

The telecommunications market is changing rapidly, and the demands on our employees are changing accordingly. This is why we have specific programs aimed at giving our employees the requisite abilities and skills and updating them on an ongoing basis. We also give our employees the freedom to develop their own talents. This is how we ensure that the expertise and abilities available in the company always meet the requirements of the market. We foster a working environment that is open and based on equal opportunity and make sure that our employees are able to combine the demands of a career and a family. All of this makes Telefónica Deutschland Group one of Germany's most attractive employers, as documented by numerous surveys and awards.

Personnel management target areas

- People for the Future
  This program aims to enable our employees to face the challenges of the fast-paced telecommunications market. We help our employees build and develop their skills and we keep these specific abilities in mind when we recruit new employees.

- Corporate Culture
  We also constantly develop our corporate culture in order to stay competitive in the telecommunications market. We use a viral approach, building on the behavior of selected change champions. As opinion leaders, these individuals shape the company. Their conduct is meant to encourage other employees to follow their example.

- Operational Excellence
  We use standardized methods to consistently optimize our personnel management processes and services in order to achieve the highest possible quality at the lowest cost. The goal is to have user-friendly electronic systems that function without a hitch and thus facilitate our employees' daily working lives. We want these systems to contribute to greater satisfaction and improved efficiency.

- Employee Commitment
  We want our employees to feel they are a part of the company, be motivated, and identify with our company. A regular employee survey demonstrates the success of our activities.

Average number of employees during the year

In 2012 the company had equally to 2011 no employees.

4. Corporate Responsibility

Taking responsibility for our employees, the environment, and society is anchored in our corporate culture. But even more important, this commitment creates the basis for our long-term business success. We consistently take action wherever we as a telecommunications firm can make the greatest impact and generate the highest value for our stakeholders. We maintain a continuous dialog with stakeholders to ensure that we focus our commitment in as targeted a manner as possible.

We have defined the following focal points in our corporate responsibility strategy:

- Think Big youth program
  With our Think Big initiative, we want to empower young people to use new media to implement their own projects and thus play an active role in shaping their environment.

- Access via telecommunications
  We want to facilitate access via telecommunications services, particularly for disabled persons, and help them take part in society by using new communications technologies.

- Climate and environment
  We contribute to climate protection by improving the energy efficiency of our operations and developing our range of environmentally friendly products and services.

Corporate responsibility management

With the help of clearly defined key ratios, we measure the success of our activities in the area of sustainability management. We use these ratios to manage our activities in the seven core areas of economy, suppliers, compliance, employees, customers, society, and the environment. The ratios also form the basis for global corporate responsibility reporting in the Telefónica Group.

Furthermore, from the reporting year 2012 on the German Corporate Responsibility data and information will be published within the Annual Report of Telefónica Deutschland. All data included in the Corporate Responsibility chapter of the annual report 2012 is calculated on the basis of the Global Reporting Initiative (3.0) criteria. Additional information on Corporate Responsibility activities and KPIs will be provided online.

To manage these key ratios, we have defined clear responsibilities. Activities are coordinated by a corporate responsibility team working on a cross-divisional basis. Each year, specific targets are agreed with the individual departments and subsequently approved at the management level.

Stakeholder dialog

Our business commitment is shaped by transparency and continuous dialog with our stakeholders. For example, we operate an internet platform called "diskutiere.de" with Unternehmen: Partner der Jugend (UPJ) e.V., a non-profit organization. We use this platform to exchange ideas with the public on socially relevant issues that ensue from our business activities. The most recent example was in November 2012, when we organized a panel discussion on the topic of "corporate partnerships and social entrepreneurship", which we followed online at "diskutiere.de". The event was held at our representative office in the capital city of Berlin, which acts as an interface between our company and policymakers, the economy, and associations.

Another important element in our stakeholder dialog is maintaining an open exchange with our employees. We use various formats to accomplish this, particularly regular surveys on employee satisfaction (for more information please refer to chapter 3. Employees).

Areas of corporate responsibility action

We want to shape the digital future, which is why we pay heed to all aspects of our responsibility. In addition to responsibility for our products and the environment, our areas of action include social responsibility toward our employees and to society. We also expect our suppliers to act responsibly and sustainably, just as we do.

Product responsibility

We aim for a long-term relationship with our customers. Their satisfaction and the service quality that we offer them are of the highest priority for us. We view this responsibility as all-encompassing. For us, product responsibility therefore includes effective data protection, barrier-free access to communication, responsible product offers for children and teenagers, and transparent consumer information on the effects of electromagnetic fields.

In addition, we received external awards for our activities in customer satisfaction in 2012. For example, nearly 1,800 readers of FOCUS MONEY rated their mobile phone providers for "fairness" in an independent study called "Bestens FAIRbunden". Of the providers with their own network, Telefónica Germany GmbH und Co. OHG received the highest rating of "very good" six times and was named the fairest mobile phone provider in Germany. Telefónica Germany GmbH und Co. OHG did especially well in the "fairness" categories of value for money, customer service, communications, sustainability, and responsibility.

We support children and teens in using our service by showing responsibility in the products we make available. The extent of our service offering is based on internal guidelines as well as external rules we have agreed to abide by. Since 2006, we have been a member of "Freiwillige Selbstkontrolle Multimedia-Diensteanbieter e.V." (FSM), a voluntary self-monitoring association for the protection of minors. Together with seven other major German companies, we have signed a code of conduct for mobile phone service providers for the protection of minors. The aim of the code is to ensure that children and teenagers are not able to view any content that could endanger their development. We also support the development and operation of the "fragFinn.de" search engine in our capacity as a founding member of the "Ein Netz für Kinder" initiative. This search engine responds to inquiries on the basis of a white list reviewed in accordance with pedagogical criteria and youth protection aspects.

We also facilitate access via telecommunications for disabled persons. For people who are hard of hearing, we have supported VerbaVoice, a speech-to-text interpreting service together with VerbaVoice GmbH. The application is also available for mobile devices. In 2012, we funded the continuing development of that service, which is now also available as an app for the iPhone and the iPad. Dealing with the environment and its resources in a responsible manner is an important management task for us. Our objective is to minimize the negative environmental effects of our activities to the greatest extent possible. In doing so, we focus on saving energy and reducing carbon emissions as well as dealing responsibly with raw materials.

Our environmental management system has been certified since 2005 in accordance with the globally applicable ISO 14001 environmental management standard, and our adherence to the standard was again confirmed in 2012.

At approximately 96% (2011: 94%), the major portion of our energy consumption is attributable to our network with its approximately 26,000 mobile network transmission stations and additional network facilities. We consistently endeavor to keep our energy consumption as low as possible by using technologies that are as energy efficient as possible. In past years, we have succeeded in keeping the rise in the energy we consume lower than the rise in the use of our network, despite more intensive use and an increasing number of customers. The situation is similar with respect to the rise in carbon emissions based on network use.

Environment		2012 [1]	2011
CO_2 emissions from electricity consumption and vehicle fleet	Tons	214,473	214,067
CO_2 emissions from business travel	Tons	6,824	6,807
Total electricity consumption	MWh	484,853	484,117
Share of electricity consumption from renewable energies	Percent	70	60
No. of used cell phones returned to O_2	Number	18,196	10,126
Share of Eco Index-tested cell phones	Percent	78.72%	n.a.

[1] At the time of data collection, not all data for 2012 was available. Approximately 8% of the stated value is therefore partly based on extrapolations derived from data for the year 2011. Tchibo Mobilfunk Beteiligungs GmbH and Tchibo Mobilfunk GmbH & Co. KG are not included in these figures.

Environmental responsibility (see table above)
Careful use of resources is an important aspect of our environmental management. We want to reduce the resources used in our own processes and make a contribution to increasing the number of cell phones being recycled.
Our mobile phone recycling program allows consumers to dispose of their old phones at no cost and in an environmentally friendly manner. The mobile phones sent in are checked by our recycling partner. Defective devices are disposed of and the raw materials they contain are reintroduced into the resource cycle. Devices that still function are resold after data deletion to allow them to be reused. We use all of the proceeds generated from the cell phones we receive to support non-profit environmental protection organizations in Germany. Moreover, in 2012 we provided active support as a partner in the "handy-clever-entsorgen" initiative of the Bavarian Ministry of the Environment (see www.handy-clever-entsorgen.de) as well as to the "Die Rohstoffexpedition" campaign of the Federal Ministry for Education and Research as part of Science Year 2012 (see www.die-rohstoff-expedition.de). Both initiatives aim to raise public awareness of the importance of recycling cell phones and the various disposal options. They focus in particular on children and teenagers.

We also involve our customers in our environmental management by making them aware of environmental aspects and will in the future offer more products and services that will allow them to minimize their environmental footprint.

A specific example of this is the Eco Index, which we have been offering to customers since 2011 to help them in selecting a new mobile phone with the assistance of sustainability criteria. The Eco Index rating includes aspects such as energy efficiency and materials used as well as social aspects related to the manufacture of the devices. Our goal with regard to the Eco Index is to provide a transparent assessment system that indicates the degree of sustainability of a mobile phone and to give device manufacturers the right initiative for product innovation. The Eco Index was developed in cooperation with Forum for the Future (www.forumforthefuture.org), an NGO in the UK for sustainable development, and various device manufacturers.

Social responsibility (see table below)
In the area of social responsibility, we see ourselves as having a duty to our employees as well as to society, which we work to fulfill together with our employees (for more information please refer to chapter 3. Employees)

In 2012, Telefónica Deutschland Group spent a total of EUR 986,739 on donations and non-profit projects, up 12.6% from the prior year (2011: EUR 876,503).

The focus of our social commitment is on fostering media competence and entrepreneurial thinking among young people. We are actively involved in a variety of projects in this area, above all the Think Big program. We also offer assistance with other social matters through donations or the corporate volunteer activities of our employees.

Society		2012	2011
Total donations and expenses for non-profit projects	EUR	986,739	876,503
Think Big participants (teenagers) per year	Number	17,000	10,000
Corporate volunteer program participants (employees)	Number	797	914
Working hours for the corporate volunteer program	Number	6,881	5,988

As in the previous year, our activities in 2012 centered around the Think Big youth program, which we are implementing jointly with Fundación Telefónica and the Deutsche Kinder-und Jugendstiftung (German Children and Youth Foundation). Our objective with this program is to enable young people to implement social projects in their environment and help them develop digital media competence in the process. Since the start of this long-term program in 2010, more than 27,000 young people have taken part and some 1,300 projects have been implemented with our assistance. In 2012, we received the "Politikaward" in the category of corporate responsibility for Think Big. This renowned award for political communication is bestowed each year by trade magazine politik&kommunikation in Berlin, with the winners being elected by a high-profile jury made up of scientists, journalists, and PR experts.

One of the reasons for the success of Think Big is the close involvement of our employees. During their working hours they act as project sponsors, mentor young people by providing their expertise and give online advice on specific issues.

Corporate volunteering has been a pillar of our social commitment since 2008. In 2012, 797 of our employees took part in the activities, providing 6,881 hours of volunteer work (2011: 914 employees, 5,998 hours).

We are continuously developing the spectrum of our social commitment in close cooperation with our stakeholders. Long-term partnerships and alliances, including those with the Deutsche Kinder- und Jugendstiftung (DKJS) and the JFF-Institut für Medienpädagogik (German Institute of media pedagogy), create a foundation that maximizes the effectiveness of our work.

5. Risk and opportunity management

Following notes to risk and opportunity management are mainly related to Telefónica Deutschland Group. Since Telefónica Deutschland Holding AG acts as a management and holding company and is additionally responsible for the management of Telefónica Deutschland Group, all mentioned risks and opportunities also relate to Telefónica Deutschland Holding AG. Therefore, a comprehensive and group-wide view is shown.

Telefónica Deutschland Group focuses on anticipating and recognizing new business opportunities so that it can successfully increase shareholder value in the long run and continue to grow its revenue. However, to maximize the opportunities and operate efficiently it is also necessary to handle certain risks our company is exposed to. Our risk management approach is to continuously detect, identify and actively manage these risks at an early stage.

5.1. Risk management and financial instruments

General

Telefónica Deutschland Group is exposed to various financial market risks as a result of its business. However, due to Telefónica Deutschland Group's regionally focused operations, foreign exchange risk is not affecting Telefónica Deutschland Group materially. Telefónica Deutschland Group is subject to credit risk from the operating business (trade receivables) as well as from receivables towards Telefónica Group.

