Telefónica
Deutschland

THE DIGITAL ME BECOMES DIGITAL US. EXPERIENCE MOBILE FREEDOM.

Magazine 2017

annualreport.telefonica.de

Being mobile, working mobile, shopping mobile – with no limits. All this is now a part of everyday life for many people, and Telefónica Deutschland has played a major role in making it so. We have consistently defined our business and our strategy to achieve this, and we are driving forward the digital transformation of society and of our company.

Our customers' demand for unlimited mobile freedom continues to grow. We meet this demand with our product portfolio and our range of different brands – designed to exactly match the varied target groups. In order to provide a first-class customer experience, we are working on the largest and most modern network. This also helps improve our position in the market. That in turn is reflected in the trends of our key performance indicators.

But digitalisation does not just create new needs and products. It also changes the way in which we collaborate within our company and which skills we ourselves need to have. And it raises socially relevant questions about how we handle the resulting data. How we use it for business and for the public good. Including how we protect it. Telefónica Deutschland is helping stimulate public discussion about this. The Digital Me becomes Digital Us.

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"In the future we're not going to be concerned about the best price but rather the best mobile solution."

Markus Haas is Chief Executive Officer (CEO) and Chairman of the Executive Board of Telefónica Deutschland Holding AG.

MARKUS HAAS

"In 2017, we formed the basis for future growth. It is important to me that we were able to improve all important key performance indicators at Telefónica Deutschland in a highly dynamic market environment with heavy regulatory interventions and parallel integration work. We are currently building the largest and most modern mobile network in Germany. We are now able to drive the digital transformation of Telefónica Deutschland forward.

In 2017, Germany experienced the start of a mobile data explosion. We were an active part of this process. With extra-large data packages, we have been able to give our customers exactly what they expect from us: mobile freedom. Our market environment depends on understanding customer needs, in particular when it comes to mobile Internet. This means not only the best price but above all also offering a mobile solution: in order to connect several mobile devices more easily and to be able to use them at all times, and so that needs can be met in real time.

In 2018, we will continue to make our customers the focus of our business. In particular, we want to meet our customers' needs with regard to the network and service. Our aim is to be better, quicker and simpler for our customers."

CUSTOMERS

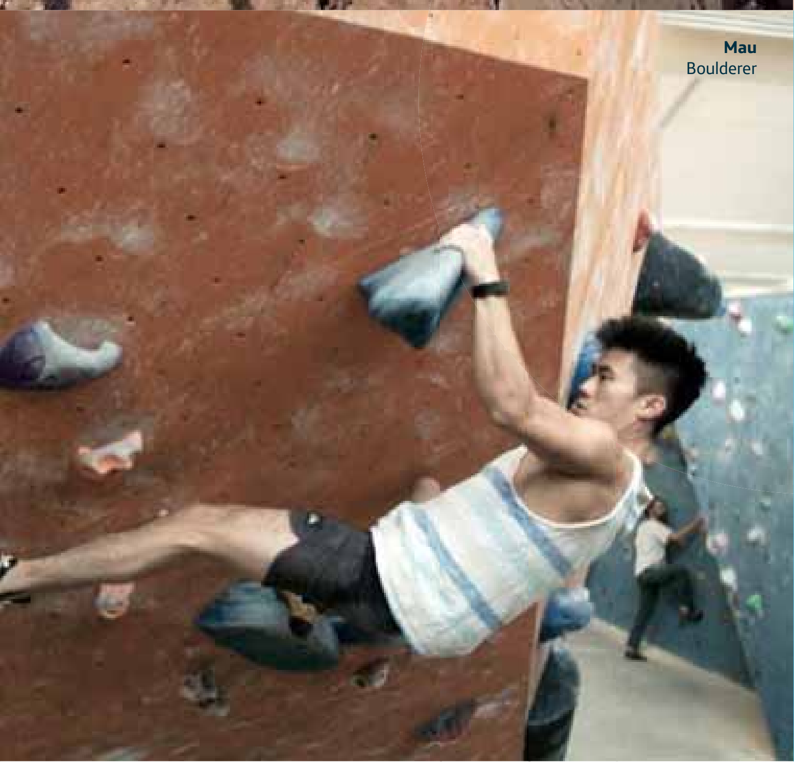
OUR FREEDOM IS MOBILE

In a networked world, people want to be able to move around as freely as possible. They seek mobile freedom. Four short videos present different kinds of users, each with their own feelings, wishes and ideas. They make everyday decisions which in turn leave a trail: they produce data. The protagonists allowed us to follow them into their daily world, tell their stories and meanwhile show us how they experience mobile freedom – individually and collectively, at home and on the move.

Claudia and Robin
YouTubers

Thorsten
Digital nomad

Manfred and Doris
Young seniors



Mau
Boulderer

STORIES ABOUT MOBILE FREEDOM

“Bouldering is a solo sport you do in a group”

Bouldering is a fast-growing sport – and a way of life. Every sportsman needs to find his own way through the rocks, but bouldering is still a group sport. When climbing without safety ropes, Mau-Dong Lau (28) is not only challenging his physical limits. An important part of it is the digital connection.

The sport of bouldering is growing steadily in Germany, and participants have extremely good mobile networks. For bouldering in the gym, Mau arranges an ad hoc chat group. Bouldering outdoors, on the other hand, needs careful preparation. Reliable and up-to-date weather information, navigation and topography apps, a mobile phone camera and video portals are must-haves. As well as digital communication. Because as a boulderer, you fight your own battles. But the community always has your back.

Video link:
annualreport.telefonica.de/customers2017/#boulderer ↗

“Our life is online – as long as we want it to be”

You can regularly meet Claudia Langer (29), Robin Blase (31) and their daughter Emily (1) in the Berlin suburb of Prenzlauer Berg – and on YouTube. In the video, they both provide insights into their everyday digital life.

Posting as “Clued”, Claudia documents her daughter Emily’s first steps in the world in her mummy vlog. On his channel, Robin, as the successful YouTuber “RobBubble”, posts parodies and comments on the YouTube scene and social issues. Both of them do not just work online, but they also live online. Mobile data consumption and network coverage are basic necessities in their lives. Both make very clear decisions about when they share with their community and when they go offline.

Video link:
annualreport.telefonica.de/customers2017/#youtubers ↗

“We can also talk to each other easily”

They grew up analogue but travel digitally: Manfred and Doris Rafalski have a long working life behind them, they love their home and they also love travelling. However, they don't want to miss out on staying in touch with their family and friends. They don't see mobile freedom as being a generational thing. It's more a question of different needs.

Sports news through an app, swapping holiday photos via WhatsApp – for Manfred (78) and Doris Rafalski (75), these have been part of their everyday digital life for years. They both enjoy their mobile freedom when they are travelling and especially when back home within their own four walls. Which doesn't stop them sometimes smirking at what their grandchildren's generation is doing.

Video link:
annualreport.telefonica.de/customers2017/#young-seniors ↗

Viewpoint
Tenerife

“Life and work are not two different worlds”

Airbnb apartment
Hamburg

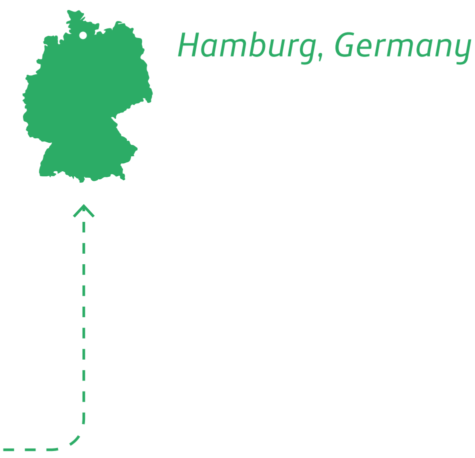
Co-working space Betahaus
Hamburg

Café Sunset
Tenerife

As an online businessman, Thorsten Kolsch (34) has no fixed workplace and no permanent address. This digital nomad lives and works wherever people need him. And wherever he likes.

Video link:
annualreport.telefonica.de/customers2017/#digital-nomad ↗

His office might be a magical location in Tenerife: Thorsten Kolsch deliberately seeks out the places where he works. Whether in an Airbnb apartment, in a co-working space or in a café – if the infrastructure works for him, he can work from anywhere. In the video, he gives us an all-round view of his life as a nomad.



"Mobile freedom is at the core of our service promise as a mobile company focused on customers."

Wolfgang Metze is Chief Consumer Officer and a member of the Executive Board of Telefónica Deutschland Holding AG.

WOLFGANG METZE

“We promise to champion the mobile freedom of our customers.”

“The world is changing at an accelerated rate. The driving force behind this is increasing digitalisation. As a service provider of connectivity and solutions, the telecommunications industry is an important trendsetter.

Freedom is becoming increasingly important in the digital world. We want to be active in creating this development for our customers to use and subsequently to use the opportunities it brings.

Mobile freedom is at the core of our service promise as a German mobile company focused on customers. We claim to reliably provide our customers with mobile freedom with the best price-performance ratio. We are setting new standards in this area. By using our services, everyone can make use of all the opportunities the digital world offers, with no compromises. This means being able to design your day-to-day digital life individually, spontaneously and independently: any time, any place.

Our own internal digitalisation allows us to be closer to people’s needs. No matter whether online, on the phone or in the O_2 shop, we rely on the close connectivity of all channels to ensure a positive customer experience throughout the entire customer journey. With our O_2 core market, we want to offer a uniform brand experience that has an even closer affinity to the customers and their needs. With the new positioning of O_2 as a brand of freedom and independence, we therefore promise to champion the mobile freedom of our customers.

For me, mobile freedom means being able to move around independently, flexibly and with no compromises, at any time, both in my professional and private life. What I observe from my own experience, my family, my friends and also our customers is that mobile data use increases considerably with large data tariffs. More data volume frees your mind and reduces the reluctance to use quick mobile surfing: photos and videos are shared and streamed directly the instant they happen, regardless of whether this does or doesn’t use a hotspot.”