Furthermore, Telefónica Deutschland Group is exposed to liquidity risks relating to its credit risks and market risks or a weakening of its operating business or financial market disturbances.

If these financial risks materialize, they could adversely affect Telefónica Deutschland Group's financial position, cash flows and profitability.

Telefónica Deutschland Group has guidelines in place for risk management procedures and for the use of financial instruments, including a clear segregation of duties with regard to financial activities, settlement, accounting and the related controlling. Derivative financial instruments are only contracted to hedge underlying risks from its commercial and treasury financing activities. However, these instruments are always contracted with Telefónica Group treasury and Telefónica Deutschland Group has established guidelines derived from best practice standards for risk assessment procedures and supervision concerning the use of financial derivatives.

Market risk

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

Foreign exchange risk

Telefónica Deutschland Group has determined the Euro as its financial reporting currency. All financial statements of Telefónica Deutschland Group's subsidiaries are prepared in Euro and therefore Telefónica Deutschland Group is not exposed to foreign exchange translation risks. Besides translation risks, foreign exchange transaction risks exist, mainly arising from Telefónica Deutschland Group's business relations with suppliers or business partners in countries that use currencies other than the Euro. Given its funding solely by self-generated cash and equity no exchange risk from debt denominated in currencies other than the Euro occurs.
The net exposure on foreign currency risk on the balance sheet consists of primary and derivative financial instruments in foreign currencies as well as planned positions in foreign currencies of the following year.

For material identified foreign currency risks, derivatives are contracted with Telefónica Group treasury.

Interest rate risk

Interest rate risks arise primarily from Telefónica Deutschland Group's cash pooling accounts and deposits and in 2012 additionally from a loan agreement as a borrower.

Telefónica Deutschland Group deposits cash surpluses in cash pooling accounts and deposit accounts with Telfisa Global B.V., Netherlands. These accounts as well as the bank accounts bear variable interest.

Credit risk

Credit risk is the risk of financial loss arising from counterparty's inability to repay or service debt in accordance with the contractual terms. Credit risk includes both the direct risk of default and the risk of a deterioration of creditworthiness as well as concentration risks. Telefónica Deutschland Group's maximum exposure to credit risk is initially represented by the carrying amounts of the financial assets (without consideration of guarantees or collateral, if available).

Telefónica Deutschland Group considers managing commercial credit risk as crucial to meet its sustainable business and customer base growth targets in a manner that is consistent with its risk management policy. Appropriate credit policies, procedures and authorization guidelines are established to manage and monitor credit risk.

This approach to managing credit risk is based on continuous monitoring of the risk assumed and the resources necessary. In particular, attention is given to clients who could have a material impact on Telefónica Deutschland Group's Consolidated Financial Statements for which depending on the segment and type of relation appropriate credit management instruments like credit insurance or collateral may be used to mitigate exposure to credit risk. In order to control credit risk, Telefónica Deutschland Group regularly performs an ageing analysis of trade accounts receivables and books allowances for doubtful accounts receivables with similar exposure to credit risk, only.

In case Telefónica Deutschland Group has entered into foreign currency derivatives, all trades have been conducted with Telefónica Group treasury according to Telefónica Group policy only.

With regard to its cash surpluses Telefónica Deutschland Group has entered into cash pooling agreements and deposit agreements with TGB.V. according to Telefónica Group policy and places most of its cash surpluses with these institutions.

Thus, most of Telefónica Deutschland Group's cash surpluses will be concentrated in these companies belonging to Telefónica Group which is rated by international rating agencies with an investment grade rating. The remaining cash surplus is spread out over several German banks which are rated by international rating agencies with an investment grade rating.

Liquidity risk

Liquidity risk comprises the risk that a company is unable to meet its financial obligations that are settled by delivering cash or another financial asset. Telefónica Deutschland Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its obligations when due, under both normal and stressed conditions. Telefónica Deutschland Group manages its liquidity in close coordination with Telefónica Group and has entered into cash pooling agreements and deposit agreements with TGB.V., according to Telefónica Group policy and places most of its cash surpluses with these institutions. The cash inflows generated by Telefónica Deutschland Groups' operating business as well as the possibility of factoring receivables and maintaining credit facilities are used to reduce Telefónica Deutschland Group's liquidity risk.

Capital management

Telefónica Deutschland Group aims to ensure sustainability of the business and maximize the value to shareholders. Telefónica Deutschland Group monitors its cost of capital with a goal of optimizing its capital structure. Telefónica Deutschland Group monitors the equity ratio and the OIBDA.

5.2. Risk management and risk reporting

Our business operations face different risks arising from the business, legal, financial and regulatory environment. We provide our services as a result of our own organizational, strategic and financial decisions, and provisions made.

Risks are inextricably linked to each business activity and can negatively affect the process of goal setting and goal achievement. They result from the cause-related uncertainty of future events – incomplete information being a regular occurrence – and represent the possibility of negative deviations from a specified target. If risks are not recognized and addressed, they can compromise the successful development of the company. In response, management has introduced and supports a risk management process that ensures prompt and complete risk transparency and evaluates changes to existing business risks.

The risk management process is an integral element of the decision making process at Telefónica Deutschland Group, assuring that risk assessments are considered in decision making and that measures to reduce and manage risks are taken at an early stage. Assessing, communicating and managing risk is one of the responsibilities of every manager at the company. The risk management is responsible for maintaining the company's risk register, which includes all subsidiaries. The risk manager is in constant contact with all areas throughout the organization and with designated risk coordinators in order to continuously track and assess risk, its management and evolution. Individual training is provided to those responsible and furthermore, basic trainings are available to all employees in order to strengthen overall risk management awareness.

Risks are evaluated to assess their impact on business goals, both from an operational and a financial perspective. The risk register is based on a database containing all individual risks identified, their status and defined action plans. A formal, proactive report on the risk register of Telefónica Deutschland and it subsidiaries' total risk exposure is submitted to the management board on a quarterly basis. The audit committee is periodically informed about the risks and their evolution.

5.3. The risks

Of all risks identified, the following section examines these risks that could materially affect our financial or competitive position or the ability to meet the set targets. Our business might be impacted by other or additional risks that we are currently not aware of or we did not consider being significant. For internal purposes risks are clustered into business, operational and financial risks.

Recessionary conditions in the Eurozone

The Eurozone debt crisis and general economic slowdown in parts of Europe from, among other factors, lower consumer confidence, decreasing gross domestic product, rising unemployment and uncertainty, may adversely impact macroeconomic conditions in Germany. As we operate exclusively in Germany, the success of our business is closely tied to the market environment and stability of the German economy and cannot be offset by developments in other markets (business risk).

Macroeconomic factors may impair growth prospects in the German telecommunications market in terms of the penetration of new value-added services and traffic, ARPU and number of customers and, in particular, the volume of business customers (business risk). Recessionary conditions may also increase the number of defaults and/or delays in payments from our customers, increase churn and prevent us from attracting new customers (business risk). Reduced German consumer spending, including telecommunications services and products, could adversely affect our number of customers and revenues as customers may no longer deem critical the services we offer (business risk).

Highly competitive markets and changes in customer demand

We operate in markets that are highly competitive and subject to constant technological development. Our company is facing increasing competition from alternative telecommunications providers such as cable providers, MVNOs and consumer electronic companies as well as from alternative telecommunication services such as Over the Top (OTT). To effectively compete with these providers we need to successfully market and deliver our products and services. We need to respond to both commercial actions by competitors and anticipate technological changes, changes in consumer preferences and general economic, political and social conditions (business risk). We have to maintain and further develop our direct and indirect distribution channels anticipating and meeting the expectations and preferences of our customers. Failure to do so appropriately could have a negative impact on our ability to attract and maintain customers and might influence our financial position, operating results and cash flow (operational risk).

Regulatory risks

Our business environment is a highly regulated market where decisions by the regulatory authorities may directly influence services, products, and prices (business risk).

Mobile termination rates have decreased across Europe in the last several years, with considerable reductions in Germany (cuts of over 50% since December 2010), and various related reviews of such rates and court proceedings on regulatory measures which are still pending. The European Commission intends to further reduce mobile and fixed termination rates significantly and has issued a recommendation on the calculation of such rates by the respective National Regulatory Authority (NRA), which must be fully applied by 2013. The Commission has also recommended that rate asymmetry between network operators be eliminated. As a result the decision of the German FNA is subject to an approval by the European Commission (notification procedure). As the German FNA still not fully complies with the recommendation, the procedure inherits the risk of changes to the preliminary decisions of the FNA. Additionally, third parties are allowed to comment and able to place proceedings against the decisions. FNA's preliminary decision MTRs from November 16, 2012, having decreased the prices since December 1, 2012, might respectively be changed by the European Commission or third party actions and even lower rates might be decided (business risk).

In 2013, ex-ante price regulation for fixed termination rates will be imposed on alternative operators including Telefónica Deutschland Group. It has already been decided that the lowest possible termination rate (the so called "local rate") will be the same as the one for Deutsche Telekom AG. It is still open how the FNA will decide on the question, if different interconnection structures in comparison to Deutsche Telekom AG will lead to different rates and if the structure will vary from operator to operator. This may influence interconnection revenue streams in a negative or positive way. Currently it is not clear when exactly this regulation will start (business risk).

Other services with regulated prices in Europe include international call roaming, short message service ("SMS") and data services. The European Parliament and Council have approved the Roaming III regulation, which aims to set ceilings on tariffs for voice calls and SMS retail and wholesale services between July 2012 and

July 2014, with subsequent further reductions. Roaming III also regulates retail and wholesale data roaming charges and lays down rules to increase pricing transparency and improve the provision of information on charges to roaming customers. From July 1, 2012 MVNOs have had the right to access other operators' networks at wholesale prices in order to provide roaming services. From July 2014, mobile network operators (MNOs) will be required to separate the sale of roaming services from their domestic services, enabling customers to choose a different network operator for calls made in other member states. Currently it is not foreseeable how the customers and the competitors will react to this situation. The products created might threaten our margins on roaming services (business risk).

Regulators could at any time adopt measures to lower roaming tariffs and mobile or fixed termination rates or require us to provide third-party access to our networks at reduced prices. Any future decreases of such tariffs and charges could have a material adverse effect on our business, financial condition and result of operations (business risk).

Licenses and frequencies

As our licenses and assigned frequency usage rights have finite terms, any inability to renew or obtain new licenses and frequency usage rights necessary for our business as well as significant changes in the financial conditions for their usage could adversely affect our operations (business risk).

Delayed approvals of microwave frequency usage rights applications by the FNA could materially adversely affect the performance and expansion of our mobile networks (business risk).

Technology operations

Sustained or repeated disruptions or damage to our wireless or wireline networks and technical systems may lead to the loss of customers or a decrease in revenues and require costly repairs (operational risk).

Other business risks

The telecommunication industry has been, and will continue to be, affected by rapid technological change. Our business success depends on our ability to anticipate and adapt to these changes and customer preferences. Wrong interpretations or decisions might impact the market acceptance of our products and prevent us from reaching our revenue or growth targets. This also relates to our ability to ensure the constant availability of handsets and smartphones as well as those handsets and smartphones being compatible with our mobile network. Constraints or prohibitions imposed on handset supplies or incompatibilities with our network could negatively affect our ability to achieve the expected customer and revenue growth (business risk).

A termination or failure to renew existing agreements or partnerships with MVNOs and branded resellers could damage our reputation and negatively impact our ability to diversify and grow our customer base (business risk).

Legal risks

We may be subject to claims that we infringe the intellectual property rights of others and may be unable to adequately protect our own intellectual property rights (operational risk). We collect and process subscriber and other personal data as part of our business. Undue use or leakage of such data could breach laws and regulations which could result in fines, loss of reputation and customer churn (operational risk).

Insurance

Despite having a risk management process in place there is always a remote risk that unexpected events may result in financial damages if provisions taken or our insurance coverage turns out to be insufficient (business risk).

Supplier failures

As a wireless and wireline telephony operator and provider of telecommunications services and products, we, like other companies in the industry, depend upon a small number of major suppliers (e.g. Deutsche Telekom AG) for essential products and services, mainly IT and network infrastructure. If these suppliers fail to deliver products and services to us on a timely basis, it could jeopardize network deployment and expansion plans, which might have an adverse impact on our business and the results of its operations (operational risk). The same applies if vendors we contract for outsourcing and out tasking projects for efficiency reasons do not deliver the services in time or in the quality needed (operational risk).