Online at:
annualreport.telefonica.de/customers2017/#brand ↗

ALFONS LÖSING

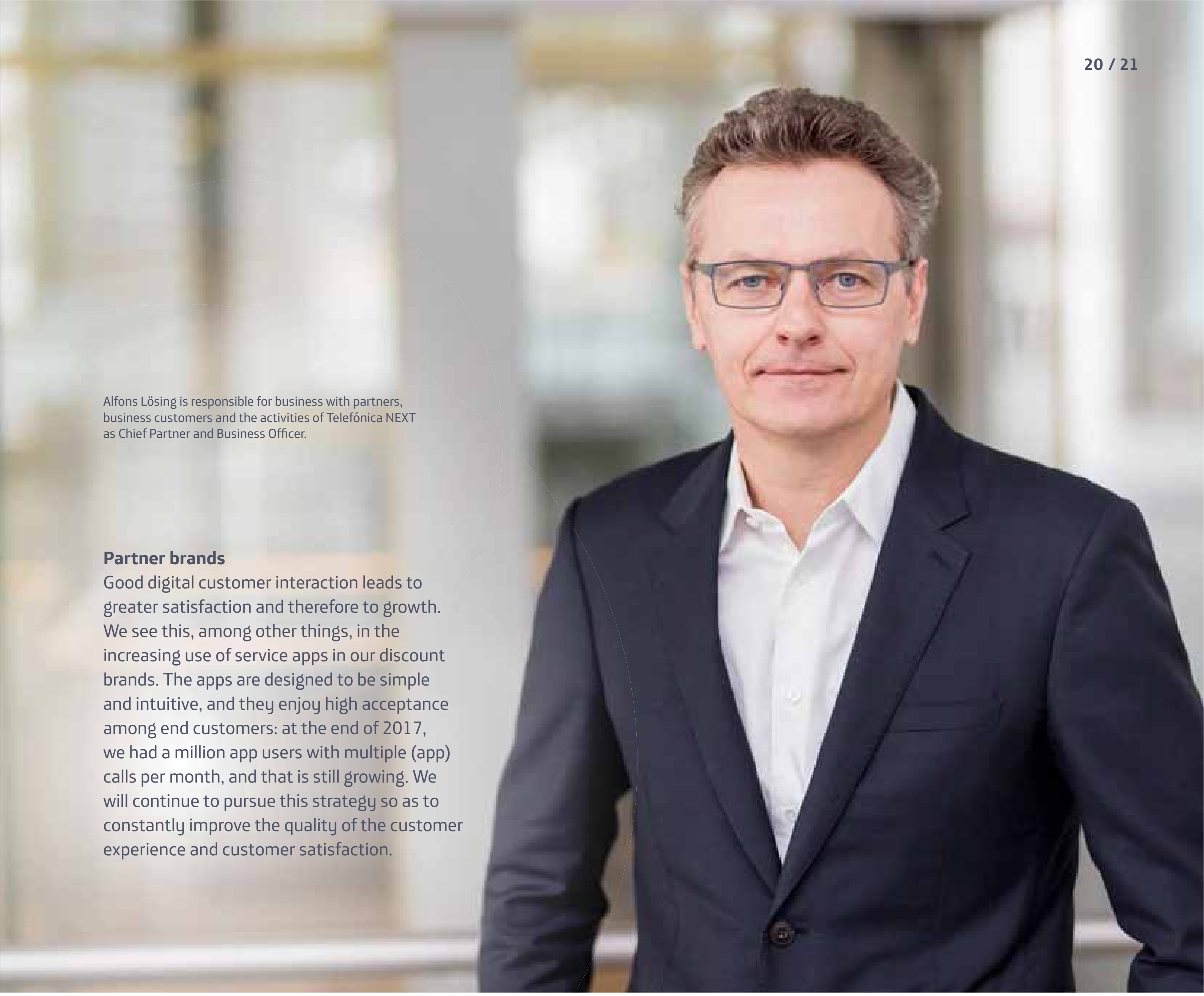
"To address the entire spectrum of customer segments and customer needs, the collaboration with partners is fundamental."

No other network provider connects more people with mobile services throughout Germany than Telefónica Deutschland. It is therefore vital for us to address the entire spectrum of customer segments and customer needs in our product range. Collaboration with partners is fundamental to this.

Partnership in the private customer sector means for us that we can reach major customer segments above and beyond our own core O_2 brand and the second consumer brand we own, Blau, by working with our partner brands such as ALDI TALK and TCHIBO mobil as well as with our own secondary brands AY YILDIZ and Ortel Mobile.

As a partner for our business customers, we principally provide mobile freedom to small and medium-sized privately owned businesses, as well as people with home offices, thanks to our mobile service solutions. In terms of landline networks, we support them in becoming independent of ISDN technology, which will not be offered by us in 2018. In addition, there are our activities in the dynamic managed connectivity market.

With our subsidiary company, Telefónica NEXT, we are acting as a partner to businesses, offering other companies as well as private and public institutions insights from data analyses and releasing the potential of smart products for end consumers.



Alfons Lösing is responsible for business with partners, business customers and the activities of Telefónica NEXT as Chief Partner and Business Officer.

Partner brands

Good digital customer interaction leads to greater satisfaction and therefore to growth. We see this, among other things, in the increasing use of service apps in our discount brands. The apps are designed to be simple and intuitive, and they enjoy high acceptance among end customers: at the end of 2017, we had a million app users with multiple (app) calls per month, and that is still growing. We will continue to pursue this strategy so as to constantly improve the quality of the customer experience and customer satisfaction.

Business customers

We are currently seeing plenty of dynamic growth and increased competition from new and existing market players. We are therefore realigning our processes in order to act as a lean, convergent provider, with innovative products like “O_2 Free Business”, “O_2 Unite” and VPN solutions that are focused on the needs of small and medium-sized businesses. With our all-IP offering, we are supporting companies whose landline connection is affected by the shutdown of ISDN technology.

Telefónica NEXT

With “Advanced Data Analytics”, Telefónica NEXT is looking at the social and economic benefits to be extracted from the analysis of big data. We are, for example, offering transport companies, towns, cities, public bodies and retailers valuable analyses based on anonymised data. This means they can gain better insights into the needs of their target customer groups.

In addition, we have developed a software platform for the Internet of Things (IoT) that enables other companies to offer smart products to end consumers. We will in principle address all customer segments in the IoT segment and enter the IoT market with mass-market products that will bring direct benefits to customers.

THREE NETWORK QUESTIONS TO CAYETANO CARBAJO MARTÍN

People want to share their experiences with others from anywhere, including from large events like the Oktoberfest in Munich. Is building a separate network infrastructure, limited in terms of time and regional scope, worth the effort?

Definitely! Even more than usual, our customers want to share their experiences during major events. For them, this is part of a good user experience, and we give them the mobile freedom to do it. Many major events, such as the Munich Oktoberfest, take place every year. That is why we then plan for this and adjust our equipment well ahead of time to manage the increase in demand, and we cover a series of recurring events or one-off major events across the whole of Germany. Because the data volume increases every year with the digital options we offer our customers.

Cayetano Carbajo Martín is Chief Technology Officer and is responsible in this role for the mobile and landline networks of Telefónica Deutschland.

More on the subject of network:
A New Milestone in Munich TechCity
telefonica.de/massive-mimo-trial ↗

telefonica.de/press/press-releases/network.html ↗

Major events bring individual challenges. Across the country, Telefónica Deutschland is currently implementing the largest network integration in the Western world. How far have you progressed with the conversion work, and what impact is this having on quality?

We are driving full steam ahead on network integration, which, for a limited period, can have local impacts in some places on the network's performance. We deploy substantial measures to ensure quality and to make sure that the customer's network experience remains at a good level. Various tests in 2017 have confirmed to us that, despite the wide-ranging integration work being carried out, customers have enjoyed the benefits of a stable network. As far as the integration is concerned, we have made extremely good progress in many cities and regions; in some areas, we have already successfully completed it. The actual integration work will be for the most part completed by the end of 2018.

And what does the roadmap look like for extending the network?

Across the entire country, we have most of the base stations and the correct mobile radio spectrum to provide good service. So we are working on the largest and most modern mobile phone network in Germany, and in parallel to the network integration we are also rapidly extending our LTE provisioning. This improves our customers' user experience. Today, we can already reach over 80 % of the population in the whole of Germany with LTE. At the same time, this means we have built an ideal basis for various important network initiatives: this includes the Internet of Things (IoT) and what is known as narrowband IoT, which allows low data volumes to be transferred using narrowband communication in the Internet of Things. In addition, the next mobile phone generation, 5G, is arriving with a plan as to how we can increasingly connect our base stations in parallel with fibre optics for high-speed data transfer.

EMPLOYEES IN EXCHANGE WITH NICOLE GERHARDT

Nicole Gerhardt is Chief Human Resources Officer on the Executive Board of Telefónica Deutschland and is responsible for the company's Human Resources division.

EMPLOYEES

LEARNING FREEDOM – DIGITAL CHANGE WITHIN THE COMPANY

All-pervasive digitalisation is now affecting many different areas of life, both at work and at home. For employers, this does not only mean enabling flexible working models. There is also an opportunity to revise processes and systems creatively, together with employees. We would like you to meet four employees in different areas of work at Telefónica: their contributions to our customers' mobile freedom are as individual as they are themselves. Talking to Nicole Gerhardt, Chief Human Resources Officer at Telefónica Deutschland, employees ask her questions about how Telefónica will continue in the future to be an innovative and responsible employer so as to exploit the opportunities offered by digitalisation.

Video link:
annualreport.telefonica.de/employees2017 ↗

Business Analyst, Munich

When Velislava started at Telefónica Deutschland nine years ago, she had a fixed work space with a fixed desktop computer. Now the technical product manager also enjoys the benefits of mobile freedom when organising her work. When working in her home office, she may herself decide when and where she will work.

VELISLAVA MARCHEVA

Which challenges do we face as employees for mobile freedom to determine the climate in the company?

Nicole Gerhardt: *"Mobile freedom gives us many opportunities: to begin with, we can work flexibly from different places. A great challenge for each individual is that each person needs to be responsible for themselves and needs to draw their own boundaries: Do I want to be reached anywhere at any time, and when do I need time for myself and my family? From a company view, this means respecting and managing boundaries. This can only happen when we look more to results and not where and when work is performed."*

Senior B2B Marketing Manager, Munich

The communications scientist and marketing expert, who has been at Telefónica NEXT since the start, handles motion data on a daily basis: a large part of the solutions at Telefónica NEXT are based on analysing anonymised motion data from the mobile network. In doing so, Mark is always on the move, both in his professional and private life. The father of three children lives life digitally connected. He uses smart-home solutions, drives a connected car and prefers to make purchases via his mobile.

MARK STOHLMANN

AIC: How data democratises knowledge
annualreport.telefonica.de/employees2017/#aic

In the future, will all employees have to be able to analyse data? To what extent does gut feeling or intuition play an important role here?

Nicole Gerhardt: *"The majority of employees must be able to work with data. We will also increasingly focus on data when making decisions. The subject of data analysis is becoming increasingly important, as are the methods for doing so. We must take care that we are not just providing data with countless pieces of information, but that employees are also able to use this data. In doing so, they can make better decisions. Intuition will always play a role but only as one of several factors when making a decision."*

Data Scientist, Munich

As a data scientist at Telefónica Deutschland, Laura has had a lot to do with large amounts of data on a daily basis for one and a half years now. Together with her colleagues, she analyses internal and external data sources in order to generate information for specialist departments. The mathematician does not just deal with new methods in her professional life: in her private life, Laura also visits "Meetup" – an exciting online platform for people to exchange knowledge and their ideas.

LAURA VELIKONJA

New tools and methods are always coming on the market. How do you definitely stay on the ball? What knowledge and capabilities will we need in the future as a company?

Nicole Gerhardt: *"Every individual needs to rediscover learning. At the same time, we also need to learn as a company. For me, this does not first and foremost mean going on training courses. Rather, it is more the question of: how do people learn? People primarily learn through experience, from feedback and, of course, from theoretical input. We must also be able to learn again and make people want to learn. To do this, we need to create the necessary free spaces. We need more security in many areas as well as other, professional capabilities, but the crux of the matter is the question of mindset: This does not mean rejecting openness, curiosity and change, but surrendering to them. This also means respect and trust, both in ourselves and in what others bring to the table."*

Senior Brand Strategy Manager, Düsseldorf

The market strategist has been working at Telefónica's Düsseldorf location for two and a half years. For his doctorate, Christoph dealt with the topic of the efficacy of social media, and now in the brand team at Telefónica Deutschland he works, in particular in cross-functional teams, on ensuring that the products meet the needs of the customer.

CHRISTOPH PÜTZ

How can we work on stopping thinking in silos?

Nicole Gerhardt: *"Cross-functional work is becoming more and more important. In recent years, we have worked in a very functional manner, which we cannot all of a sudden change. The best thing we can do is experiment. We must bring more and more cross-functional teams together and integrate employees. We must enable and promote this integration as a company by giving management the necessary tools and methods. At first glance, it seems a lot easier to make decisions in a team of people where each person speaks about the same thing. If many different people with various perspectives come together, that is a new challenge. We need to learn how to manage this and use the advantages ourselves."*

SOCIETY

DATA DIALOGUE

A MEETING OF EXPERTS AT THE TELEFÓNICA BASECAMP, BERLIN

Video link:
annualreport.telefonica.de/society2017

Data is the fuel of the future. It provides the basis for future technology-based applications; it's valuable and requires special protection. Data protection is not just a question of security policies. It is also a question for everyone in society. At the **Telefónica BASECAMP** in Berlin, we therefore have set up discussions with a number of different target groups and are exploring topics related to mobile freedom. **In the video, follow discussions between Valentina Daiber**, Director for Legal and Corporate Affairs at Telefónica Deutschland, **Prof. Rolf Schwartmann**, Head of the Cologne Research Centre for Media Law, which is part of the Technical University of Cologne, who is also Chair of the Society for Data Protection and Data Security (GDD) e. V., and **Matthias Kreienbrink**, Social Media Editor and freelance journalist.

Data and mobility

Mobility faces new challenges, and its future seems to be data-based. How can the data of individuals be advantageous for many people?

"In order for there to be applications that deal with collecting and evaluating data of social use, we need legal security as a company. We also need to develop transparency criteria for our customers on this basis."

"At Telefónica NEXT, we, together with the Fraunhofer-Institut, analyse mobility behaviour in Stuttgart based on anonymised data in order to improve traffic flow."

Valentina Daiber

"I travel a lot and use local public transport. I prefer buying a travel card using an app. How exciting would it be if the apps could also tell me which trains are particularly full and which detour could make particular sense?"

Matthias Kreienbrink

"In order to collect and use personal data, we always need justification. Consumer protection and economic freedom are played off against each other as a result of the data protection ordinance. As a user, I always have the right to find out what data about myself is saved and to take it with me, for example if I change suppliers."

Prof. Dr Rolf Schwartmann

Data and security

Data protection and data security are subjects that many consumers deal with. What obligations do companies have here?

"The individual responsibility of the consumer and the obligation of companies providing solutions to ensure sufficient transparency are an important matter. In addition, as a company we must put educational facilities in the position to teach media literacy. In doing so, we must involve all societal groups and enter into dialogue with them. That's exactly what we do in projects, studies and at the Telefónica BASECAMP."

Valentina Daiber

"The user must understand what they're doing when using data-based services. The risks must also be explained to them. It is only then that they can make a decision and develop trust in the solution."

Prof. Dr Rolf Schwartmann

"When we talk about digital topics, it's mostly in a language that excludes many people. When elderly people are involved in communication, they feel heard and want to understand the advantages digital services offer for them in particular."

Matthias Kreienbrink

Data and privacy

Thanks to social media, is there a new definition of privacy? How do we get clarity when handling data when it comes to the protection of children and young people?

“There must be awareness of the fact that the Internet is not detached from our other life: I can always object when I don’t want something or if something violates my personal rights.”

Matthias Kreienbrink

“We need to take care that young people are informed of the rights, protection obligations and consequences when exchanging data on social media. With projects like Think Big, which we launched with the German Children and Youth Foundation (DKJS), we inspire young people to use digital media at the same time teaching media literacy.”

Valentina Daiber

“There are people who say privacy isn’t important anymore and they have nothing to hide. However: As long as animals find a secluded spot to die and I shut my front door behind me when I come home, there will always be privacy. When we give that up, we are giving up an important part of our humanity. And we also need to be careful that it doesn’t happen to us.”

Prof. Dr Rolf Schwartmann

Hotspot for digital subjects: the Telefónica BASECAMP
Events take place almost every day at the Telefónica BASECAMP. They deal with the progress or even the consequences of digitalisation, which is currently turning all areas of our lives upside down.

telefonica.de/video-basecamp-2017 ↗
telefonica.de/telefonica-basecamp-photo-album ↗

DIGITAL TECHNOLOGIES OFFER OPPORTUNITIES FOR A MORE SUSTAINABLE WORLD

Responsible management, strengthening life in the digital world and protecting the environment and climate: these are the cornerstones of the Responsible Business Plan, in which Telefónica Deutschland defined important sustainability goals for the company and stakeholders. All initiatives and programmes are geared towards these goals. Using digital technologies, we want to contribute to solving societal challenges and advance sustainable development.

Responsible management
The key to our success in the digital world and in developing sustainable solutions is the trust of our stakeholders. Fair conduct towards customers, employees, suppliers and all other stakeholders is therefore of the utmost importance for us. This is why we have set the goal that, by 2020, we will achieve consistently good to very good results in relevant external assessments and our stakeholder surveys.

Strengthening life in the digital world
We want people from all age groups to participate in digitalisation. That's why the Think Big programme of the Telefónica Stiftung and the German Children and Youth Foundation (DKJS), together with O_2, is inspiring young people to come up with their own ideas. In contrast, in our project with the Digital Opportunities Foundation, "Digital mobil im Alter" (old-age digital mobility), elderly people can try out tablet PCs. A 2017 project study showed that older people benefit from mobile Internet.

Protecting the environment and climate
Thanks to digitalisation, we are saving on raw materials and energy. This means that by 2020 we will reduce our direct and indirect CO_2 emissions by 11 % and our energy consumption per data volume by 40 % compared to 2015. Each year, we purchase 100 % of the energy that we procure and control ourselves from green energy. Furthermore, via our mobile phone recycling programme, we safely dispose of old devices or prepare them for further use and support NABU (the German Nature and Biodiversity Conservation Union) in the renaturalisation of the lower river Havel with its proceeds.

As Chief Officer for Legal and Corporate Affairs, Valentina Daiber is responsible for the areas of legal, compliance, data protection and corporate security in addition to the company's regulation work, relationships with officials and government bodies, PR and corporate responsibility on the Executive Board of Telefónica Deutschland. Ms Daiber also manages the representative office in Berlin and the Telefónica BASECAMP.

VALENTINA DAIBER

"I am completely convinced that we can contribute to conquering societal challenges and drive sustainable development forward using digital technologies."

GUIDO EIDMANN

"Personal and business cyber-security should be as normal as locking your front door."

No one can deny: digitalisation brings huge opportunities for our society. Every individual profits in everyday life from things becoming easier, companies can break into new business areas, and potential digital solutions are emerging for global problems like the destruction of the environment and hunger. But there is another face to technological advance: cyberattacks on individuals, companies and society as a whole are on the rise. According to an IBM study, in 2016 alone more than four billion data records were stolen – as many as in the previous two years combined. This ranges from the theft of patents and expertise to cyberblackmail. In May 2017, for example, "WannaCry" – a typical "blackmail Trojan" – quietly locked up the data on more than 230,000 infected computers. Although Telefónica Deutschland was not affected, we immediately installed an update on several thousand notebooks, PCs and servers to protect ourselves against any potential further attacks. In my opinion, this kind of rapid and preventive security is exactly what will work in the future.

Increased confidence in digitalisation

Digitalisation cannot be successful while we are permanently worrying about criminal attacks in the digital world. In a Bitkom study in 2017, six out of ten companies see the risk that they will fall victim to hackers or cybercriminals as very high. Scepticism about some parts of the digital world is growing. That is why I argue in favour of finding a pragmatic way of working with cybersecurity and increasing public confidence in digitalisation.

As Chief Information Officer, Guido Eidmann is responsible for IT strategy and the company's digitalisation.

Telecommunication companies have a central role to play in this. As the provider of mobile telephony to the majority of people in Germany, we are very much aware of this responsibility. Telefónica Deutschland wants to see mobile freedom in the digital world – and this freedom needs to be based on confidence. With a smart security strategy, we can protect our customers' data and our own infrastructure.

As well as data security, data sovereignty is a priority for us. We are convinced that only by customers being able to decide what happens to their data will we create the necessary level of acceptance to allow society and business to seize the opportunities offered by Big Data. Customers need to be free to decide who they will grant access to which data. We allow them to weigh up the usefulness of smart analysis of their anonymised data for business and for society. To achieve this, we have developed our own TÜV-certified anonymisation process.

Data security is everybody's business
What is beyond any doubt, however, is that data security and control cannot just be managed by the telecommunications industry alone. Of course, companies need to defend themselves against cyberattacks by using comprehensive security strategies and training their employees.

But I would also like to see public authorities and government offices becoming more active in combating cybercrime and politicians creating strategic alliances with business. In private life, too, total protection is not possible in a digital world – but a high level of security is. Personal protection from cyberattacks, therefore, needs to become just as normal as locking your front door.

The huge opportunities of digitalisation should inspire us to master the challenges of cyberattacks.

In a nutshell, that means: we need to protect critical infrastructure better, politicians and business need to come closer together in relation to cybersecurity, and every private individual needs to take more responsibility for themselves.

INVESTOR RELATIONS

FINANCIAL CALENDAR AND CONTACT

2018

21 February
Q4 2017 – Preliminary results

25 April
Q1 2018 – Preliminary results

17 May
Annual General Meeting

25 July
Q2 2018 – Preliminary results

30 October
Q3 2018 – Preliminary results

(We reserve the right to make changes)

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LETTER TO SHAREHOLDERS

Dear shareholders of Telefónica Deutschland, Dear Sir or Madam,

We look back on a successful and eventful 2017. In a dynamic market environment, we have again proven with the introduction of the new O_2 Free tariff portfolio that we stand for mobile freedom in our customers' digital lives. Thanks to the large 4G data packages and a guaranteed 3G speed to further surf the web after consumption of the included high-speed volume, our customers are always able to move around in the digital world without compromising and worrying about data usage.

A good value for money ratio and a reliable, high-performance network are key components for a positive customer experience. Independent network tests based on customer assessments have confirmed the performance of our network in the already consolidated areas. We are developing the largest and most state-of-the-art network in Germany, placing real customer needs at the centre of our network investments. We will be largely completing the network consolidation by the end of 2018 and will build up our 4G network step by step. This will, among other things, allow us to be ready for the next generation of mobile technology – 5G.

We have executed our integration activities in 2017 according to plan and achieved the higher synergy targets set at the beginning of 2017. Three years post-merger, we have already realised 75 % (approximately EUR 670 million) of the cumulative operative cash flow savings target of EUR 900 million in 2019. The integration is largely completed, and we are fully on track to be able to achieve the overall target.

In addition, we are increasingly focused on the digital transformation of Telefónica Deutschland and putting our customers at the centre of our transformation agenda. We want to be the Mobile Customer & Digital Champion for our customers. Furthermore, we are firmly convinced that with the simplification and digitalisation of our processes not only will our customers be winners, but we will also be able to increase our efficiency.

The cornerstones of the digital transformation of Telefónica Deutschland are growth opportunities in the areas of "Advanced Data Analytics" and the "Internet of Things (IoT)". We are focusing on the social and economic benefits from the analysis of large volumes of data. For instance, in IoT our subsidiary Telefónica NEXT developed a software platform which assists other companies in offering smart products for end consumers.

We see ourselves as being well positioned for the future. We owe this success to the tireless efforts and commitment of our employees. We specifically would like to thank all our employees for their contribution and their openness in the integration process as well as in the start of the transformation of the company.

And, last but not least, we would like to thank our shareholders for the trust they have placed in us. We confirm our dividend outlook, with an annual increase of dividend over three years (2016–2018) and, as announced, we will propose a cash dividend in the amount of EUR 0.26 per share for the financial year 2017 at the next Annual General Meeting. The dividend is based on our belief in the expected FCF development. We therefore continue to offer our shareholders a highly attractive dividend yield.