Financial risks

Our business is capital intensive and requires significant amounts of investments. We have implemented an extensive capital expenditure program that will continue to require significant expenses in the foreseeable future, including the maintenance and optimization of our wireless and wireline network as well as further investments in the High-Speed Package Access (HSPA) coverage and LTE technology. In addition, costs associated with frequency usage rights needed in order to operate our existing networks and technologies, and costs and rental expenses related to their deployment as well as costs associated with our wireline network, are a significant portion of our cost base and subject to increases (also partly a business risk). We believe that we will be able to meet our financial obligations for the next twelve months. Currently, we have negotiated favorable payment and delivery terms with our suppliers and have in place cash pooling arrangements and factoring agreements to support our working capital. However, there can be no assurance that such arrangements or agreements will be available in the future or on satisfactory terms. Furthermore, we may not be able to generate sufficient cash flows in the future to meet our capital expenditure needs. Therefore, we may require additional sources of working capital in connection with our continued growth, our strategy, market developments or the development of new technologies. Consequently, we may need to raise additional debt or equity financing in amounts that could be substantial. Our ability to raise additional capital to fund our operations can be further influenced by factors such as changing market interest rates, restrictive covenants in our debt instruments or negative changes in our credit rating or the credit rating of our majority shareholder. Future debt agreements we may enter into may include provisions restricting our ability to raise financing or to make certain business changes. Our exposure to the credit risks of our customers could also make it difficult for us to collect accounts receivables and thus impact our working capital position.

Like every company we are regularly subject to tax audits which may result in higher tax payments for previous periods if the authority does apply a dissenting opinion on interpretations and figures underlying our tax declaration. In 2012 Telefónica Germany Management GmbH and Telefónica Germany GmbH & Co. OHG filed a correction of the wage tax declaration for the period from January 2008 to October 2012 for employee benefits. The effects for wage tax, VAT as well as corporate income and trade tax require final agreement with the tax authorities. Since December 2012 both subsidiaries are subject to a wage tax audit for the periods January 2008 to October 2012. There are no findings yet from such audit.

5.4. The opportunities

Growth of the German market

Germany is one of Europe's largest telecommunications markets, with revenues from telecommunications services up 1.4% from EUR 47.9bn in 2011 to EUR 48.6bn in 2012. We believe our market position and size, serving approximately 25.4 million accesses as of December 31, 2012 (2011: 24.5 million), enable us to capitalize on the anticipated growth opportunities presented by one of Europe's largest telecommunications markets, in particular for wireless data services. Rising consumer spending in the German mobile telecommunication market is being driven partly by increased smartphone use and partly by digital trends. Germany holds significant market catch-up and growth potential for data, with a relatively low smartphone penetration of 45.7% (France: 50.5%, Sweden 57.5%, UK: 55.95%) and blended data ARPU of EUR 6.1 (France: EUR 10.9, Sweden: EUR 8.1, UK: EUR 10.2) in 2012 compared to other developed western European telecommunications markets.

(Source: Yankee Group Research Global ConnectedView Forecast December 2012)

Increasing smartphone penetration

Smartphones have been a phenomenal success and are likely to remain so in 2013. In 2012 we had a smartphone share of above 90% of total handset sales, resulting in rapid smartphone penetration growth. We expect wireless services growth to be our main growth driver over the next few years. We intend to maintain our strategic focus on the provision of wireless services to smartphone users who generally generate sustainable, above average ARPU. Our early focus on the wireless data area has already enabled us to successfully monetize data traffic growth. We believe there is significant growth potential in this area in Germany due to increasing smartphone penetration and a marked increase in the demand for newly developed digital media. We intend to leverage our large and growing smartphone customer base to monetize wireless data opportunities, as smartphone users are increasingly accessing the internet and a range of digital media through their devices.

Though generally concentrating on the postpaid market, we recently have seen market momentum especially in prepaid wireless data and believe there is a dynamic growth opportunity in this area. We intend to exploit this opportunity by further driving smartphone penetration and encouraging wireless data usage by continuing to provide attractive and competitive prepaid data offers, services and devices in line with the special needs of prepaid customers.

LTE impact

We believe that we have the right assets to participate in the future growth of the wireless data business. After having acquired additional spectrum, particularly in the 800 MHz band, we have started to build a next-generation network based on the new LTE technology. This investment will open the door to further opportunities in the data sector.

We see 2013 and 2014 as key years for our LTE rollout. We initially approached the German LTE market with a smart follower strategy, which allowed us to adjust investments to overall market development. As white spots have been covered, our aim is to focus the rollout of our LTE network in the most profitable areas. In 2013 we will also be able to employ much more targeted advertising/branding in terms of customers who are already educated about LTE and we will be able to focus on product marketing, distribution and selling.

In 2013 we will further accelerate the rollout of our LTE network and significantly increase the population coverage. We will continue to expand our LTE network in accordance with market demand, focusing on providing service in major cities, and have proven our ability to do so in the past. Our LTE strategy will also lead to CapEx savings in the mid-term as traffic can be offloaded from UMTS to LTE with increased LTE usage.

The highly improved user experience provided by LTE technology through maximum download speeds of up to 50 Mbit/s on the go, improved latency leading to short reaction times and fluent surfing as well as better indoor coverage through 800 MHz frequency gives us the opportunity to target quality oriented high value customers. With LTE becoming mass market in terms of demand and affordable devices in 2013 (expected 5.1 million registered LTE lines and 3.4 million LTE smartphones in use in Germany 2013) resulting in high commercial impact, we are positioning LTE within our premium O_2 tariffs at a higher than average price point to fully leverage the resulting benefits.

(Source: Yankee Group Research Global ConnectedView Forecast December 2012)

Network cooperation

In 2011 we signed an attractive backhaul sharing agreement with Deutsche Telekom GmbH. However, the agreement terms do not prevent us from reaching further network cooperation agreements. We are constantly exploring strategic cooperation scenarios, including in the field of network sharing. Even in case of a more comprehensive network sharing agreement in the access network, we will still be able to secure our competitive advantage by having exclusive access to the acquired LTE 800 MHz spectrum.

High-speed wireline offering – VDSL

Regulation enables competitors to access Deutsche Telekom GmbH's super-fast VDSL network. In recent years there has been a significant investment in VDSL network infrastructure, primarily by Deutsche Telekom GmbH, with its network coverage reaching 11 million households in 48 cities across Germany. In late 2012 we signed a long-term partnership with Deutsche Telekom GmbH, enabling us to utilize the VDSL contingent model and have a highly competitive high-speed wireline offering in addition to our successful wireless offer.

Demand for converged products

We anticipate customer demand for converged product offerings, and we therefore plan to continue to attract customers by maximizing the potential of bundled offerings. We believe that our convergence strategy will allow us to protect our growth in wireless services, increase the profitability of our wireline services and reduce churn.

Next generation sales and services

We intend to offer a truly simple, reliable and personalized customer experience across all touch points and channels. This will be realized by leveraging our customer insights more efficiently offering customers the products and services that suit their needs and allow them to seamlessly switch channels. Additionally, we will bring more service to our shops and sell more via our customer service channel, allowing us to use all existing touch points to generate additional revenue.

We are extending our online and eCare capacities in order to enable our customers to easily answer their questions and problems online on their own through various channels such as our web portal, mobile portal, help and support community, self-service and social media. To achieve this, we are strengthening our digital services within our retention, telesales and customer services teams and also increasing online facilities at our point of sales. Furthermore, we foster an internal mindset change towards a fundamental digital behavior. In order to support this we have developed a new multi-channel customer journey as a strategic guideline for interacting with our customers. This will not only lead to higher customer satisfaction but also minimize customer service costs.

Corporate segments and wholesale markets

We intend to raise customers' perception of our core O_2 brand as a business brand. Opportunities to gain market share among larger business customers include providing managed services, which we see as a key growth driver in the German telecommunications market. Such managed services include WAN and LAN and PBX management. We also intend to expand our product offerings to business customers to include selective cloud, security and IT consulting services. Through specialized and tailored service offerings to wholesale partners, we aim to increase revenues and improve margins. We offer an extensive portfolio of wireless and wireline services to our wholesale partners to enable them to service their end customers, which allows us to increase our reach and leverage scale.

Cloud-based business solution: Office Voice Cloud

In October 2012 Telefónica Germany GmbH & Co. OHG and nfon AG, a leading vendor of IP-Centrex telecommunication systems jointly launched the "Office Voice Cloud" for Telefónica Deutschland Group's business customers. This integrated and future-oriented solution enhances all business communications by perfectly combining wireline telephony with wireless communication. The offering consists of a cloud-based telephone system provided by nfon AG with integrated O_2 wireless service via a VPN-linkage. This enables users to access the cloud-based telephone system's features on the go via their mobile phone and employees are available on their office phone number during their international business travels. With this cooperative approach we aim to increase sales of our O_2 branded business wireless contracts and to position ourselves as a provider of converged cloud based business solutions in a dynamic growth market.

Digital innovation

In order to leverage our strong position in the German wireless services market and monetize additional growth opportunities, we either recently have launched or intend to launch several digital innovations in a variety of business areas such as communication (e.g. Joyn), financial services (e.g. mpass) and M2M (e.g. fleet management). These innovations have been or are primarily developed together with the Telefónica Digital division or by one of the many sponsored start-up companies at our Wayra academies. Telefónica Digital is a global business division of Telefónica Group. Its mission is to seize the opportunities within the digital world and deliver new growth for Telefónica Group.

Joyn

As a communications company, we want our customers to enjoy the latest communication products with no compromise on reliability, security and trust. Joyn – based on RCS (Rich Communication Services) technology – is a major play by the operator community to compete more effectively with the OTT players. It enables services such as enhanced messaging and voice, video calling and content sharing directly from the phone's contact book, regardless of the network or device used. Offering new features that will enrich and simplify our customers' lives, Joyn is the evolution of core Telco services. As a global initiative under the GSM Association, we will benefit from this newly created Telco ecosystem. The seamless integration within our core services and products gives us a competitive advantage compared to existing OTT services.

mpass

The German market will see an increased importance of mobile payment via smartphone (expected EUR 2bn transaction value through remote or proximity mobile payments in 2013). People will use their smartphones for mobile payment more and more as this gives them a safe and convenient way to make day-to-day payments.

With mpass, Telefónica Deutschland Group is the first German network provider to offer mobile payment in retail. Since October 2012 mpass-customers have been able to pay contactless via mobile phone in thousands of stores in Germany and abroad. A multi-level security system makes mpass safe and convenient. As more and more people own smartphones and shops install the infrastructure, mobile payment will become a huge trend in 2013. And mpass is just the first step: With "O_2 Wallet", which starts mid-February, we are offering a whole bundle of wireless financial services including person-to-person payments and a digital wallet.

(Source: Yankee Group Research Global ConnectedView Forecast December 2012)

M2M

The M2M market will see a positive trend (expected EUR 133m M2M revenue in Germany). Connectivity is becoming more and more a mere enabler and customer expectations are growing. To satisfy these expectations we have set up an end-to-end business model in close collaboration with Telefónica Digital, which has been very well received by our customers. Our M2M activities focus on a variety of different business segments such as vending machines/ point of sale, automation, mobility, energy and healthcare.

We have developed a customized time-tracking terminal geared to the needs of a leading personnel service provider, resulting in significant potential savings. At the moment we are preparing the international rollout. Furthermore, we are in the final development stage of a fleet management solution for one of the world's leading car rental service providers in close collaboration with M2M suppliers. To position ourselves in the very promising energy market, we established a competence center within our M2M unit that already develops and markets energy efficiency solutions for companies in collaboration with market-leading partners. The same holds true for the vertical markets automation and mobility.

(Source: Yankee Group Research Global ConnectedView Forecast December 2012)

With pay how you drive insurance telematics solutions Telefónica Deutschland Group is providing an end-to-end solution to car insurers, which enables them to offer a usage based insurance. Developed by Telefónica Digital, our telematics-based solutions to collect and analyze individual driving behavior open up a whole new range of possibilities for insurers to acquire new customers and improve customer engagement. With a volume of EUR 20.9bn in 2011, the car insurance market in Germany is currently undergoing a significant change triggered by technical developments such as telematics as well as by legal requirements such as the E-Call initiative. Telefónica Deutschland Group will enter this market in 2013 as part of its overarching M2M strategy for Germany.

(Source: ARS Marktreport 2012)

Wayra

Wayra is a Telefónica Digital initiative whose main aim is to identify talent and promote innovation in Latin America and Europe by supporting and accelerating digital business ideas from concept to reality. Its global project acceleration model helps to develop entrepreneurs, providing them with technological tools, qualified mentors, a cutting edge working space and the financing required to accelerate their growth.

With our direct investment in "early stage" companies in 2012, Telefónica Deutschland Group has once again proven its commitment to taking the first step in the area of venture capital. In a little over a year, Wayra has received more than 16,000 business proposals (nearly one per hour since Wayra launched operations) that feature the internet and technology as a driving force.

The Wayra portfolio of 178 sponsored companies covers fast-paced and high potential industries such as cloud computing, machine-to-machine, video or e-Learning, just to name a few. However, it also extends to emerging and disruptive sectors such as wearable technology, security and artificial intelligence.

In 2012, Telefónica Deutschland Group introduced its start-up-accelerator Wayra in Germany. During the six-week application period, 268 teams submitted their proposals. Seven start-ups were selected, who then moved into the new Munich Academy in fall. These innovative companies receive an investment of up to kEUR 50 in the form of a convertible note, have access to a large network of high-caliber mentors and experts both from within Telefónica Deutschland Group and the German entrepreneurial community and over 1000 square meters of creative co-working space in the heart of Munich's Kaufingerstrasse.

The launch of Wayra around the globe has generated a great deal of attention and interest, not only exposing Telefónica Deutschland Group to a great variety of new technologies, but also potentially opening up a world of 300 million customers to Wayra start-ups from Munich and around the world.

As reflected during the last Global demoDay held in the United States, nearly 90% of the start-ups have been launched or are in a beta phase, seven out of ten are already selling to customers and nearly one-third are already partnering with different Telefónica Group companies around the world.

Digital signage

In 2013, Telefónica Deutschland Group plans to introduce an out-of-the-box Digital Signage service addressing the yet untapped market segment of small retailers and small businesses. Overall we see a market potential of about 1 million businesses in this sector.

The innovative subscription-based offering will allow small businesses to create and display promotions and general information about their products and services in a professional fashion right at the point of sale. At the core of the service is a cloud-based easy-to-use content management system that does not require customers to have any previous or in-depth software experience. The offering will be complemented by a range of connected screens of various sizes, professional pre-configured content and optional content service packages.

Distribution of the service is planned through existing Telefónica Deutschland Group's sales channels and third-party aggregators.

6. Events after the reporting period

Rating

On January 16, 2013 the international rating agency FitchRatings, London assigned Telefónica Deutschland Holding AG an initial first long-term issuer default rating (IDR) of "BBB" with a stable outlook and a senior unsecured rating to Telefónica Germany GmbH & Co. OHG of "BBB".

7. Basics of compensation system

Compensation of management board members

Admission to trading on the Frankfurt Stock Exchange was granted to Telefónica Deutschland Holding AG on October 29, 2012 and the trading in the shares commenced on October 30, 2012. According to a shareholders' resolution adopted on October 5, 2012 and based on section 314 (2) sentence 2 and section 286 (5) German Commercial Code (HGB), Telefónica Deutschland Holding AG does not disclose the additional information for listed stock corporations in accordance with section 285 no. 9 lit. a) s. 5-8 German Commercial Code (HGB). In this chapter the basics of the compensation system of the Management Board is described except this restriction.

The aggregate compensation pursuant to section 285 no. 9 lit. a) German Commercial Code (HGB) which was granted to the management of Telefónica Germany Verwaltungs GmbH (which was converted into Telefónica Deutschland Holding AG by shareholders' resolution dated September 18, 2012 and registration ("Eintragung") with the Commercial Register on September 26, 2012) and respectively to the management board of Telefónica Deutschland Holding AG, for the year ended December 31, 2012, amounted to kEUR 882 and to kEUR 0 for the year ended December 31, 2011, respectively.

Furthermore, commitments for stock options in the Telefónica S.A., Madrid, Spain were granted to the Management Board in the financial year. The total commitments granted to the Management Board amounted to kEUR 547 consisting of 56,638 stock options and respective fair value of EUR 9.6531.

Total compensation to the management board consists of fixed salary, cash bonus, long-term incentives, company car, life and accident insurance, pension supplements and monetary benefit of i. a. disturbance and accommodation allowances, compensation of costs of UK national insurance, relocation, home leave flights, school fees and employer expenses, tax equilization and exchange rate loss. Such benefits are not granted to each member of the management board.

The compensation of the members of the management board consists of a fixed portion and a variable portion.

The fixed portion consists of the fixed annual salary, which is paid in twelve equal monthly installments, and monetary benefits mentioned above. The members of the management board receive either a pension allowance equal to 20% of the fixed component of his or her remuneration or a pension commitment.

Since November 1, 2012, the variable portion of the compensation consists of three variable, performance-based components.

1. The first variable component of the compensation is an annual cash bonus ("Bonus I"). Bonus I is calculated according to the formula target bonus x business performance x personal performance. The target bonus is determined as a percentage of the fixed annual salary.

For the company or business performance in general six parameters (operating revenue, OIBDA, Operating Cash Flow, market share, customer satisfaction and employee satisfaction) are determinative, for which the targets and weighting are set annually by the supervisory board. For the business performance factor the respective result of the telecommunications segment* of Telefónica Deutschland Group for the relevant parameter is weighted at 70%. The remaining 30% are divided equally between the respective results of Telefónica Europe and Telefónica Group. If less than 50% of the respective goals are reached the value for the factor business performance is 0% (knock-out). In the event of target attainment it amounts to 100% and if the target is exceeded there is a cap at 125%. Intermediate values of the target achievement are not interpolated linearly but rather on the basis of a pay-out curve set by the supervisory board.

To determine the personal performance for each member of the management board personal goals are set by the supervisory board annually at the beginning of the year. After the end of the year the target attainment is reviewed and the supervisory board ranks the members of the management board in one of five performer classes to which respectively ranges of target achievement percentages are allocated and it assigns a certain percentage value to each member of the management board. Here the knock-out threshold is also 50%. The personal performance is capped at 150%.

2. The second variable component of the compensation is the participation in the Performance and Investment Plan 2011, which was adopted by the general meeting of Teleónica S.A. in 2011 ("PIP").

Under the PIP a certain number of Performance Shares is offered as award to each member of the management board with the consent of the supervisory board. The number of Performance Shares is calculated by dividing an amount equivalent to a percentage of the fixed annual salary of the respective board member by the average share price of Telefónica S.A. ("Core Award"). After three years the Performance Shares give rise to the entitlement to acquire (free of charge) the corresponding number of shares of Telefónica S.A., if the individual remains employed by a Telefónica S.A. Group company at the end of such period and the change in share price of Telefónica S.A.'s shares over the vesting period aggregated with dividends paid on such shares during such period (the "Total Shareholder Return S.A.") is at least equal to the median total share return reflected in a benchmark index of global telecommunications companies. 30% of the awarded shares will vest if the Total Shareholder Return S.A. equals the median performance of such companies. The amount of vested shares equals 100% if the Total Shareholder Return S.A. is in the upper quartile of the benchmark index. If the Total Shareholder Return S.A. is between the upper quartile and median, the awarded shares are calculated on a linearly proportionate basis. If the Total Shareholder Return S.A. is below the median of the benchmark index, the awarded shares do not vest and will lapse.

In addition to this Core Award there is an Enhanced Award which requires members of the management board to acquire a certain number of shares of Telefónica S.A. at his or her own expense. The own investment is limited to 25% of the Performance Shares offered as Core Award. If the targets relating to the Total Shareholder Return S.A. are reached, the member of the management board receives shares of Telefónica S.A. corresponding to 30% rsp. 100% of the shares acquired with own funds. The number of such granted shares is 25% of the Core Award.

3. The third variable component is a deferred cash bonus ("Bonus II"). In order to avoid an excessive incentive through the PIP and thus too strong incentives to pursue corporate group targets, the Bonus II exists. Here an amount equalizing to a percentage of the fixed annual salary is offered as an award to each member of the management board. The board member is entitled to this amount in full after a period of three years if the Total Shareholder Return ("TSR") of Telefónica Deutschland Holding AG is in the upper quartile of the TSR of the peer group composed of the DAX 30 companies and in the amount of 50% of the award if the TSR of Telefónica Deutschland Holding AG is at the median of the peer group. If the TSR of Telefónica Deutschland Holding AG is between the upper quartile and median, the Bonus II is calculated on a linear proportionate basis. If Telefónica Deutschland Holding AG is below the median, no entitlement to payment arises.

From September 18, 2012 until October 31, 2012 the variable portion was based on two variable, performance-based components.

1. The first variable component was a cash bonus. It was construed and calculated in the same manner as the Bonus I.

2. The second variable component was the participation in the PIP 2011 (tranche 2012), however, the amounts of the Core Award and the Enhanced Award were higher. In order to comply with section 87 (1) German Stock Corporation Act after the listing of Telefónica Deutschland Holding AG those Awards were reduced by approximately 50% and the Bonus II was added to the compensation system as second long term incentive.

Until September 17, 2012 the variable portion of the remuneration was composed of a cash bonus, construed and calculated in the same manner as the Bonus I and the participation in various share and investment plans.

1. Performance Share Plan 2006 of Telefónica S.A. (tranche 2009), pursuant to which shares in Telefónica S.A. were awarded to

* The telecommunications segment represents the continuing operations of Telefónica Deutschland Group.

members of the management board in 2009 depending on the achievement of certain targets, and subject to a three year vesting period ended in 2012. Conditions for vesting include: the individual remains employed by a Telefónica S.A. Group company at the end of such period; and the change in share price of Telefónica S.A.'s shares over the vesting period aggregated with dividends paid on such shares during such period (the "Total Shareholder Return S.A.") is at least equal to the median total share return reflected in a benchmark index of global telecommunications companies. 30% of the awarded shares will vest if the Total Shareholder Return S.A. equals the median performance of such companies. The amount of vested shares increases on a sliding scale, up to 100% if the Total Shareholder Return S.A. is in the upper quartile of the benchmark index. If the Total Shareholder Return S.A. is between the upper quartile and median, the awarded shares are calculated on a linear proportionate basis. If the Total Shareholder Return S.A. is below the median of the benchmark index, the awarded shares do not vest and will lapse.

2. Performance Share Plan 2006 of Telefónica S.A. (tranche 2010), pursuant to which shares in Telefónica S.A. were awarded to members of the management board in 2010 depending on the achievement of certain targets and subject to a three year vesting period ending in 2013. The award and vesting criteria are the same as the Performance Share Plan 2006.

3. Performance and Investment Plan 2011 (tranche 2011), pursuant to which shares in Telefónica S.A. were granted to members of the management board in 2011 depending on the achievement of certain targets and subject to a three year vesting period ending in 2014. The award and vesting criteria are the same as the Performance Share Plan 2006, subject to an optional co-investment right. This option allows a member of the management board to receive an additional award in the amount of 25% of the awarded shares, if such member holds a number of shares in his or her account at the end of the vesting period equal to 25% of the awarded shares.

4. Performance and Investment Plan 2011 (tranche 2012), pursuant to which shares in Telefónica S.A. were granted to members of the management board in 2012 depending on the achievement of certain targets, and subject to a three year vesting period ending in 2015. The award and vesting criteria are the same as the Performance Share Plan 2006, subject to an optional co-investment right. This option allows a member of the management board to receive an additional award in the amount of 25% of the awarded shares, if such member holds a number of shares in his or her account at the end of the vesting period equal to 25% of the awarded shares.

5. A Global Employee Share plan of Telefónica S.A. from 2010, pursuant to which the members of the management board, will, if they purchase shares in Telefónica S.A. with a minimum value of EUR 300 and a maximum value of EUR 1,200 in the first year, receive a matching number of shares as a benefit, if they hold these shares for one more year and if the individual remains employed by a Telefónica Group company at the end of the plan. Matching shares had been released in 2012.

6. A Global Employee Share plan of Telefónica S.A. from 2012, pursuant to which all employees, also the members of the management board, will, if they purchase shares in Telefónica S.A. with a minimum value of EUR 300 and a maximum value of EUR 1,200 in the first year, receive a matching number of shares as a benefit if they hold these shares for one more year and if the individual remains employed by a Telefónica Group company at the end of the plan. Matching shares will be released in 2014.