Yours sincerely,
The Management Board

Top row (left to right):
Alfons Lösing (Chief Partner and Business Officer), Valentina Daiber (Chief Officer for Legal and Corporate Affairs), Guido Eidmann (Chief Information Officer)

Middle row (left to right):
Markus Rolle (Chief Financial Officer), Markus Haas (Chief Executive Officer, Chairman of the Executive Board of Telefónica Deutschland Holding AG), Cayetano Carbajo Martín (Chief Technology Officer)

Bottom row (left to right):
Wolfgang Metze (Chief Consumer Officer),
Nicole Gerhardt (Chief Human Resources Officer)

VISION AND STRATEGY

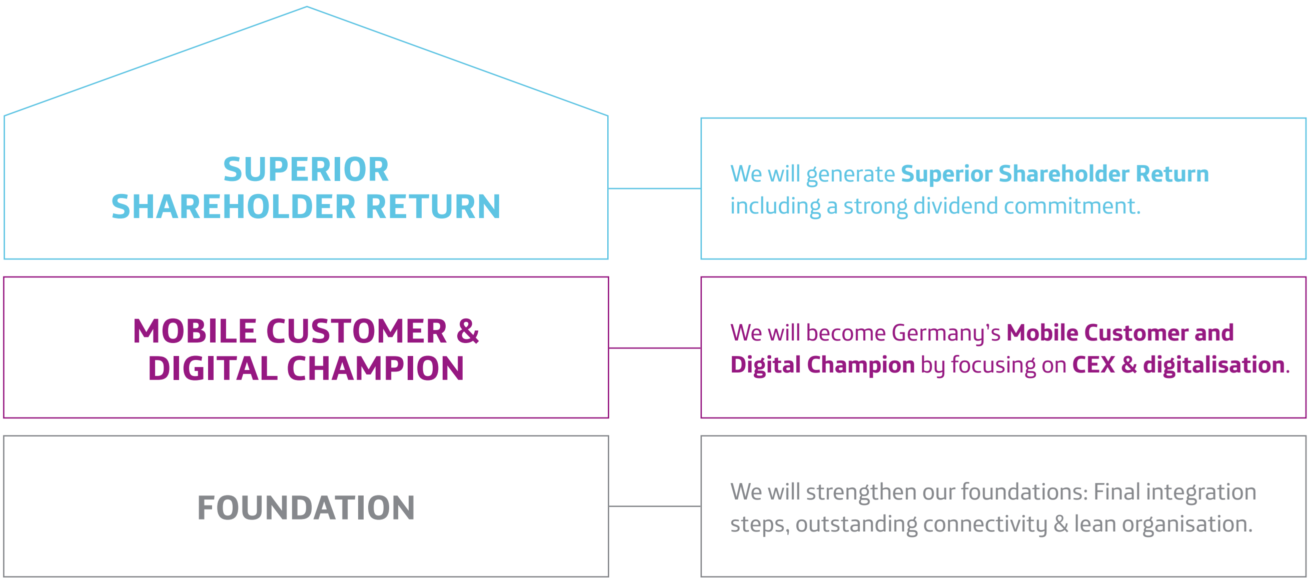
Our vision

The merger of E-Plus and Telefónica Deutschland is the largest and most quickly executed transaction to have taken place in the European telecommunications market in recent years. As a result, we have become one of the three leading integrated network operators in Germany. No other network provider connects more people to mobile services than Telefónica Deutschland. We want to make the most of this potential, and we have defined a clear vision to do so:

"We make the lives of our customers simpler and better, and give them mobile freedom in the digital world."

Our strategic priorities

Consequently, we base our corporate strategy on this vision. To date, it has focused on quick integration and maintaining market momentum. Our company is fully on course to broadly complete integration by the end of 2018: in recent years, we have reached all planned milestones and will realise all target synergies. With competitive, innovate products, we increasingly make use of the potential of data growth and continue to support the market momentum. In order to make our vision a reality, we now require focus to be on phenomenal customer experience.



G 01 / Strategic priorities

Three strategic priorities emerge as a result:

- Initially, we will create the foundation for optimising the customer experience by completing integration and optimising the fundamental success factors of our business. This in particular includes very strong performance in the areas of network and customer service in addition to stable IT systems and effective organisation.

- Our second priority lies in transforming and digitalising our business so as to create a fantastic customer experience. This will allow us to position ourselves as the Mobile Customer and Digital Champion in the German market.

- This leads to our third priority: to take what makes us stand out in customer service and translate this into new growth which will continue to show a positive development and profitability in addition, finally, to strong returns for our shareholders.

First strategic priority: Laying the foundation for optimising the customer experience

Network
Our strong network is a key building block for the best possible customer experience. As a result of our outstanding spectrum portfolio, we are in an excellent position to drive future network developments forwards. We have access to a spectrum of 315.5 MHz in total, which allows us a balanced ratio between network coverage and capacity. It is on this basis that we are building Germany's largest and most state-of-the-art mobile network geared towards the actual needs of our customers in day-to-day digital life.

We have made good progress in consolidating our network and have already completed it in several regions in southern Germany. It should be largely finalised by the end of 2018. In parallel, we are also taking continuous measures to improve network quality. The CHIP network test[1] of November 2017 confirmed that we provide our customers with stable network quality despite the comprehensive integration works. The "network weather" test from the magazine connect[2] showed that we provide the best UMTS provision of the three network operators and win our customers over with the best LTE signal quality. Further quality initiatives such as our "Customer Experience Management Tool" (CEM) and technologies for managing network capacities allow us to further optimise network quality.

Once integration is completed, we will continue to accelerate the expansion of our 4G network, which has already achieved coverage of over 80 %. 2018 will see the continuation of the expansion of our 800 MHz LTE network, and the expansion of the 1,800 MHz LTE network is being implemented with even greater speed. Smart investments in expansion ensure that we are developing into areas where customers most benefit from better coverage and higher transfer speed. Furthermore, we ensure that we will have sufficient access to the fibre optic infrastructure in future.

Finally, we are taking on a role as pioneer for technological innovations. We cooperate with companies like Huawei so as to build communication networks of the future and were able to achieve transfer speeds of 1.65 Gbit/s in 5G test runs in our "TechCity" testing environment in Munich. Since the start of 2018, we have also entered into cooperation with Nokia in order to make significant advancements in 4G and 5G development in our Telefónica test laboratory in Munich. During the year, a joint outdoor test network, known as the "early 5G innovation cluster", shall also be built in Berlin. Furthermore, we benefit from the progress made by Telefónica, S.A., in defining a future 5G technology standard as part of international initiatives such as NGMN and 5G PPP.

Customer service
We aspire to offer consistent service and excellent quality at every point of customer contact. We therefore increased our resources for the hotline and chat service channels. This led to clear improvements in performance indicators like waiting times and how easy it is to reach customer service. We have been at the same level as our competitors since the end of 2017. We will also carry out targeted service initiatives in 2019 so as to continue to improve our hotline service and increase customer loyalty.

[1] CHIP network test of 28 November 2017 "Die Mobilfunknetze im Härtetest"
[2] Connect "network weather"-test of 5 January 2018

G 02 / Milestones of integration
Largest and fastest mobile merger ever executed in the western hemisphere

>25 %
OIBDA growth in 3 years

>25 million
Customers migrated to one IT stack in 2016

>14 thousand
Network sites to be consolidated by 2019

O_2 Free
First 3G unlimited
First 4G big bucket portfolio

Second strategic priority: Mobile Customer & Digital Champion

We also find that more and more customers prefer digital interaction and would like to be able to solve their own issues. We are therefore increasing the proportion of our digital customer contacts. We are also digitalising our internal service processes. As a result, we can, for example, process the customer's service concerns digitally and solve the customer's concerns more quickly thanks to automation and artificial intelligence. By using AURA, the intelligent user interface, customers can, for example, inform themselves about the products and services they used, ask service questions, obtain information on their favourite programmes or record them or be notified if mobile data consumption is higher than usual.

IT and organisation

In order to guarantee a good customer experience, we ensure the stability of IT systems in the distribution and service area. Furthermore, we are transforming our IT systems by using the approach of Telefónica, S.A. Group in order to create a uniform IT landscape across all market segments and distribution paths: a standardised product catalogue ensures consistency with regard to product and price information across all distribution channels. In addition, we will standardise our ordering system and Customer Relationship Management system (CRM) so as to benefit from the advantages of efficiency and market standards.

As part of the integration, we will continue to expand our company into a dynamic and robust organisation. The focus here is on a high level of engagement with our employees, promoting continuous learning and ensuring a trusting cooperation with the company.

Private customers

We address all the needs of our customers in the digital world. As a pioneer in the German market, we are gearing our core O_2 market towards the customer promise of freedom. Our customers expect that they themselves can determine and enjoy their digital lifestyle without compromises. Telefónica Deutschland offers its customers exactly that: with us, everyone can make use of the opportunities of the digital world, and we claim to offer the best price-performance ratio in doing so.

In a dynamic but rational environment, the German mobile phone market had indicated an increasing focus on larger data packages since the third quarter of 2017. With the new O_2 free tariff portfolio, which introduced large data packages, Telefónica Deutschland became the pioneer of this development. We are putting an end to compromises in the digital life of our customers and are setting new standards for our customers' freedom. At the same time, we are stimulating data consumption, thereby continuing our successful data monetisation strategy. Momentum in the retail business improved considerably as a result of the new O_2 free tariff and by the promotional tariffs on the 15th birthday of the O_2 brand. We also introduced the principle of freedom to the landline world: O_2 customers can design their digital lives not only when they are on the move but also when they are at home, with no compromises. With O_2 DSL, we offer the right tariff for every customer's needs – even without a contractual term if the customer so desires. In the coming years, we will continue to underpin our customer promise of freedom through innovative products.

We are also going beyond the provision of mobile and landline connectivity by offering innovation digital services under the O_2 brand. For example, O_2 TV & Video offers our customers access to live TV content from over 70 channels and to catch up TV services from public broadcasting companies, any time, anywhere. Furthermore, we are continuing our cooperation with Sky so that we can further expand our offering with attractive content. In addition, with O_2 banking in cooperation with Fidor Bank, we are offering an innovative mobile banking product which will enable the use of smartphones as a fully fledged bank account.

Partner customers
With a focused multiple-brand strategy, we successfully operate in all market segments. Thanks to our wholesale channels with partner brands, we reach a bigger customer base that we are not addressing with our core O_2 brand and our secondary brands. We aspire to grow our entire core O_2 brand with these wholesale partners as a complement. We will therefore flexibly and quickly meet the needs of our wholesale partners and support them in improving the customer experience.

Business customers
Telefónica offers sleek, tailor-made mobile and landline products for its business customers. We service small and medium-sized enterprises in particular with our core O_2 brand. In September 2017, we brought the new O_2 Free Business tariffs to the market that also offer business customers more freedom thanks to an excellent price-performance ratio with even more high-speed data. For companies whose employees only need a small volume of data, we also introduced the O_2 Business Basic portfolio with flexible talk tariffs for those who make frequent phone calls and individual options.

Innovative services like machine-to-machine (M2M) and the Internet of Things (IoT) that are close to our core product of connectivity will continue to increase the customer experience. At this year's Funkschau readers' choice awards, we were able to take first place in the M2M services/platforms category with our IoT smart centre platform. Our platform provides automated data transfer between objects and machines and the simple management of IoT connection technologies. Furthermore, since 2017 we have offered a holistic, modular security solution in CyberThreats, which enables companies to react quickly and effectively to possible dangers from the network.

Intelligent data analysis, Internet of Things and innovation
We are developing new growth fields close to our core business which help us to improve the customer experience across the board. By using intelligent data analysis (ADA: Advanced Data Analytics), we are able to offer services in the area of traffic, trade and advertising. With the anonymisation platform we developed, we ensure the security of our customers' data. In the area of transport analytics, we use anonymised data from the largest mobile network customer base in Germany in order, for example, to analyse air pollution or optimise traffic in towns and cities.

We will develop the IoT growth environment for all market segments which we already address with our core business. We are taking the opportunities that arise from the exponential growth of devices and things connected to the Internet by means of mobile technologies. As part of Telefónica, S.A. Group, innovation is one of our fundamental values. For example, we benefit from the innovative, voice-based user interface AURA which is operated by Telefónica, S.A. Group and which we implement. Our internal departments develop innovative products and services to optimise the customer experience. Moreover, our venture department Wayra honed in on the "venture client approach" in 2017: it helps more mature start-ups from the areas of IoT, data analytics, cybersecurity and artificial intelligence to gain direct access to our Group.

Transformation to the digitalisation of the company
In addition to completing the integration and optimisation of the existing business, digitalisation is the crucial lever for creating a phenomenal customer experience and making us stand out from the crowd. We will therefore transform our company: We are initially creating a high-performing and flexible IT infrastructure. Building on this, we will establish a way of working digitally in our company. Finally, we are improving the customer experience by optimising our interaction with the customer by means of digitalisation.