The members of the management board receive either a pension allowance equal to 20% of the fixed component of his or her remuneration or a pension commitment.

Compensation of supervisory board members

Pursuant to the articles of association, the members of the supervisory board receive a fixed compensation payable after the end of the fiscal year in the amount of EUR 20,000 per annum. The chairperson of the supervisory board will receive EUR 80,000 and the deputy chairperson EUR 40,000. The chairperson of the audit committee will additionally receive EUR 50,000 unless the chairperson of the supervisory board or his deputy chair this committee. Members of the supervisory board who hold their office in the supervisory board or who hold the office as chairperson or chairperson of a committee only during a part of the fiscal year will receive a corresponding portion of the compensation to be determined pro rata temporis.

In addition to the compensation the company will reimburse the members of the supervisory board for their out-of-pocket expenses incurred in the performance of their duties as supervisory board members as well as the value-added tax on their compensation and out-of-pocket expenses, if applicable.

All current members of the supervisory board also working for Telefónica S.A. or Telefónica Europe plc. waived for their compensation of their current term of office to the extent that such claims exceed an amount of kEUR 2 per year. The two former members of the supervisory board who held office as members of the supervisory board only for a short period of time received a remuneration pro rata temporis, together in the amount of kEUR 2. The independent financial expert within the meaning of section 100 (5) of the German Stock Corporation Act (AktG) received an amount of kEUR 17 for his pro-rata activity since October 5, 2012. No remuneration was paid for services provided personally beyond the aforementioned board and committee activities, in particular for advisory or agency services.

8. Internal control and risk management system related to the process of accounting

The risk management and internal control system related to Telefónica Deutschland Group and Telefónica Deutschland Holding AG accounting is an integral element of the overall risk management process and reports and tasks intermesh with it extensively.

Under the given corporate governance the accounting related internal control system ("ICS") of Telefónica Deutschland Group is designed in a way to meet both the provisions of statutory requirements such as section 107 (3) sentence 2 of the German Stock Corporation Act (AktG) and section 243 (1) of the German Commercial Code (HGB) to ensure appropriate accounting. The accounting related ICS aims to ensure that the Consolidated Financial Statements of Telefónica Deutschland Group are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), as well as the regulations under the commercial law as set forth in section 315a (1) of the HGB. Furthermore, the preparation of annual financial statements of Telefónica Deutschland Holding AG in accordance with German GAAP is another objective of our accounting related ICS. Acknowledging the obligations of its majority shareholder under the Sarbanes-Oxley Act (SOX), released in the U.S. in 2002 deriving from the listing with the "U.S. Securities and Exchange Commission" (SEC) also affecting subsidiaries, Telefónica Deutschland Group is ensuring compliance with SOX requirements.

The audit committee of Telefónica Deutschland Holding AG supervises the effectiveness of the Internal Control System as required by section 107 (3) sentence 2 of the AktG leaving the definition of precise scope and structure to the discretion of the management board.

The internal audit department is assigned the responsibility of performing independent reviews on the effectiveness and efficiency of the ICS within all subsidiaries. In order to fulfill its tasks, Internal Audit is granted unlimited audit, information and access rights. At least twice a year an opinion on the effectiveness of the SOX-relevant controls, covering currently among others some 95% of our total revenue and expenses, is reported to the CEO and CFO of Telefónica Deutschland.

The internal control system embraces both the complete set of processes relevant for the accounting process as well as those supporting the IT systems. With regard to the IT systems, especially IT security, change management and operations are controlled. The main pillars of the control systems are the employment of sufficient qualified and continuously trained professionals, strict observance of a four-eyes-principle wherever necessary and a clear segregation of duties to meet the objectives of the ICS such as ensuring the correctness and completeness of the individual and Consolidated Financial Statement.

The accounting process follows a set of accounting principles and is communicated to all relevant entities and departments, ensuring a group-wide homogeneous approach. All subsidiary accounting is further handled either by or in close cooperation with Telefónica Germany GmbH & Co. OHG. In order to ensure the identification of risks at an early stage, financial reporting occurs on a monthly basis. Under the SOX (section 302) activity additionally a quarterly reporting of financial indicators is compiled, making transparent and assessing the reasons for major changes in the most relevant accounts.

Identified failures, weaknesses or improvement possibilities are addressed to the respective owner with action plans that are the object for follow-up activities by Internal Audit in order to further enhance the effectiveness and efficiency of the ICS.

9. Other declarations

9.1. Report on relations with affiliated companies

Telefónica Deutschland Holding AG was a directly dependent company in the sense of section 312 of the German Stock Corporation Act of Telefónica Germany Holdings Limited, Slough, United Kingdom, during the period from September 26 to December 31, 2012. Furthermore, Telefónica Deutschland Holding AG was an indirectly dependent company in the sense of section 312 of the German Stock Corporation Act (AktG) of O2 (Europe) Limited, Slough, United Kingdom and of Telefónica S.A., Madrid, Spain. Neither a domination agreement nor a profit and loss pooling agreement is in place.

Therefore, the management board of Telefónica Deutschland Holding AG drew up a report on its relations to related parties in accordance with section 312 (1) of the AktG. This report contains the following final conclusion:

"Our company has, with respect to the legal transactions and measures reported in the report on related party transactions, according to the circumstances known to us at the time of entering into the legal transaction or undertaking or refraining from a measure, received an adequate compensation in all legal transactions and has not been disadvantaged by undertaking or refraining from such measures."

9.2. Management Declaration in accordance with section 289a of the HGB

The company has published this declaration which also comprises the Declaration of Compliance under section 161 of the AktG on its website (www.telefonica.de). This Management Declaration in accordance with section 289a of the HGB shall form part of this management report.

9.3. Takeover-related disclosures pursuant to section 289 (4) of the HGB

Composition of subscribed capital

The registered share capital of Telefónica Deutschland Holding AG totals EUR 1,116,945,400. It is divided into 1,116,945,400 registered shares with no-par value, each representing a notional amount of EUR 1.00 of the registered share capital ("shares"). The registered share capital is fully paid in. As of December 31, 2012 and when compiling this management report Telefónica Deutschland Holding AG did not hold any treasury shares. Pursuant to section 6 (2) of the articles of association, shareholders' claims to the issuance of individual share certificates are in principle excluded. Each share confers one vote at the general shareholders' meeting. The shares are freely transferable.

Restriction on voting rights or transfer of shares

There are no restrictions on voting rights. We are not aware of any contractual agreements with Telefónica Deutschland Holding AG or other agreements restricting voting rights or the transfer of shares. Apart from the statutory law on insider-related issues, there are no internal governance provisions implementing further lock-up periods for management board members or employees with regard to the purchase and sale of shares linked to the publication of quarterly and annual results.

Restrictions on voting rights pursuant, inter alia, to section 136 of the German Stock Corporation Act may exist.

Shareholdings in share capital exceeding 10% of voting rights

Telefónica Germany Holdings Limited, Slough, United Kingdom, holds more than 75% of the shares in Telefónica Deutschland Holding AG; thereby Telefónica Germany Holdings Limited holds more than 75% of the voting rights. Via Telefónica Germany Holdings Limited both O2 (Europe) Limited, Slough, United Kingdom, and Telefónica S.A., Madrid, Spain, hold indirectly more than 75% of shares in Telefónica Deutschland Holding AG. Beyond that we have not been notified of, and are not aware of, any shareholdings in the share capital of Telefónica Deutschland Holding AG exceeding 10% of the voting rights.

Shares with special rights

There are no shares bearing special rights. In particular there are no shares with rights conferring powers of control.

Voting right control if employees have a share in the capital

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

Management board members' appointment and dismissal

Pursuant to section 7 of the articles of association and section 84 of the AktG the supervisory board is responsible for determining the number of management board members, for their appointment and dismissal as well as for the appointment of the chief executive officer (CEO). Deputy members of the management board may be appointed. Currently the management board of Telefónica Deutschland Holding AG comprises the CEO as well as two further members. Management board members are appointed by the supervisory board for a maximum period of five years. Such appointment may be renewed and the terms of office may be extended, provided that no term exceeds five years. The supervisory board may revoke the appointment of an individual member of the management board or CEO for good cause, such as gross negligence of duties or a vote of no-confidence by shareholders at the general meeting.

Telefónica Deutschland Holding AG is subject to the regulations of the German Co-Determination Act (Mitbestimmungsgesetz – MitbestG). The election of employees' representatives to the supervisory board has not yet taken place, which is why the supervisory board of Telefónica Deutschland Holding AG at present is made up of only six members elected at the general shareholders' meeting. Pursuant to section 31 of the MitbestG, the appointment of management board members and also their dismissal require a majority of at least two-thirds of the supervisory board members. If such majority is not established in the first vote by the supervisory board, upon proposal of the mediation committee, which has to be established according to section 27 (3) of the MitbestG, the appointment or dismissal may be made in a vote with a simple majority of the votes cast by the supervisory board members. Should the required majority not be established in this case either, a third vote, again requiring a simple majority, must be held in which, however, the chair of the supervisory board has two votes.

Furthermore, the local court in Munich shall in accordance with section 85 (1) of the AktG in urgent cases make the necessary appointment upon application by any party involved, if the management board does not have the required number of members.

Amendments to the articles of association

Pursuant to section 179 (1) sentence 1 of the AktG the articles of association of Telefónica Deutschland Holding AG may in principal only be amended by a resolution passed at the general shareholders' meeting. Pursuant to section 27 of the articles of association in conjunction with section 179 (2) sentence 2 of the AktG the general meeting of Telefónica Deutschland in principle resolves upon amendments to the articles of association with a simple majority of votes cast and with a simple majority of the nominal capital represented when passing the resolution. If mandatory legal provisions stipulate a larger majority of voting rights or capital, such provisions shall apply. When it comes to amendments solely relating to the wording, the supervisory board is, however, authorized to make these modifications in accordance with section 179 (1) sentence 2 of the AktG in conjunction with section 17 (3) of the articles of association.

Authorization of the management board to issue shares

The authorizations of the management board are regulated by section 76 et seq. of the AktG in conjunction with section 8 et seq. of the articles of association. In particular, the management board is responsible for managing the company and for representing the company judicially and extra-judicially.

The authorization of the management board to issue shares is regulated by section 4 of the articles of association and by statutory provisions:

Authorized Capital

Until September 17, 2017 and subject to the approval of the supervisory board, the management board is authorized to increase the registered share capital of the company on one or more occasions by a total amount of up to EUR 558,472,700, by issuing up to 558,472,700 new non-par value registered shares against contribution in cash and/or in kind (Authorized Capital 2012/I). The authorization provides that the subscription right of the shareholders, however, may be excluded in total or in part in certain situations (section 4 (3) of the articles of association).

Contingent Capital

By resolution at the general meeting of October 5, 2012 the management board has been authorized until October 4, 2017 and subject to the approval of the supervisory board to, on one or more occasions, issue convertible bonds, warrant bonds, profit participation rights and/or participating bonds (and/or combinations of such instruments) (together "bonds") in bearer and/or registered form with or without limited maturity in an aggregate nominal value of up to EUR 1,500,000,000 and to grant and/or impose on the holders or creditors of bonds conversion or option rights to shares in the company representing a total notional amount in the share capital of up to EUR 558,472,700 (in words: five hundred fifty-eight million four hundred and seventy-two thousand and seven hundred Euro), subject to the more detailed terms and conditions of issue of such bonds. Shareholders shall in principle be granted a right to subscribe for the bonds. The authorization provides that subject to the approval of the supervisory board, the subscription right of the shareholders can, however, be excluded
a) for fractional amounts; furthermore
b) provided that the issue price is not substantially lower than the market value of the bonds with conversion and/or option rights or option obligation and the shares issued or to be issued in order to satisfy the conversion and option rights or conversion obligation do not exceed in total 10% of the share capital;
c) to the extent profit participation rights or participating bonds are issued without conversion rights or obligations or an option right, provided the interest rate and the issue price of the profit participation rights or participating bonds correspond at the date of issue to current market values; and
d) to the extent the bonds are issued in written form contributions in kind for the purpose of directly or indirectly acquiring companies, parts of companies, participations in companies or other assets and the value of the contribution in kind is reasonably proportionate to the value of the bonds.

For the purpose of granting non-par value shares in registered form to holders or creditors of bonds the share capital of the company is increased conditionally by up to EUR 558,472,700 by issuing up to 558,472,700 new non-par value shares in registered form ("Contingent Capital 2012/I")

Authorization of the management board to repurchase shares

The authorizations of the management board to repurchase own shares are governed by section 57 (1) sentence 2 and section 71 et seq. of the AktG. An authorization of the management board by the shareholders at the general shareholder's meeting according to section 71 (1) no. 8 of the AktG to repurchase own shares does not exist.

Change of control/Compensation agreements

Material agreements entered into by Telefónica Deutschland Holding AG containing a change-of-control clause relate to financing. In the case of a change of control, these agreements, in accordance with common practice, entitle the parties to terminate the agreement followed by the settlement of outstanding obligations.

The employment contracts of the members of the management board grant the right to terminate with three-month notice their respective employment contracts with Telefónica Deutschland Holding AG in the event of a takeover offer by a third party, provided however that such termination is declared within six months after a change of control. In such case the respective board member is entitled to a one-time compensation of an annual salary plus the recently received bonus; however, no more than the compensation payable up to the end of the contract.

10. Outlook for Telefónica Deutschland Holding AG

As Telefónica Deutschland Holding AG acts as a management and holding company, the company's future performance decisively depends on the development of the operating companies of the Telefónica Deutschland Group, especially of the performance of the Telefónica Deutschland GmbH & Co. OHG. Therefore, the development of the economic and market as well as the expected development of key performance indicators at Telefónica Deutschland Group level is described below. In the view of existing contracts relating to the compensation of management services, we expect also to cover arising expenses incurred in future operational business.

10.1. Economic outlook for Germany

Germany's economy is expected to continue to grow in 2013 (GDP growth of around 0.7% in 2013). According to Germany's GfK research company, income expectations, willingness to buy and consumer climate for 2013 remain at a constant high level. Stable labor market data, a positive overall trend in wages and salaries and modest inflation reinforce the indications. Furthermore, the interest rate in Germany is still well below the level of inflation, which means that consumers think it is prudent to spend their money on major purchases rather than saving.

(Source: Federal Statistical Office, FocusEconomics Consensus Forecast Euro Area, February 2013; GfK Consumer climate press release, January 2013)

10.2. Market expectations

Market development in Germany, one of Europe's largest telecommunications markets, will continue to be driven by wireless business, strongly benefitting from wireless data due to increased adoption of wireless data devices such as smartphones and tablets. This trend will be reinforced in 2013 with the deployment of LTE networks. Mobile voice, which still accounts for the majority of revenues in the wireless market, will be affected by mobile termination rate cuts. Increasing demand for speed in both mobile and fixed networks with strong demand from German consumers for convergent solutions will also be an additional market driver.

(Source: Company data)

10.3. Expectations for Telefónica Deutschland Group

Our strategy will remain focused around gaining scale in the telecommunications market, driven by our innovative multi-brand approach based on data services. We expect the German telecommunication market to remain active and competitive in 2013 and 2014, with significant impacts from mobile termination rate cuts, changing customers' communication behaviors, and the variability of device launches and replacement cycles.

We see the introduction of the LTE technology in mobile networks as one of our drivers for future revenues and performance during 2013 and 2014, with timing of impacts depending on the uptake of new LTE-centric devices in the German market.

As a challenger in the market we are, of course, impacted by the variability of these diverging trends. Thus, our goal for long term success is to maintain a consistent focus on gaining service revenue market share in our core wireless business and achieve further efficiencies of scale.

For the financial years 2013 and 2014, we aim to continue outperforming the German wireless market and increase our wireless service revenue market share. Our wireline business is not expected to be a driver of growth for us within the next two years but will strengthen our wireless business through converged product offerings. Total wireline revenues are expected to decline. As a result, we would expect to see total revenue trends to be more or less stable. The development of revenues will depend on the variability of the above mentioned factors.

In the past periods, we have implemented a series of cost saving measures that, paired with strong revenue performance, has helped us to improve our margins. In the financial years 2013 and 2014, we aim for our OIBDA margin to sustain this trend on the back of scale effects and efficiency improvements, driven by our focus on market share expansion.

In terms of investments, we consider 2013 and 2014 as being key years for our LTE network roll-out. However, we do not expect capital expenditures to exceed the levels reached in 2010 (EUR 680m) when we were rolling out 3G capacity. Thereafter, we expect CapEx to decline to lower levels again. Future investments to be made by the group will be funded by operating cash flow generation of the business. We like to point out that actual results may differ significantly from our expectations due to uncertainties, or if the assumptions underlying the forward-looking information prove to be inappropriate.

We have a clearly stated financing policy to support a strongly funded and stable statement of financial position, aiming to maintain the leverage ratio (defined as Net Financial Debt divided by last twelve month OIBDA excluding non-recurring factors) below 1.0x for the financial years 2013 and 2014.

Munich, February 28, 2013

Telefónica Deutschland Holding AG

The management board

René Schuster | Rachel Empey | Markus Haas

Financial statements

for the financial year ended December 31, 2012

Balance Sheet

Euros

Assets	As of December 31, 2012	2011
A) Fixed assets		
I. Financial Assets		
1. Interests in affiliated companies	5,758,877,283.31	10,375,941,761.17
	5,758,877,283.31	**10,375,941,761.17**
B) Current assets		
I. Receivables and other assets		
1. Receivables from affiliates	5,953,930.80	2,890,109,466.19
– thereof from shareholders EUR 0.00 (prior year: EUR 2,885,896,413.00) –		
2. Other assets	–	25,345.22
	5,953,930.80	2,890,134,811.41
II. Cash on hand and bank balances	3,100,000.00	3,100,000.00
	9,053,930.80	**2,893,234,811.41**
Total	**5,767,931,214.11**	**13,269,176,572.58**

Equity and Liabilities	As of December 31, 2012	2011
A) Equity		
I. Subscribed capital	1,116,945,400.00	1,116,945,300.00
II. Additional paid-in capital	430,095.00	–
III. Revenue reserves	14,083.91	–
1. Legal reserve	14,083.91	–
IV. Net retained earnings	4,648,809,332.27	11,834,438,151.08
	5,766,198,911.18	**12,951,383,451.08**
B) Provisions		
I. Other provisions	1,028,400.00	11,000.00
	1,028,400.00	**11,000.00**
C) Liabilities		
I. Trade accounts payable	306,116.44	–
II. Liabilities to affiliates	32,311.09	317,782,121.50
– thereof to shareholders EUR 0.00 (prior year: EUR 206,090.00) –		
III. Other liabilities	365,475.40	–
– thereof of taxes EUR 365,475.00 (prior year: EUR 0.00) –		
	703,902.93	**317,782,121.50**
Total	**5,767,931,214.11**	**13,269,176,572.58**

Income Statement

Euros

	January - December	
	2012	2011
Revenues	1,675,894.93	–
Other operating income	206,637.32	4,747,454,661.17
Personnel expenses	(931,656.13)	–
a) Salaries	(930,666.81)	–
b) Social security contribution	(989.32)	–
Other operating expenses	(702,891.54)	(26,594.34)
Other interest and similar income	19,997.90	67,061.61
– thereof from affiliated companies EUR 12,139.55 (prior year EUR 38,980.76) –		
Income from ordinary business activities	**267,982.48**	**4,747,495,128.44**
Income taxes	13,695.62	(7,406.31)
Profit for the period	**281,678.10**	**4,747,487,722.13**
Profit / Loss carryforward	11,834,438,151.08	(10,991,589,790.56)
Withdrawals from additional paid-in capital	0.00	18,078,540,219.51
Distribution from net retained earnings	(7,185,896,413.00)	–
Addition to legal reserve	(14,083.91)	–
Net retained earnings	**4,648,809,332.27**	**11,834,438,151.08**

Statement of changes in fixed assets for the period from January 1, 2012 to December 31, 2012

	Historical costs			
	1.1.2012	Additions	Disposals	31.12.2012
Financial assets				
Interests in affiliated companies	10,375,941,761.17	430,195.00	4,617,494,672.86	5,758,877,283.31
	10,375,941,761.17	430,195.00	4,617,494,672.86	5,758,877,283.31

Euros

			Depreciation		Book value
1.1.2012	Additions	Disposals	31.12.2012	31.12.2012	31.12.2011
0.00	0.00	0.00	0.00	5,758,877,283.31	10,375,941,761.17
0.00	0.00	0.00	0.00	5,758,877,283.31	10,375,941,761.17

Notes to the financial statements

for the year ended December 31, 2012

1. General information for the financial statements

The Financial Statements of Telefónica Deutschland Holding AG formerly Telefónica Germany Verwaltungs GmbH, Munich, for the financial year 2012 have been prepared in accordance with the principles of the German Commercial Code (HGB) and the German Stock Corporation Act (AktG). The income statement has been prepared by using the nature of expense method in accordance with section 275 (2) HGB.

As at reporting date Telefónica Deutschland Holding AG complies with the size characteristics of a large corporation in accordance with section 267 (3) sentence 2 HGB.

Limited comparability to the Financial Statements of the previous year

Change of legal form

By resolution dated September 18, 2012 and registration ("Eintragung") with the Commercial Register on September 26, 2012 Telefónica Germany Verwaltungs GmbH located in Georg-Brauchle-Ring 23-25, 80992 Munich has changed its name and legal form into Telefónica Deutschland Holding AG (transformation of legal form).

Capital promise

On March 28, 2003 and April 30, 2004 O2 (Europe) Limited issued a declaration of capital contribution obligation to Telefónica Deutschland Holding AG (formerly Telefónica Germany Verwaltungs GmbH, formerly O2 Germany Verwaltungs GmbH) by which O2 (Europe) Limited is obliged to provide Telefónica Deutschland Holding AG, by way of voluntary shareholder's contribution, with an amount of kEUR 4,650,000 and kEUR 500,000 respectively. These amounts were to be remitted on first demand of Telefónica Deutschland Holding AG and obligations have been unlimited in time. Until December 31, 2011 O2 (Europe) Limited contributed kEUR 2,264,104 of cash in the course of the declaration of obligation.

On September 13, 2012 it was agreed that the capital contribution obligation of O2 (Europe) Limited to Telefónica Deutschland Holding AG will be set off against the obligation from the pre-IPO dividend distribution.

Pre-IPO dividend

By resolution dated September 13, 2012 Telefónica Deutschland Holding AG declared a pre-IPO dividend to O2 (Europe) Limited amounting to kEUR 7,185,896, which has been fulfilled by a cash dividend amounting to kEUR 4,300,000 and the offsetting against the capital promise amounting to kEUR 2,885,896.

Capital increase resolution

With resolution on September 18, 2012, and with entry in the Commercial Register on September 26, 2012, O2 (Europe) Limited has increased the share capital of Telefónica Deutschland Holding AG from EUR 1,116,945,300 by EUR 100 to EUR 1,116,945,400 in return for a contribution in kind. The increase of the share capital was made through the issue of new shares with a total nominal value of EUR 100, which was subscribed by O2 (Europe) Limited. The capital increase in kind was made in full through the contribution of all shares of Telefónica Germany Management GmbH into Telefónica Deutschland Holding AG.

Based on this contribution in kind at book values Telefónica Deutschland Holding AG holds all shares in Telefónica Germany Management GmbH in the amount of kEUR 430 as of December 31, 2012 (prior year: kEUR 0). The surplus of the book value exceeding the nominal value of EUR 100 has been added to the additional paid-in capital.

Reimbursement agreements for management services

Telefónica Deutschland Holding AG has entered into agreements with Telefónica Germany GmbH & Co. OHG, Munich, and Telefónica Germany Management GmbH, Munich. The agreements include the obligation of rendering management services to Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH shall reimburse to Telefónica Deutschland Holding AG an overall flat fee of kEUR 30 per quarter. Furthermore, Telefónica Germany GmbH & Co. OHG will reimburse the costs for the remuneration of the members of the management board as well as further administration costs. The full amount of the reimbursement is included in the revenues of the company.

2. Accounting policies

The accounting policies used in preparing the Financial Statements as of December 31, 2012 are in accordance with sections 242 to 256a and sections 264 to 288 HGB and according to the relevant provisions of the AktG. The accounting policies remained unchanged in relation to prior year.

Financial assets are recognized at historical cost minus necessary impairments to account for lower fair values at the reporting date. If the reasons for impairment do not exist any longer, impairment losses are reversed according to section 253 (5) sentence 1 HGB.