With a dedicated transformation programme, we are improving the three crucial dimensions of the customer experience. First of all, we want to achieve new simplicity in customer interaction. In order to do so, we are implementing a cross-channel distribution and service concept (omnichannel). In addition, the "My O_2" app simplifies the digital life of the customer. It will considerably simplify the management of devices, tariffs and service parameters for individuals or several users. Furthermore, it will offer the customer new opportunities to quickly and easily solve their problems themselves.

Third strategic priority: Growth and profitability

Through digitalisation, we will also interact more quickly with our customers and be able to meet their desires in real time. We are therefore modularising and digitalising our products in order to shorten the time from development to market launch. End-to-end processes with far-reaching automation will accelerate our interaction with customers considerably. We will also use intelligent data analysis to best meet the needs of the customer and make the best use of our internal resources.

"The 'My O_2' app simplifies the digital life of the customer."

We do not just want to be simpler and faster but also better in the eyes of the customer. To do so, we are relying on support in identifying and solving customer problems using intelligent data analysis, accompanied by digital tools for the customers to solve problems themselves. Additional digital tools will improve interaction with the customer in the shop.

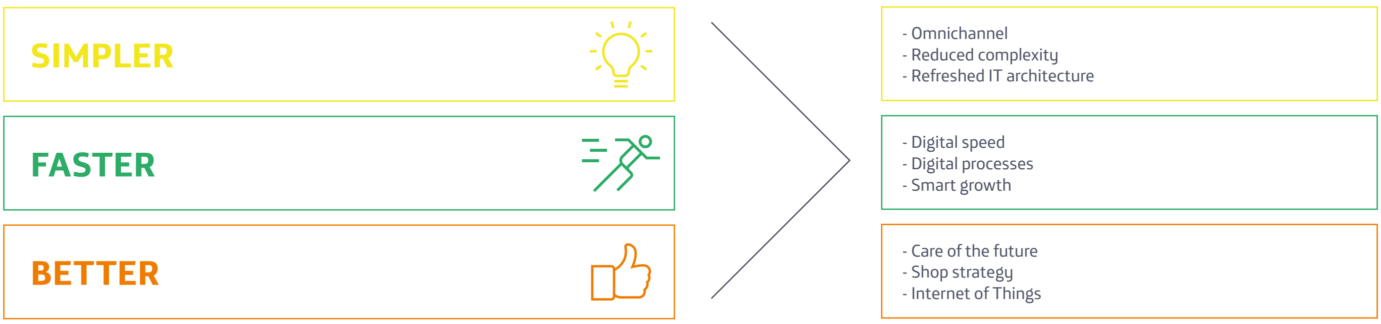
By optimising fundamental success factors and creating a fantastic customer experience through transformation and digitalisation, we will stand out from our competitors and be able to enable new growth. When it comes to customer service, standing out allows us to return to sales growth. We will continue our data monetisation strategy and develop new sales potential through digitalisation, meaning that we can grow in a similar way to the German market.

We are therefore making intelligent investments in our network and transforming our company where we are keeping the amount of our expenses for investments stable. In particular, transformation to a digital company enables us to constantly increase efficiency, meaning that we can consistently reduce our operating costs. We are also tapping into the sales potential arising from the transformation in order to support the development of our cash flow and dividends.

Overall, we are therefore able to ensure the continuous, positive development of our profitability. Last but not least, we are keeping our promises to our shareholders: we are firmly convinced that we are able to generate a solid free cash flow and continue to support above-average shareholder returns with an increased dividend payment in proportion to the free cash flow.

G 03 / Full steam ahead for our transformation programme: Digital4Growth

How to become a Mobile Customer and Digital Champion?
We want to be simpler, faster and better and transform our business.



HIGHLIGHTS OF FINANCIAL YEAR 2017

G 04 / Mobile accesses (postpaid/prepaid)
In million

In a dynamic, yet rational environment, the German mobile market has showed an increasing focus on larger data packages since the middle of 2017. With its anniversary offer, O_2 Free 15 and the update of the O_2 Free tariff portfolio at the beginning of September, Telefónica Deutschland Group was a pioneer of this development. We are hereby setting new standards for the mobile freedom of our customers. We continue to further stimulate the consumption of mobile data and, among other things, are investing in our core brand O_2. This will strengthen our market positioning.

At the same time, we have further progressed with the integration of Telefónica Deutschland and the E-Plus Group as planned. In 2017, we again successfully realised the higher synergy target set at the beginning of the year, with OIBDA-relevant savings of approx. EUR 160 million and additional capex synergies of approx. EUR 80 million. Likewise, we are making solid progress with the integration of our networks – the objective is to largely complete the consolidation by the end of 2018. We are now increasingly focusing on the digital transformation of the company and are placing the customer at the centre of our activities.

As of the end of December 2017, Telefónica Deutschland Group had 47.6 million customer accesses, -3.5 % year-on-year. Mobile customer accesses declined to 43.2 million, down by 2.6 % compared to the previous year. The reason for this was, in particular, the declining demand for mobile prepaid accesses due to regulatory changes. In addition, we saw a technical base adjustment at the end of the year as a result of the IT harmonisation associated with the customer migration in the year before. With 737 thousand net additions, mobile postpaid continued to register a solid trend. At the beginning of 2017, we introduced an additional access base count based on market standards for inactivity accounting. On this basis, we had more than 45.9 million mobile customer accesses as of the end of 2017.

Mobile service revenue was EUR 5,287 million, a decline of 2.8 % year-on-year, mainly due to regulatory influences, ongoing OTT trends, ongoing tariff rotations of the legacy base and a higher share of revenues from the wholesale business. Adjusted for regulatory effects from the reduction of termination rates and the European roaming regulation with a total amount of EUR 146 million, MSR in financial year 2017 remained largely flat at -0.1 % year-on-year. The sequential improvement in MSR thus continued.

G 05 / Mobile service revenues
In million EUR

(-1.1 % without regulatory effects)

Operating income before depreciation and amortisation (OIBDA) amounted to EUR 1,785 million compared to EUR 2,069 million in the previous year, which included the net capital gain from the sale of the passive mobile tower infrastructure to Telxius. Adjusted for exceptional effects[1], OIBDA amounted to EUR 1,840 million in financial year 2017, an increase of 2.6 % year-on-year compared to EUR 1,793 million in 2016[2]. On this basis, the OIBDA margin increased by 1.3 percentage points year-on-year to 25.2 %.

G 06 / OIBDA/OIBDA Margin excluding exceptional and special effects
In million EUR

Capex was 13.7 % lower in the financial year 2017 at EUR 950 million with additional synergies of approx. EUR 80 million being realised. Telefónica Deutschland Group focused on network consolidation and the further extension of LTE.

G 07 / Capex
In million EUR

Please refer to page 44 of the Group Management Report for details on the financial outlook for 2018.

[1] As of 31 December 2017, exceptional effects include restructuring expenses of EUR 82 million, acquisition-related consultancy fees of EUR 2 million and income from the sale of assets amounting to EUR 28 million. As at 31 December 2016, exceptional effects include restructuring expenses of EUR 89 million and the net gain on the sale of passive tower infrastructure to Telxius in the amount of EUR 352 million.

[2] We have calculated a comparative figure for OIBDA, adjusted by the special effects, for 2016, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016 as if it had occurred on 1 January 2016.

“We have kept all of our promises to the capital market.”

Since August 2017, Markus Rolle has been Chief Financial Officer (CFO) of Telefónica Deutschland Holding AG.

MARKUS ROLLE

2017 was a successful year for us. In a competitive environment, we have held our ground very well and also kept all of the promises we made to the capital market. This is mainly determined by three factors: we were able to increase sales trend quarter-on-quarter and actually break the zero-line in Q4 and show growth again. The second factor: OIBDA. Aside from the network consolidation, we have broadly completed integration, thereby managing to introduce the promised synergies. Despite investments in the market for future growth and increased regulatory requirements for the entire sector, we were still able to increase the operating result. A third factor is capex: in 2017, we also invested in the future of our company and spent almost one billion euros to future-proof our network in particular.

We met our financial goals for 2017. We will suggest to the Annual General Meeting increasing dividends by 4 % to 26 cents per share. We are also setting ambitious goals for 2018. We will broadly end the network integration work and open the next chapter in the history of Telefónica Deutschland: the transformation to Germany’s “Mobile Customer & Digital Champion”. Our customers are key, and we want to be simpler, faster and better. We are convinced that we can continue to increase our profitability in this way and be able to keep to our attractive dividend policy.

OUR SHARE

The objective of the Investor Relations department is to provide the public regularly, quickly and effectively with relevant information. We act as an interface between the company, the financial community and other stakeholders and inform interested parties comprehensibly and transparently about the strategic and operative development of our company. We thus want to give investors the opportunity to proactively inform themselves and to enable them to make realistic assumptions about the relative assessment of the company and to take informed investment decisions.

Economic situation and capital market environment

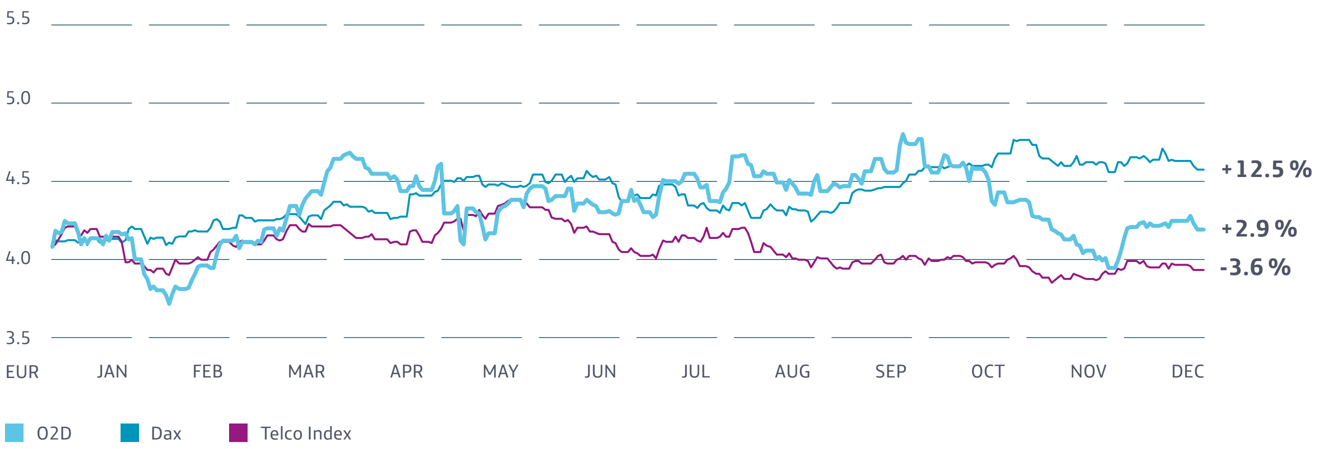
In 2017, the German economy continued to experience a significant upswing and was therefore able to achieve a solid GDP growth of 2.2 % (price-adjusted) despite global crisis. Significant momentum came from the revived strong global demand for industrial goods. The business climate in both the commercial sector and the service sector was at a record high. The construction industry almost reached its capacity limits and the order books in the manufacturing industry improved significantly. According to the German Federal Ministry for Economics Affairs and Energy (BMWi), the uncertainty in the economy decreased as well.

The capital markets were also able to look back on a successful 2017, notwithstanding the continuing global influences as a result of the US presidential elections and the Brexit vote in the previous year. In order to stimulate the economy, no interest rate increases were carried out in the eurozone in 2017.

The benchmark indices DAX and Stoxx 600 performed similarly over the course of 2017. Both figures recorded highs in October before going down again in the short term shortly before the end of the year due to the political unrest in Catalonia. At the end of the year, the DAX as well as the Stoxx 600 recovered and closed with an annual gain of +12.5 % and +7.7 % respectively. The European telecommunications sector was not able to follow this strong annual performance. After the first half of the year, Europe performed largely positively, but losses became noticeable from the middle of the year, among other things, due to the effects of regulatory changes. The price trend of the European telecommunications sector reversed, and the index closed the year slightly negatively at -3.6 %.