Receivables and other assets are stated at their nominal values. Adequate allowances have been recorded for all risk positions.

Provisions consider all identifiable risks and uncertain liabilities. They have been measured at the amounts considered to be necessary by reasonable business judgement. Discounting according to section 253 (2) of the HGB was not required.

Liabilities are recorded at their settlement values.

Deferred taxes resulting from tax loss carryforwards or temporary and quasi-permanent differences between the commercial law-related valuations of assets, liabilities and deferred income and the tax bases are determined as follows: The amounts of the resulting tax burden or relief are measured considering each company's individual tax rate on the date of the temporary differences' reversal. They are not discounted. Deferred tax liabilities and deferred assets are offset. An overall surplus of deferred tax assets arising after offsetting is not recognized by exercising the corresponding option.

3. Notes to the balance sheet

Financial assets

The interests in affiliated companies refer to the interests in Telefónica Germany GmbH & Co. OHG, Munich, whose personally liable partner is the company, amounting to kEUR 5,758,447 (prior year kEUR 10,375,942) and the interests in Telefónica Germany Management GmbH, Munich, amounting to kEUR 430 (prior year kEUR 0). The reduction in the interests' accounting value is mainly driven by withdrawals from reserves of Telefónica Germany GmbH & Co. OHG amounting to kEUR 4,300,000 and the cancellation of the existing capital promise in the amount of kEUR 317,495. For further details please refer to the attached statement of changes in fixed assets.

Receivables from affiliated companies

Receivables from affiliated companies mainly comprise cash pooling receivables from Telfisa Global B.V., Amsterdam amounting to kEUR 3,256 (prior year from Telefónica Finanzas S.A., Madrid amounting to kEUR 4,213), and receivables concerning management services from Telefónica Germany GmbH & Co. OHG of kEUR 1,959 (prior year kEUR 0) and Telefónica Germany Management GmbH of kEUR 36 (prior year kEUR 0) as well as other receivables from Telefónica Germany Management GmbH amounting to kEUR 703.

Receivables from shareholders amounted to kEUR 2,885,896 (in 2012: kEUR 0) in the previous year and comprised the capital promise as stated in the section “Limited comparability to the financial statements of the previous year”. This receivable was set off against the pre-IPO dividend distribution in September 2012.

All receivables and other assets have less than one year to maturity.

Equity

Subscribed capital

With resolution on September 18, 2012, and with entry in the Commercial Register on September 26, 2012, O2 (Europe) Limited has increased the subscribed capital of Telefónica Deutschland Holding AG from EUR 1,116,945,300 by EUR 100 to EUR 1,116,945,400 in return for a contribution in kind. The increase of the subscribed capital was made through the issue of new shares with a total nominal value of EUR 100, which was subscribed by O2 (Europe) Limited. The capital increase through contribution in kind was made in full through the contribution of all shares of Telefónica Germany Management GmbH into Telefónica Deutschland Holding AG.

The subscribed capital of Telefónica Deutschland Holding AG amounted to kEUR 1,116,945 as of the reporting date. It comprises 1,116,945,400 non-par value shares issued with an imputed interest of EUR 1.00 per share.

Authorized capital

Telefónica Deutschland Holding AG has authorized capital allowing the management board, upon approval by the supervisory board, to increase the subscribed capital against contribution in kind until September 17, 2017 on one or more occasions by a total amount of up to kEUR 558,473 by issuing new non-par value registered shares.

Additional paid-in capital

Additional paid-in capital amounts to kEUR 430 (prior year kEUR 0) and fulfills the requirements according to section 272 (1) No. 1 of the HGB. The additional paid-in capital results from the surplus of the contribution in kind of all shares of Telefónica Germany Management GmbH into Telefónica Deutschland Holding AG in the amount of kEUR 430.

Legal reserve

The legal reserve is based on section 150 (2) AktG and amounts to kEUR 14.

Distribution of profits

On September 13, 2012 the shareholders' meeting of Telefónica Germany Verwaltungs GmbH determined a pre-IPO dividend to O2 (Europe) Limited amounting to kEUR 7,185,896, of which kEUR 4,300,000 have been fulfilled by cash payment and kEUR 2,885,896 have been offset against the capital promise. As a consequence the net retained earnings are reduced from kEUR 11,834,438 as at December 31, 2011 to kEUR 4,648,809 as at December 31, 2012.

Other provisions

Other provisions amounting to kEUR 1.028 (prior year kEUR 11) concern expenses for the compensation of the management board.

Liabilities

Trade payables amount to kEUR 306 (prior year kEUR 0) and comprise IPO related costs.

Liabilities against shareholders are reduced to kEUR 0 (prior year kEUR 206).

Other liabilities amounting to kEUR 365 (prior year kEUR 0) comprise value added taxes and payroll tax.

All liabilities mature in less than one year and are unsecured.

Deferred taxes

Deferred tax assets arising from temporary differences resulting from tax base differences at the level of Telefónica Germany GmbH & Co. OHG. As shareholder of the partnership Telefónica Deutschland Holding AG is the taxable entity for purposes of the corporation income tax (CIT). The deferred (corporation) tax according to HGB is carried out on the difference between carrying amount of the interests and the tax base of the equity of the general partnership (mirror-image method ["Spiegelbildmethode"]). Furthermore, Telefónica Deutschland Holding AG has tax loss carryforwards. The tax rate on the deferred tax assets is 15.83% (corporate income tax and solidarity surcharge). The option to recognize deferred tax assets in accordance with section 274 (1) sentence 2 HGB is not exercised.

4. Notes to the income statement

Revenues

Revenues amount to kEUR 1,676 (prior year kEUR 0) and mainly comprise the management services rendered by Telefónica Deutschland Holding AG to Telefónica Deutschland Group companies amounting to kEUR 1,000, based on the reimbursement agreement for management services, as described in section "I. General information for the financial statements". Revenues also comprise the reimbursed IPO related costs (kEUR 676).

Other operating income

The other operating income amounts to kEUR 207 (prior year kEUR 4,747,455) and mainly comprises the reversal of the liabilities against the shareholder due to a cancellation.

Personnel expenses

Personnel expenses amount to kEUR 932 (prior year kEUR 0) and comprise the compensation of the management board since September 26, 2012.

Other operating expenses

The other operating expenses amount to kEUR 703 (prior year kEUR 27) and mainly comprise IPO related costs (kEUR 685).

Other interest and similar income

The other interest and similar income amount to kEUR 20 (prior year kEUR 67) resulting from the positive cash pooling balance and other bank accounts.

Income taxes

Income taxes of kEUR 14 (prior year kEUR minus 7) mainly comprise a corporate tax refund and relate to ordinary business activities.

Reconciliation to net retained earnings

Thousands of euros	2012	2011
Profit for the year	282	4,747,488
Profit carryforward/ Loss carryforward	11,834,438	(10,991,590)
Withdrawals from additional paid-in capital	–	18,078,540
Distribution from net retained earnings	(7,185,896)	–
Addition to legal reserve	(14)	–
Net retained earnings	4,648,809	11,834,438

5. Other information

Compensation of the management board and supervisory board

The aggregate compensation granted to the members of the management board for the year ended December 31, 2012, amounted to kEUR 822 (prior year kEUR 0).

The aggregate compensation consists of fixed salaries of kEUR 494 (prior year kEUR 0) and cash bonus of kEUR 328 (prior year kEUR 0).

Furthermore, commitments for stock options in the Telefónica S.A., Madrid, Spain were granted to the management board of Telefónica Deutschland Holding AG in the financial year. The total commitments granted to the management board amounted to kEUR 547 consisting of 56.638 stock options and respective fair value of EUR 9.6531.

According to a shareholders' resolution adopted on October 5, 2012, Telefónica Deutschland Holding AG does not disclose the additional disclosures for listed stock corporations in accordance with section 286 (5) sentence 1 and section 285 (9a) sentence 5-8 of the HGB.

Compensation granted to the supervisory board of Telefónica Deutschland Holding AG amounted to kEUR 18.7 (prior year: kEUR 0).

Auditor's remuneration

The information concerning the total auditor's remuneration of Telefónica Deutschland Holding AG, is omitted pursuant to section 285 (17) of the HGB. Telefónica Deutschland Holding AG is part of the consolidation group of Telefónica Deutschland Holding AG ("Telefónica Deutschland Group") and the information is included in the Consolidated Financial Statements as of December 31, 2012.

Average number of employees during the year

In the financial year 2012 the company had no employees as in 2011.

Management board

The members of the management board of Telefónica Deutschland Holding AG (formerly: Telefónica Germany Verwaltungs GmbH) are listed below:

Name	Function
René Schuster	Chief Executive Officer (CEO)
	Chairperson of the Management Board
	Member Telefónica Europe Executive Commitee
	Telefónica Europe Advisory Board
	Telefónica Europe Project Approvals Commitee
	Board member of Telefónica Global Transformation Commitee
Rachel Clare Empey	Chief Financial Officer (CFO)
	Member of the Management Board
Markus Haas	Chief Strategy Officer & General Counsel (CSO)
	Member of the Management Board
Joachim Kugoth	Managing Director Human Resources, Telefónica Germany GmbH & Co. OHG, recalled by resolution dated September 4, 2012
Peter Alec Rampling	Managing Director Marketing, Telefónica Germany GmbH & Co. OHG, recalled by resolution dated September 4, 2012
Michiel Jantje van Eldik	Managing Director Wholesale & Partner, Management, Telefónica Germany GmbH & Co. OHG, recalled by resolution dated September 4, 2012
Dr. Eckart Pech	Managing Director Service Technology (CIO), Telefónica Germany GmbH & Co. OHG, recalled by resolution dated September 4, 2012
John Gerald McGuigan	Managing Director Consumer Sales, Telefónica Germany GmbH & Co. OHG, recalled by resolution dated September 4, 2012
Andrea Fabiana Folgueiras	Managing Director Network Technology, Telefónica Germany GmbH & Co. OHG, recalled by resolution dated September 4, 2012
Carsten Wreth	Chief Executive Officer (CEO), Telefónica Global Services GmbH, recalled by resolution dated September 4, 2012
Johannes Pruchnow	Managing Director Business & Wholesale Service, Telefónica Germany GmbH & Co. OHG, recalled by resolution dated July 10, 2012

Supervisory board

The members of the supervisory board of Telefónica Deutschland Holding AG are listed below:

Name	Function
Eva Castillo Sanz	Chairperson of the Supervisory Board since 5. October 2012
	Telefónica S.A., Member of the Board of directors
	Telefónica Europe plc, Chairperson of the Board of directors
	Telefónica Czech Republic, a.s., Deputy Chairperson of the Supervisory Board
	Bankia S.A., Member of the Board
	Comillas – ICAI Foundation, Member of the Board
María Pilar López Álvarez	Deputy Chairperson of the Supervisory Board since September 18, 2012
	Telefónica Europe plc, Director
	Telefónica Czech Republic, a.s., Member of the Supervisory Board; Deputy Chairperson of the Audit Committee and member of the Nomination and Remuneration Committee
	mmO2 plc, Director
	O2 Holdings Limited, Director
	O2 (Europe) Limited, Director
	Wolseley plc, Non-Executive Director
Angel Vilá Boix	Member of the Supervisory Board since September 18, 2012
	Telefónica S.A., Chief Financial Officer (CFO) and Corporate Development Officer; Responsibility: Finance and Corporate Development
	Telefónica Czech Republic, Member of Supervisory Board
	Telco S.P.A., Deputy Chairperson of the Board
	Telefónica de Contenidos, Chairperson of the Board
	D.T.S. Distribuidora de Televisión Digital, Member of the Board
Patricia Cobián González	Member of the Supervisory Board since September 18, 2012
	Telefónica Czech Republic, Member of the Supervisory Board, Deputy Chairperson of the Nomination and Remuneration Committee
	Telefónica Europe, Director

Name	Function
Enrique Medina Malo	Member of the Supervisory Board since September 18, 2012
	Telefónica Czech Republic, a.s., substitute Member of the Supervisory Board, Member of the Nomination and Remuneration Committee
	Member of the Ethics and Corporate Social Responsibility Committee
	Telefónica Europe plc, Member of the Board, Director
	mmO2 plc, Director
	O2 Holding limited, Director
	O2 (Europe) Limited, Director
	Wayra UK Limited, Director
Michael Hoffmann	Member of the Supervisory Board since October 5, 2012
	Lekkerland AG & Co. KG; Chief Executive Officer (CEO)
Christoph Herbert Günter Steck	Member of the Board from September 18, 2012 until October 5, 2012
	Chief Regulation Office, Telefónica Europe
José María Álvarez-Pallete López [1]	Chairperson of the Supervisory Board from September 18, 2012 until October 5, 2012
	Colombia Telecomunicaciones S.A., ESP, Director
	Telecomunicacoes de Sao Paulo S.A., Director
	Telefónica Chile S.A., Alternate Director
	Telefónica Data Corp S.A.U., Director
	Telefónica de Argentina S.A., Alternate Director
	Telefónica del Peru S.A.A., Director
	Telefónica Internacional S.A.U., Executive Chairperson
	Telefónica Larga Distacia de Puerto Rico Inc., Director
	Telefónica Móviles Colombia S.A., Alternate Director
	Telefónica Móviles México S.A. de C.V., Director / Deputy Chairperson

[1] Corporate Governance Report of Telefónica S.A. as of 31.12.2010

Parent company / Consolidated Financial Statements

The Consolidated Financial Statements of the Telefónica Deutschland Holding AG, Munich, will be published in the electronic version of German Federal Gazette at www.e-bundesanzeiger.de. The Consolidated Financial Statements of the Telefónica Deutschland Holding AG are included in the Consolidated Financial Statements of the Telefónica S.A., Madrid, which is the largest group of companies for which group financial statements are drawn up. These Consolidated Financial Statements are available at the ultimate parent company and published at www.telefonica.com.