The Telefónica Deutschland share started 2017 at a price of EUR 4.07 and in February recorded the annual low of EUR 3.66. During the course of the year, the Telefónica Deutschland share performed with significantly higher volatility than the market. In September, it reached its annual high of EUR 4.86 and, at this point, was able to exceed the sector as well as German and European benchmark indices. In autumn, however, the share came under pressure and had to give up some of the gains from the summer. It recovered slightly at the end of the year, with the result that the Telefónica Deutschland share closed 2017 at EUR 4.19, an increase of 2.9 % and thus ahead of the sector.

G 08 / Share price performance 2017
1 January to 31 December, rebased



Shareholder remuneration at Telefónica Deutschland

We are maintaining our attractive shareholder remuneration policy with a high payment ratio in relation to free cash flow, and we will continue to take into account the free cash flow before restructuring provisions here.

As announced on 25 October 2017, we intend to propose to the next Annual General Meeting (expected to be held on 17 May 2018) a 4 % increase in the cash dividend to EUR 0.26 per share for financial year 2017.

Financial flexibility and a conservative financial policy remain at the core of our financing strategy. We are retaining our medium-term target of a leverage ratio (net debt/OIBDA) of at or below 1.0x and will constantly review this figure – also with regard to the implementation of IFRS 16 as of 1 January 2019.

Activities of the Investor Relations department of Telefónica Deutschland

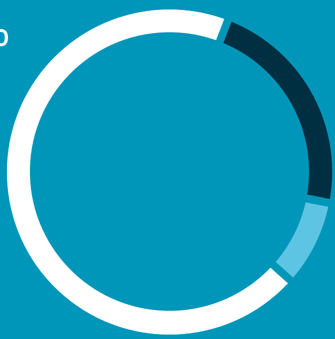
Throughout 2017, we continued the intensive and transparent dialogue with our shareholders, analysts, investors and other stakeholders. We were specifically looking for discussions with national and international investors by participating in conferences and roadshows taking place around the world.

Despite the changes to management in 2017, the Management Board and the IR team participated in 259 investor meetings (2016: 326) in Europe, North America and Asia. In total, the team was on the road for 9 weeks (2016: 14 weeks) in the last year.

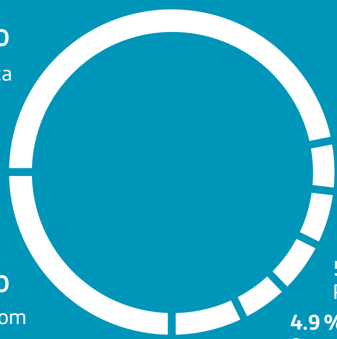
We hold telephone conferences on the publication of our annual and quarterly results. Here, investors and analysts have the opportunity to pose their questions directly to the Management Board. A replay of these conferences is available on our website for one year after the event.

Further information on the company and the Telefónica Deutschland share can be found via the contact details provided on the next page.

G 09 / Shareholder structure of Telefónica Deutschland



G 10 / Geographical distribution of free float[3]



[1] Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefónica, S.A.
[2] Status: 31 December 2017 according to KPN press release from 31 January 2018.
[3] Source: NASDAQ, October 2017.

T 01 / Telefónica Deutschland fixed income

Issue date	Currency	Volume	Tenor	Coupon	Instrument rating	Listing
22 November 2013	EUR	600,000,000	5 years	1.875 %	BBB, stable outlook	Regulated market of the Luxembourg Stock Exchange
10 February 2014	EUR	500,000,000	7 years	2.375 %	BBB, stable outlook	Regulated market of the Luxembourg Stock Exchange

Since 2013, Telefónica Deutschland holds a long-term issuer credit rating by rating agency Fitch, which is subject to regular evaluation. Fitch confirmed the BBB rating with a stable outlook on 26 January 2016.

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Telefónica

FROM THE DIGITAL ME TO THE DIGITAL US. EXPERIENCE MOBILE FREEDOM.

Annual Report 2017

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The figures in the following have been rounded in accordance with established commercial practice. Therefore, recalculations may slightly differ from the totals shown in the tables.

Telefónica Deutschland Group at a Glance

Financial Overview

(Euros in millions)	2017	1 January to 31 December 2016	% Change
Revenues	**7,296**	**7,503**	**(2.8)**
Mobile service revenues	5,287	5,437	(2.8)
Mobile service revenues (excl. regulatory effects 2017)	5,433	5,437	(0.1)
Operating income before depreciation and amortization (OIBDA), adjusted for exceptional effects[1]	**1,840**	**1,805**	**2.0**
OIBDA margin, adjusted for exceptional effects	*25.2%*	*24.1%*	*1.2%-p,*
Operating income before depreciation and amortization (OIBDA), adjusted for exceptional effects[1,2]	**1,840**	**1,793**	**2.6**
OIBDA margin, adjusted for exceptional effects	*25.2%*	*23.9%*	*1.3%-p,*
Operating income before depreciation and amortisation (OIBDA)	**1,785**	**2,069**	**(13.7)**
OIBDA margin	*24.5%*	*27.6%*	*(3.1%-p,)*
Operating income	**(84)**	**(50)**	**69.7**
Profit/(loss) for the period	**(381)**	**(176)**	**116.2**
Basic earnings per share (in EUR)[3]	**(0.13)**	**(0.06)**	**116.2**
CapEx	**(950)**	**(1,102)**	**(13.7)**
Operating cash flow (OIBDA-CapEx)	**835**	**967**	**(13.7)**
Free cash flow pre dividends and payments for spectrum[5]	**680**	**1,408**	**(51.7)**
Total accesses as of 31 December (in thousands)	**47,604**	**49,346**	**(3.5)**
Mobile accesses (in thousands)	43,155	44,321	2.6
thereof M2M accesses (in thousands)	1,027	788	30.4
Mobile accesses (in thousands) according to calculation customary to the market[6]	*45,918*	–	–
Net Adds in mobile prepaid business (in thousands)	(1,903)	(195)	874.2
Net Adds in mobile postpaid business (in thousands)	737	1,453	(49.3)
Postpaid share (%)	**49.3%**	**46.3%**	**3.0%-p,**
Total ARPU (in EUR)	**9.7**	**10.3**	**(5.7)**
Postpaid churn excl. M2M (%)	**1.6%**	**1.6%**	**0.1%-p,**
Non-SMS data over total data revenues (%)	**80.8%**	**76.9%**	**3.9%-p,**

	As of 31 December 2017	As of 31 December 2016	% Change
Net financial debt[7]	**1,064**	**798**	**33.3**
Debt ratio[8]	0.6x	0.4x	30.8
Number of employees	**9,281**	**9,476**	**(2.1)**

(1) As of 31 December 2017, exceptional effects include restructuring expenses of EUR 82 million, acquisition-related consultancy fees of EUR 2 million and income from the sale of intangible assets of EUR 28 million. As of 31 December 2016, exceptional effects included restructuring expenses of EUR 89 million and a net gain on the sale of passive tower infrastructure to Telxius of EUR 352 million.

(2) For comparative purposes, a comparative value for financial year 2016, was calculated for OIBDA adjusted for exceptional effects, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016 as if it had occurred on 1 January 2016.

(3) Basic earnings per share are calculated by dividing profit / (loss) after taxes for the period by the weighted average number of ordinary shares of 2,975 million for the years 2017 and 2016.

(4) Including the additions from capitalised financing leases and excluding capitalised borrowing costs for investments in spectrum.

(5) Free cash flow pre dividends and payments for spectrum is defined as the sum of cash flow from operating activities and cash flow from investing activities and does not contain payments for investments in spectrum nor related interest payments.

(6) Telefónica Deutschland Group introduced an additional method of counting the number of customers with mobile accesses at the beginning of the financial year. This method takes market practices into account, among other things, when determining the time frame for inactive customers.

(7) Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents.

(8) The debt ratio is defined as net debt divided by the OIBDA adjusted for exceptional effects for the LTM.

Basic Information on the Group

This report combines the Group Management Report of the Telefónica Deutschland Group, consisting of Telefónica Deutschland Holding AG (also referred to as Telefónica Deutschland or Company) and its consolidated subsidiaries and joint ventures (together referred to as the Telefónica Deutschland Group or the Group), and the Management Report of Telefónica Deutschland Holding AG.

Telefónica Deutschland Holding AG is a stock corporation (AG) under German law with its registered office in Munich, Germany.

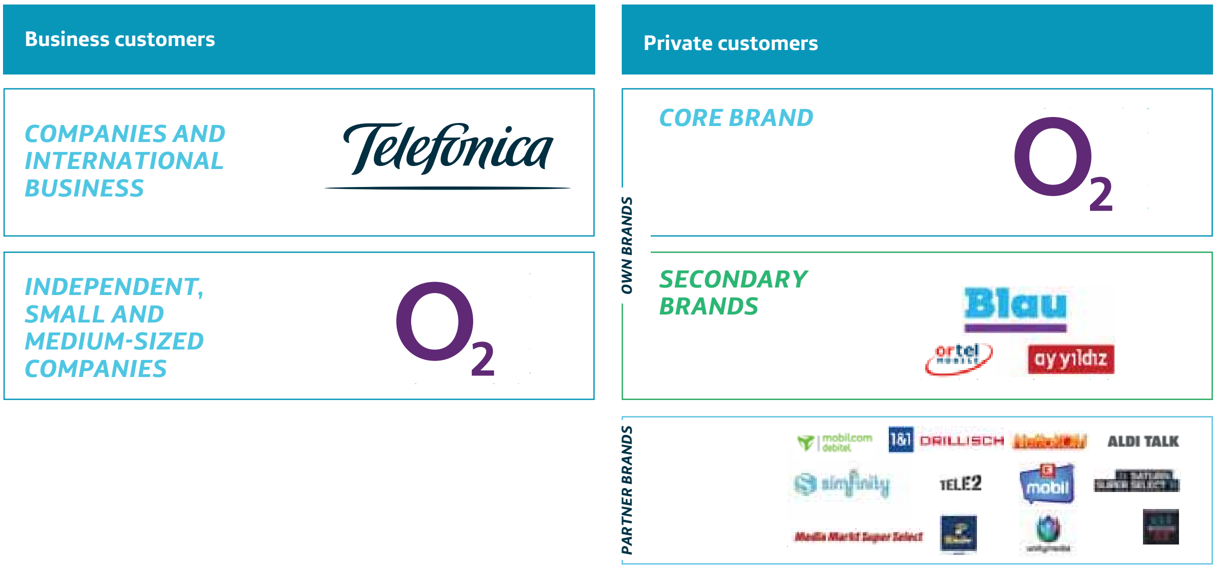
Telefónica Deutschland Holding AG is the parent company of the Telefónica Deutschland Group. It is included in the Consolidated Financial Statements of the ultimate parent company, Telefónica, S.A., Madrid, Spain (Telefónica, S.A.; its group: the Telefónica, S.A. Group). The direct parent company of the Telefónica Deutschland Group is Telefónica Germany Holdings Limited, a wholly owned subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited), and an indirect subsidiary of Telefónica, S.A.

The financial year is the calendar year (1 January to 31 December).

Business Activity

With over 47.6 million customer accesses as of 31 December 2017, Telefónica Deutschland Group is one of the three leading integrated network operators in Germany. In the mobile sector, we serve the increasing demand for mobile services as a consequence of the digitalisation of ever more areas of life. With a total of 43.2 million mobile accesses as of 31 December 2017, we are the leaders in the mobile market. More than 80% of our mobile customers have a direct contract with us. We are a part of Telefónica, S.A. Group, one of the biggest telecommunications companies in the world.

Our brands: Covering all market areas & customer needs
G 01 / Our brands[1]



[1] Example illustration of the brands of the secondary and partner brands.

Our marketing and sales strategy follows a consistent and focused multi-brand strategy. We offer private and business customers a wide range of high-quality mobile services and fixed line products with our core brand, O_2. Large international businesses are addressed through the Telefónica brand.