List of investments holdings according to section 285 (11) respectively (11a) HGB

Thousands of euros

Name and legal form	Registered office	Share in capital	Equity year end as of 31.12.2011	Profit for the year 2011 (financial year)
Telefónica Germany GmbH & Co. OHG (former: Telefónica O_2 Germany GmbH & Co. OHG) [1]	Munich	100%	7,432,370	(64,135)
Telefónica Germany Management GmbH	Munich	100%	614	123
Telefónica Germany 1. Beteiligunggesellschaft mbH (former: Telefónica Germany Holding GmbH; former: O_2 (Germany) Holding GmbH)	Munich	100%	815,589	30
Telefónica Germany Customer Service GmbH (former: Telefónica Deutschland GmbH)	Munich	100%	589,660	20,238
Telefónica Germany Online Services GmbH	Munich	100%	525	0 [2]
Wayra Deutschland GmbH	Munich	100%	275 [3]	0 [4]
Fonic GmbH	Munich	100%	25	0 [5]
TCHIBO Mobilfunk Beteiligungs GmbH	Hamburg	50%	35	1
TCHIBO Moblifunk GmbH & Co. KG	Hamburg	50%	3,898	106

[1] Personally liable partner is the Telefónica Deutschland Holding AG
[2] after profit and loss transfer agreement
[3] Financial year 2012, preliminary
[4] after profit and loss transfer agreement
[5] after profit and loss transfer agreement

Voting rights notification pursuant to section 26 (1) WpHG in conjunction with section 21 (1a) WpHG:

On November 1, 2012, Telefónica Germany Holdings Limited, Slough, United Kingdom, has notified the company in accordance with section 21 (1a) of the WpHG that its proportion of voting rights in Telefónica Deutschland Holding AG, Germany, amounted to 100% (1,116,945,400 voting rights) on October 29, 2012, the date the shares were initially admitted to trading on the Frankfurt Stock Exchange.

On November 1, 2012, O2 (Europe) Limited, Slough, United Kingdom, has notified the company in accordance with section 21 (1a) of the WpHG that its proportion of voting rights in Telefónica Deutschland Holding AG, Germany, amounted to 100% (1,116,945,400 voting rights) on October 29, 2012, the date the shares were initially admitted to trading on the Frankfurt Stock Exchange. Thereof, 100% (1,116,945,400 voting rights) are attributable to O2 (Europe) Limited pursuant to section 22 (1) sentence 1 No. 1 of the WpHG. Of the following shareholder whose proportion of voting rights in Telefónica Deutschland Holding AG amount to or more 3%, voting rights will be assigned to O2 (Europe) Limited: Telefónica Germany Holdings Limited.

On November 1, 2012, Telefónica S.A., Madrid, Spain, has notified the company in accordance with section 21 (1a) of the WpHG that its proportion of voting rights in Telefónica Deutschland Holding AG, Germany, amounted to 100% (1,116,945,400 voting rights) on October 29, 2012, the date the shares were initially admitted to trading on the Frankfurt Stock Exchange. Thereof, 100% (1,116,945,400 voting rights) are attributable to Telefónica S.A. pursuant to section 22 (1) sentence 1 No. 1 of the WpHG.

Of the following shareholder whose proportion of voting rights in Telefónica Deutschland Holding AG amount to or more 3%, voting rights will be assigned to O2 (Europe) Limited: Telefónica Germany Holdings Limited and O2 (Europe) Limited.

Voting rights notification pursuant to section 26 (1) of the WpHG:

BlackRock, Inc., New York, USA:
On November 13, 2012, BlackRock, Inc., New York, USA has informed the company according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have exceeded the 3% threshold of the voting rights on November 05, 2012 and amounted to 3.77% (this corresponds to 42,154,906 voting rights) on that day. All voting rights in Telefónica Deutschland Holding AG were attributed to BlackRock, Inc. pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.

On December 27, 2012, BlackRock, Inc., New York, USA has informed the company according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have fallen below the 3% threshold of the voting rights on December 20, 2012 and amounted to 2.99753% (this corresponds to 33,480,782 voting rights) on that day. According to section 22 (1) sentence 1 No. 6 in conjunction with sentence 2 of the WpHG, 2.99753% of the voting rights (this corresponds to 33,480,782 voting rights) is to be attributed to the company.

BlackRock Advisors Holdings, Inc., New York, USA:
On November 13, 2012, BlackRock Advisors Holdings, Inc., New York, USA has informed us according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have exceeded the 3% threshold of the voting rights on November 05, 2012 and on that day amounted to 3.63% (this corresponds to 40,575,924 voting rights). All voting rights in Telefónica Deutschland Holding AG were attributed to BlackRock Advisors Holdings, Inc. pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.

On November 21, 2012, BlackRock Advisors Holdings, Inc., New York, USA has informed us according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have fallen below the 3% threshold of the voting rights on November 15, 2012 and amounted to 2.98% (this corresponds to 33,333,434 voting rights) on that day. According to section 22 (1) sentence 1 No. 6 in conjunction with sentence 2 of the WpHG, 2.98% of the voting rights (this corresponds to 33,333,434 voting rights) is to be attributed to the company.

BlackRock Holdco 2, Inc., Willmington, DE, USA:

On November 13, 2012, BlackRock Holdco 2, Inc., Willmington, DE, USA has informed the company according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have exceeded the 3% threshold of the voting rights on November 05, 2012 and on that day amounted to 3.72% (this corresponds to 41,555,696 voting rights). All voting rights in Telefónica Deutschland Holding AG were attributed to BlackRock Holdco 2, Inc. pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.

On December 07, 2012, BlackRock Holdco 2, Inc., Wilmington, DE, USA has informed the company according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have fallen below the 3% threshold of the voting rights on December 03, 2012 and amounted to 2.996% (this corresponds to 33,459,940 voting rights) on that day. According to section 22 (1) sentence 1 No. 6 in conjunction with sentence 2 of the WpHG, 2.996% of the voting rights (this corresponds to 33,459,940 voting rights) is to be attributed to the company.

BlackRock Financial Management, New York, USA:
On November 13, 2012, Blackrock Financial Management, New York, USA has informed the company according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland

Holding AG, Munich, Germany, have exceeded the 3% threshold of the voting rights on November 05, 2012 and amounted to 3.72% (this corresponds to 41,555,696 voting rights) on that day. All voting rights in Telefónica Deutschland Holding AG were attributed to Blackrock Financial Management, Inc. pursuant to section 22 (1) sentence 1 No. 6 in conjunction with section 22 (1) sentence 2 of the WpHG.

On December 07, 2012, BlackRock Financial Management, Inc., New York, USA has informed the company according to section 21 (1) of the WpHG that via shares its voting rights on Telefónica Deutschland Holding AG, Munich, Germany, have fallen below the 3% threshold of the voting rights on December 03, 2012 and amounted to 2.996% (this corresponds to 33,459,940 voting rights) on that day. According to section 22 (1) sentence 1 no. 6 in conjunction with sentence 2 of the WpHG, 2.996% of the voting rights (this corresponds to 33,459,940 voting rights) is to be attributed to the company.

Declarations of Conformity German Corporate Governance pursuant to 161 of the AktG

On February 28, 2013, the management board and the supervisory board of Telefónica Deutschland Holding AG issued the declaration of conformity in accordance with section 161 of the Stock Corporation Act (AktG) and is publicly available to the shareholders on the company's website (www.telefonica.de).

Munich, February 28, 2013

Telefónica Deutschland Holding AG

The management board

René Schuster | Rachel Empey | Markus Haas

Audit opinion

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of Telefónica Deutschland Holding AG (formerly: Telefónica Germany Verwaltungs GmbH), Munich, for the fiscal year from 1 January to 31 December 2012. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with Sec. 317 HGB ["Handelsgesetzbuch": German Commercial Code] 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 annual financial statements in accordance with [German] principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company 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 books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and 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 annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with [German] principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Munich, 28 February 2013

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Bostedt
Wirtschaftsprüfer
[German public auditor]

Weiß
Wirtschaftsprüferin
[German public auditor]

Glossary

3G	Third generation mobile communications standard supporting higher transmission rates (see UMTS)
ARPU	Average Revenue per User
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
CapEx	Capital Expenditure: Additions in fixed and intangible assets (without goodwill)
CF	Cash flow
Cloud Service	Cloud services are dynamic infrastructure, software or platform services provided online
Cross-selling	Marketing term denoting the sale of related or complementary products or services
DLD	Digital-Life-Design
DSL	Digital Subscriber Line, technology to transmit data in the local loop to private end-customers
EC	European Commission
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FCF	Free Cash Flow
FNA	Federal Network Agency: Bundesnetzagentur
FTR	Fixed network Termination Rates
GDP	Gross Domestic Product
GfK	Gesellschaft für Konsumforschung (Consumer research association)
GPS	Global Positioning System
GSM	Global System for Mobile Communications: This is the global standard for digital mobile communications.
HGB	Handelsgesetzbuch (German Commercial Code)
HSPA	High-Speed Package Access
IDR	Issuer Default Rating
Internet	Worldwide network of computers on the basis of an IP (Internet Protocol) without any central network management
IPO	Initial public offering
IT	Information Technology

Joint-venture	Two or more companies founding a new enterprise for cooperation
LAN	Local Area Network: A group of computers and associated devices that share a common communications line or wireless link
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
MMS	Multimedia Messaging Service
mpass	Mobile payment service
MTR	Mobile termination rates
MVNO	Mobile Virtual Network Operator
NFC	Near Field Communication: a short-range wireless connectivity standard
NGO	Non Governmental Organization
n.m.	not measured
NRA	National Regulatory Authority
OIBDA	Operating Income before Depreciation and Amortization
OTT	Over The Top
PBX	Private Branch Exchange: A telephone system within an enterprise that switches calls between enterprise users on local lines while allowing all users to share a certain number of external phone lines
PIP	Performance and Investment Plan
POS	Point of Sale
Prepaid	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	Wireless handset that can be used as a mobile phone, a web browser, and an e-mail reader simultaneously
SME	Small and Medium sized Enterprises
SMS	Short Message Service
SoHo	Small and Home offices
Tablet	A wireless, portable personal computer with a touch screen interface
Telefónica	Telefónica S.A., Madrid, Spain
Telefónica Deutschland	Telefónica Deutschland Holding AG (former: Telefónica Germany Verwaltungs GmbH), Munich
Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telefónica Group	The companies included in the Consolidated Financial Statements of Telefónica
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 2 GHz.
VAT	Value Added Tax
VDSL	Very High Data Rate Digital Subscriber Line
VPN	Virtual Private Network
WAN	Wide Area Network: a geographically dispersed telecommunications network
Wholesale	Selling services to third parties who sell them to their own end customers either directly or after further processing
WpHG	Wertpapierhandelsgesetz (Securities Trading Act)

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