With our secondary and partner brands and through our wholesale channels, we reach further large groups of customers that we do not target with our O_2 brand. Our secondary brands include Blau, AY YILDIZ and Ortel Mobile. In addition, by means of joint activities and strategic partnerships, we offer further mobile services brands. These include, for example, ALDI TALK, in cooperation with MEDIONmobile and TCHIBO mobil. Our multi-brand approach enables us to address the whole spectrum of customers with tailored product offerings, sales and marketing, thereby increasing our potential revenue.

Mobile service is the main revenue stream
In 2017, at EUR 5,287 million, mobile services were the most important revenue stream for the Telefónica Deutschland Group (72% of total volume).

As the market leader for mobile services in Germany, we operate a state-of-the-art network. We provide a high-quality network experience particularly in urban and suburban areas. Our customers benefit from the combined strength of the O_2 and E-Plus networks and can make even better use of mobile data applications. The combined UMTS network infrastructure reaches around 89% of the population in Germany.

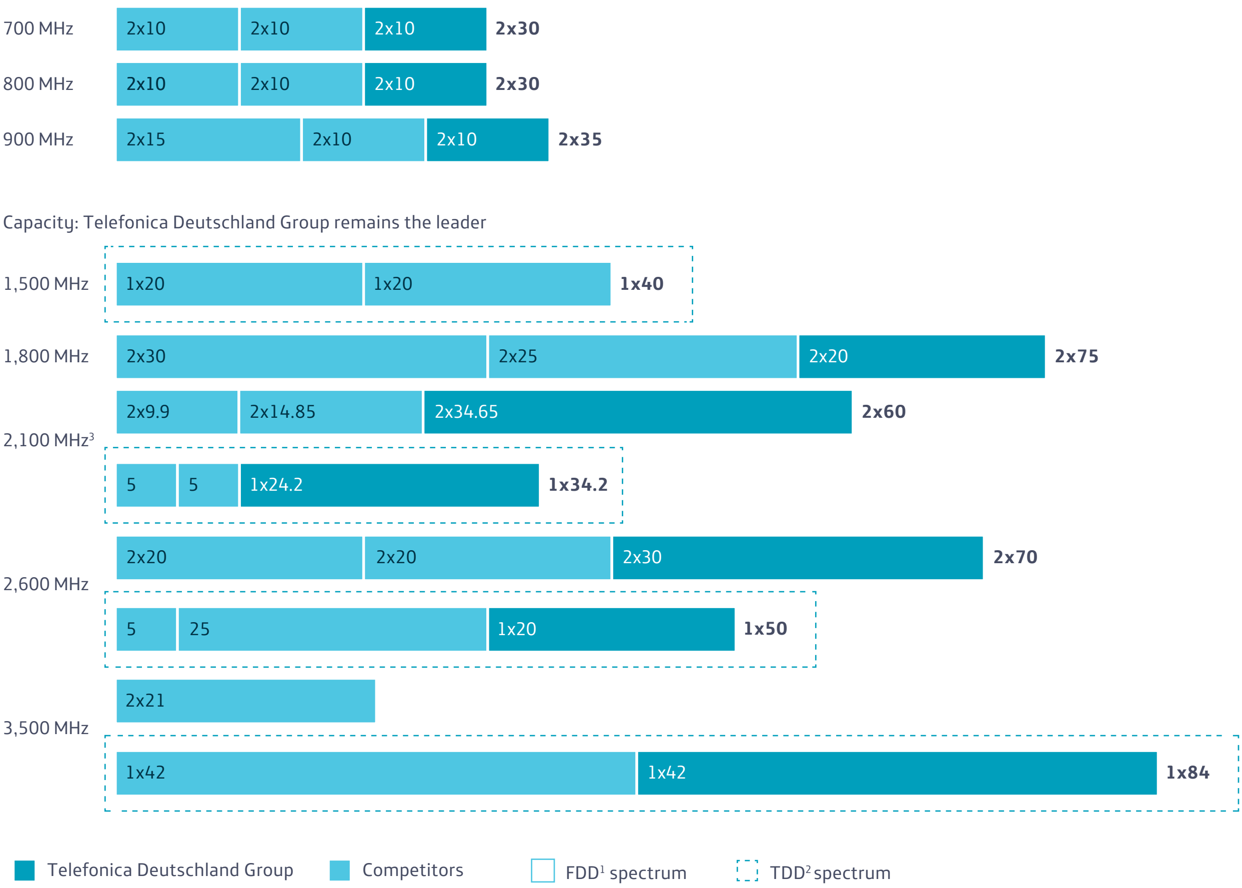
In order to improve the network experience beyond using mobile data on UMTS, Telefónica Deutschland Group has also further continued the deployment of its LTE network. As of end December 2017, the Company achieved a Germany-wide LTE coverage rate of more than 80 %.

We are also pressing ahead with the consolidation of our 4G networks, which we aim to complete no later than the end of 2018.

We are also in an excellent position with respect to our spectrum portfolio. Telefónica Deutschland has access to 315.5 MHz of spectrum with a good balance between frequencies providing coverage (low frequencies) and those providing capacity (high frequencies). Compared with our competitors, we are in an excellent position to drive future network developments.

G 02 / Frequency bands for mobile operators in Germany

Network coverage on a level playing field with competitors



[1] FDD = Frequency division duplex
[2] TDD = Time division duplex
[3] UMTS core band also identified as "2 GHz band" by BnetzA (German Federal Network Agency)

Fixed-line business: Full service offers based on future-proof infrastructure
We offer nationwide fixed services to complement our mobile services. The offer is based on our strategic partnership with Telekom Deutschland GmbH, Bonn. It grants us long-term access to future-proof next-generation fixed-line infrastructure, currently supplying a total of more than 28 million households in Germany with high-speed VDSL internet access.

In addition, Telefónica Deutschland Group benefits from all Deutsche Telekom's future network improvements such as an increase in VDSL coverage and higher speeds based on new technologies like FTTX.

With these advantages, Telefónica Deutschland Group is in an excellent position to provide full service offerings to both residential and business customers.

Handset business: State-of-the-art products, services and financing offers
We sell a large variety of mobile phones and other hardware to our customers independently of mobile communications contracts. The best example is our successful "O_2 My Handy" model. Here, the customer can choose whether to pay the entire price upfront or to make a down payment and pay the remaining purchase price in 24 monthly instalments. For the customer this approach provides price transparency with regards to the cost of both the mobile phone and the telecommunication services contract. Our customers can choose from a wide variety of mobile phones, including the latest premium devices, take advantage of attractive payment terms and replace their device at the end of the 24-month term of a telecommunication services contract. We also supply our partners with hardware to some extent and support them as needed in the sales and marketing of the hardware to their customers.

Our most important suppliers for mobile phones are the manufacturers Samsung, Apple, Huawei and Sony, where we focus in particular on the sale of LTE-enabled smartphones. As a result, the number of customers with LTE-enabled devices and LTE tariffs grew by 10 percentage points compared to 31 December 2016 to around 37 %[2] of our customer base. We cover the growing demand from our secondary brand customers for more mobile data services with a wide range of affordable smartphones.

In order to make our smartphone offers even more attractive for our customers, we offer additional services and products. These include insurance services for smartphones, virus protection and state-of-the-art additional devices. Further positive examples are the marketing of virtual reality glasses and smart watches.

Our market areas

We are strengthening the market position of O_2, our core brand. We aim to gain further high-quality customers in the private and business customer segments. In addition, Telefónica Deutschland Group is the leading wholesale provider in Germany. We offer our wholesale partners access to our infrastructure and to our services.

We rely on supplementary sales channels in order to serve the various customer needs to the best of our ability. Our sales landscape includes both direct sales channels as well as our own shops, a countrywide network of independently operated franchise and premium partner shops, online and telesales, as well as indirect sales channels such as partnerships and co-operations with retailers via physical and online channels.

Private customers: Value management and sustain leadership

The O_2 brand is a market leader in the consumer post-paid market as measured by accesses in Germany. We honour this trust and endeavour to offer our clients mobile freedom in the digital world. As a pioneer in the German market, our strategic focus is on the sale of data-centric mobile communications contracts to smartphone users, such as our O_2 Free offering, launched on the market in September 2017 for the first time.

We have incorporated large data packages into the new pricing structure for our O_2 customers, winning them over with good value for money. This way we fuel the growing use of mobile data services. Since our customers are also increasingly using LTE-enabled devices that further promote data use, we are able to boost revenues per customer compared to users without a smartphone. We are also seeing rising interest in smartphones and the use of mobile data in the prepaid area. Here, we offer special tariffs for smartphone users.

In addition, we supplement our product portfolio with innovative services, such as the offer of O_2 Banking, the O_2 TV & Video app and our partnership with Sky, which has been offering customers of O_2 affordable access to exclusive sporting events, films and series since the beginning of 2017.

Wholesale partners: Cementing market leadership

Our partner business is an important pillar of our multi-brand approach. We offer our partners a wide portfolio of options, which is based on a scalable business model with a variety of value creation levels that we can offer potential partners who wish to enter the German mobile communications market.

Our largest partners include MEDIONmobile (ALDI TALK), 1&1 Drillisch, mobilcom/debitel and cable providers. We have committed to selling 20 % of our mobile network capacity via mobile bitstream access (MBA) to Drillisch Online AG (formerly: MS Mobile Service GmbH)), which now belongs to the 1&1 Drillisch Group part of the merger with E-Plus. With a holding that is already over 20% , Drillisch will be adding network capacity under the MBA contract and will also, has the option of increasing its total capacity to up to 30%.

In the fixed-line business, we offer our existing wholesale partners a range of "unbundled local loop" (ULL) services, including fixed-line telephony and high-speed internet. However, we will phase out this model by 2019 as part of the transition to the next generation fixed network of Telekom Deutschland GmbH.

Business customers: Focus on small and medium-sized enterprises (SMEs)

We address SMEs as well as small office/home office (SoHo) through our core brand O_2, for example with our innovative products like "O_2 Free Business" or "Digital Phone". This is a cloud-based telephony system that allows customers flexible use irrespective of location and hardware, as well as secure communication via German data centres.

Within the business customer market area we also offer our machine-to-machine-communication (M2M) managed connectivity services. This business line currently contributes to mobile service revenues to a minor extent. However, we intend to develop this further in the future. Managed connectivity, part of the IoT (Internet of Things), is a very dynamic market with expected double digit annual growth in the customer base[3].

[2] Based on mobile accesses excluding M2M accesses.

[3] Machina Research IoT Forecast May 2016.

New Business: Internet of Things and intelligent data analytics
The Telefónica Deutschland Group focuses on driving innovation forward in the area of data analytics and IoT. We are tapping the major economic, social and ecological potentials of the Internet of Things and intelligent data analysis (ADA: Advanced Data Analytics). We are currently developing new business models in these fields and, in the process of doing so, we make use of both agile methods as well as the Telefónica Deutschland Group's strengths.

With the takeover of the Berlin start-up Minodes in May 2017, we are strengthening our capability in the area of advanced data analytics for stationary retail trade. The core competence of Minodes is the analysis of anonymised customer flows in a shop. This gives stationary retailers in the brick-and-mortar trade access to the same analysis and marketing opportunities already available to online retailers today. As a result, they can tailor their offers better to their customers' needs and ensure a better shopping experience. The applications are integrated into the data anonymization structures of the Telefónica Deutschland Group.

We will open up the growth area of the Internet of Things (IoT) for all market segments that we already serve with our core business. We intend to play a leading role in the Consumer IoT area, by offering an attractive range of IoT hardware and software and our own consumer IoT platform.

Management System

The Telefónica Deutschland Group is managed by the members of the Management Board.

The Management Board runs the business of the Telefónica Deutschland Group and reports to the Supervisory Board. It participates in the Management Board transactions requiring consent (e.g. for the adoption of the annual budget, for changes to the corporate structure or the principles of the corporate strategy). Together with the Supervisory Board, the Management Board issues an invitation to the Annual Shareholders' Meeting.

In the eight-person Management Board, all operational and strategic decisions are taken in the weekly meetings for successfully managing the Company in the individual business divisions. This is comprised of the specification and adoption of the strategy across all operational divisions, the consistent and uniform operationalisation of the strategy, the management of operational performance, the assurance of cross-functional coordination and cooperation, assurance of the achievement of budgetary targets, definition and implementation of measures for performance improvement and the functional risk management for the respective area of responsibility.

Our aim is to increase the value of our company for the benefit of our shareholders. We are also firmly convinced that the satisfaction of customers and employees makes a major contribution to achieving this value growth.

The management of the Telefónica Deutschland Group has introduced a comprehensive internal management system for the control of the group, which primarily comprises the following components:

- Process for strategic goal setting
- Integrated budgeting and planning system
- Financial and non-financial performance indicators
- Monthly reporting to Management Board and Supervisory Board
- Ongoing opportunity and risk management
- Leadership by target agreements at all levels of the organisation

Strategic objectives are reviewed and redefined annually

As part of the annual planning process, the Management Board of Telefónica Deutschland reviews the corporate strategy with the support of the Strategy division. We develop long-term strategic goals for the positioning of the company on the German market as well as strategy plan, including financial planning for the next three years as part of this process. Decisions are based on current market and competitor analyses as well as market forecasts, which are compared with the corporate vision and the long-term strategic goals.

Through this systematic approach, we determine odds and opportunities for growth and make investment decisions.

The corporate strategy as well as the identified opportunities and growth potential of the company are translated into concrete strategies for each organisational unit. In terms of the practical implementation of the strategies at the level of the organisational units, the relevant opportunities are prioritised in each case. In addition, specific targets in the form of key performance indicators (KPI) are defined. These track the strategic implementation as well as the most important measures required for realising these targets. Detailed budget planning for the next financial year is then prepared on the basis of the agreed multi-annual goals. The short-term priorities are defined at the same time.

Management system includes financial and non-financial indicators

We have established key performance indicators (KPIs) for the management of our strategic and operating goals. Financial and non-financial performance indicators are a component of the management system of the Telefónica Deutschland Group and reflect the interests of our various stakeholders.

The following monitoring parameters were of particular significance for our company's value-oriented monitoring and evaluation in financial year 2017:

G 03 / Performance Indicators in 2017

Key financial performance indicators	Mobile service revenue (MSR)	Operating result (OIBDA) adjusted for exceptional effects	Capital expenditure (CapEx)		
Other financial and non-financial performance indicators	Free cashflow	Net leverage ratio	Nets adds in mobile communications business	Customer satisfaction	Employee satisfaction

Mobile service revenues

The development of mobile service revenues is a key indicator of the success of our company. Mobile service revenues are largely generated by base fees and the fees levied for voice, short message and mobile data services, as well as the revenue from services contracts. Alongside roaming revenues, mobile service revenues include access and interconnection fees paid by other service providers for calls and SMS delivered via our network. A central revenue driver for sustainable development is the mobile data business and the monetisation of data usage.

Operating result adjusted for exceptional effects

The OIBDA corresponds to the operating income before depreciation on intangible assets and property, plant and equipment. On the basis of the OIBDA, we measure the profitability of our operating activities. This analysis provides a comprehensive view of our expense and revenue structure. As exceptional effects make comparability with previous years difficult, we use the OIBDA adjusted for exceptional effects for a transparent presentation. These non-recurring effects have a direct impact on the result of operations and follow, for example, from a changed composition of the Group, from sales of businesses, acquisition-related consultancy fees, restructuring expenses or non-operational transactions. For better comparability, we also adjust for impacts on the prior year's operating income that result directly from a transaction completed in the course of the previous year and thus are not fully included in the comparison year (e.g. higher operating leasing expenses due to a corporate transaction). However, as other companies may use a different basis of calculation for OIBDA, it is possible that our representation is not comparable with other companies.

Investment activity

Capital expenditure (CapEx) consists of the additions to property, plant and equipment and intangible assets. The investments in property, plant and equipment are primarily to expand the coverage and capacity of our network (particularly for LTE and UMTS) as well as product development. CapEx does not include payments for licences in mobile phone frequency usage rights. It predominantly serves to secure our future business activity.

The following performance indicators will be of particular significance for the value-focused management and assessment in our company as of 2018.

G 04 / Performance indicators from 2018

Key financial performance indicators	Revenues	Operating result (OIBDA) adjusted for exceptional effects	Investment ratio (CapEx/Sales ratio)			
Other financial and non-financial performance indicators	Mobile service revenue (MSR)	Free cashflow	Net leverage ratio	Nets adds in mobile communications business	Customer satisfaction	Employee satisfaction

Revenue
The development of revenues is a key indicator of the success of our company. Revenues depict the total value of our operational activity and are therefore a crucial indicator of the success of our products' and services' sales on the market.

They are essentially based on mobile service revenues (base fees, the fees levied on customers for voice, short message and mobile data services, as well as access and interconnection charges paid by other service providers for the use of our network). Furthermore, our revenues are generated by sales of mobile service hardware as well as landline services (base fees, user fees levied on customers as well as access and interconnection charges).

In addition, revenues are created increasingly by selling additional products and services; examples include the 'Internet of things' (IoT) in the digital markets of the future, 'intelligent data analysis' (ADA) and 'cloud computing'.

In light of the foregoing, we view our revenues from financial year 2018 onwards as key performance indicators whereas mobile service revenues are additional performance indicators.

Operating Income adjusted for Exceptional Effects
'OIBDA adjusted for exceptional effects' will continue to be one of our most important KPIs.

Investment Activity (CapEx to Sales Ratio)
Capital expenditures (CapEx) are essentially used to secure our future business activity and comprise additions to property, plant and equipment and intangible assets. The investments in property, plant and equipment are primarily to expand the coverage and capacity of our network as well as product development. CapEx does not include payments for licences in mobile phone frequency usage rights.

In the context of industry standards and comparability, we think that the CapEx to sales ratio is more informative as an indicator than the absolute CapEx value. As of financial year 2018, we will be using this ratio as a KPI.

Alongside our fundamental financial internal key performance indicators, other financial and non-financial indicators are also observed.

Other financial and non-financial performance indicators
Free cash flow
The internal monitoring parameter of free cash flow pre dividends and payments for spectrum is defined as the sum of the cash flows from operating activities and investing activities. Free cash flow implicitly provide information about the change in working capital. Working capital management is thus an essential element of the managing of free cash flow in the relevant reporting period.

As a performance indicator, free cash flow describes the change in financial liquidity from operational inflows and outflows of funds as well as all investment-related inflows and outflows that were made for the maintenance or expansion of the business. The figure provides information about the change in the company's available financial funds, which enable us to make investments in growth or to pay dividends or service debt, for example.

Net leverage ratio
The net leverage ratio is defined as the quotient of the net financial debt and the operating result before depreciation and amortisation (OIBDA) adjusted for exceptional effects for the last twelve months. Net financial debt includes short and long-term interest-bearing assets and interest-bearing financial liabilities and cash and cash equivalents.

The net leverage ratio compares the net debt level with an operational success parameter (OIBDA adjusted for exceptional effects) and provides management with information about the company's debt reduction ability. We are actively monitoring the capital structure with the objective of keeping the net leverage ratio at or below 1.0x in the medium term (target level). In relation to the effects of the implementation of IFRS 16 on 1 January 2019, we will validate the target goal level.

As part of its dividend policy, Telefónica Deutschland has also decided to refrain from paying dividends by distributing capital or capital reserves in cash or buying back shares if the net leverage ratio materially and consistently exceeds the target leverage of 1.0x.

Mobile net adds in mobile communications business
New customers in the period less those customers leaving the company are designated as net additional customers ("net adds"). A continually positive number of net adds leads to a growing customer base. A distinction is made between contractual customers (post-paid) and customers without a contractual commitment (prepaid). The number of net adds is influenced by various factors: More new customers can be won with a highly attractive product portfolio and a high level of customer satisfaction among existing customers leads to a lower churn rate. One of the goals of this performance indicator is to allow the evaluation of customer acquisition and retention measures.

Customer satisfaction
Customer satisfaction is among the most important priorities of our business. Accordingly, we continually strive for a better positioning of our brands in order to attract private, partner and

business customers for our products. Our objective is to serve the most satisfied customers on the German telecommunications market with the most popular brands. This means that we always strive to create customer-oriented offers and provide outstanding services across all our customer interfaces. We are confident that high customer satisfaction values reduce termination rates and increase recommendation rates.

Employee satisfaction

Our employees are a key element of our success and it is only with their dedication that we will succeed in transforming into a leading digital telco. Our employees have made our company what it is today. We regularly carry out internal surveys to review the satisfaction of our employees and we use their feedback to improve and become a better company for them. In order to measure customer satisfaction we are using the Net Promoter Score (NPS) and the Customer Satisfaction Index (CSI) as the key performance indicators.

Budgeting and planning system defines specific targets

The integrated planning system is based on strategic and operating goals. With respect to the most important performance indicators, the Management Board of Telefónica Deutschland sets internal objectives for the Group. To define a three-year plan, the anticipated market development as well as internal expectations with regard to progress in the areas of growth and efficiency evolution are discussed once a year. The first year of planning is depicted on a monthly basis in order to establish a detailed budget. For controlling reasons, the budget is updated twice a year. Alongside the results that have already been achieved and which are analysed as part of monthly reporting, current market developments and the additional opportunities or risks that are known at the relevant point in time are taken into account in the update. This prognosis is then used to introduce operational improvements and take advantage of new opportunities presenting themselves to the group.

Economic Report of the Group

Overall Economic and Industry Conditions

Solid economic development in Germany

The German economy remains on its growth trajectory: according to calculations by the Federal Statistical Office, the calendar-adjusted gross domestic product (GDP) grew by 0.8% in the third quarter of 2017 compared to the second quarter of 2017. On the whole, the German economy grew by 2.2% in 2017 In comparison to the previous quarter, positive stimulus came from both the domestic situation and abroad. In 2017, German consumer sentiment was high, despite global economic crises. The economic outlook indicator increased for the fifth time in succession in September 2017. This is the highest level it has reached in over two years. A further indicator for this development is that income expectations increased further, buoyed by the extremely good state of the German labour market. At the end of 2017, 44.3 million employed persons had their place of work in Germany, according to a report by the Federal Statistical Office.

Trends on the German telecommunications market indicate growth potential

The telecommunications industry is a major trailblazer for digitalisation, a process that is advancing and changing the world. Various trends are visible in the telecommunications market:

The use of mobile devices such as smartphones, tablet computers and wearables is extremely important. The smart phone has developed from a pure communications device into a universal mobile companion and the control centre of mobile life. 71% of current smartphone users can no longer imagine life without a smartphone. Numerous services and apps, such as messaging and surfing the Internet, are now considered to be indispensable by a majority of Germans. On the one hand, smartphones are replacing products such as digital compact cameras, mobile navigation devices and mp3 players. On the other hand, they are driving development on the market as interconnection with other devices opens up new growth areas. The smartphone is establishing itself as the control centre for other networked devices, and the range of potential applications is growing every year. For example, smartphones can be used for the wireless transfer of music to multi-room systems, or smart TVs can be operated using an app. Household devices can also be activated and controlled remotely by smartphone. Wearables introduce additional functions and intelligent sensors to the smartphone concept. The industry association Bitkom was, for instance, expecting sales of 2.8 million smart watches and fitness trackers in Germany in 2017.

In the end-customer segment, voice assistants – such as Alexa by Amazon or Google Home – and virtual reality devices (glasses) are also playing an increasingly important role even if they are not yet mass-market products.

Last but not least, the television market is undergoing fundamental changes in Germany that also affect the telecommunications industry. Linear television is becoming increasingly less interesting for many people, even if it remains by far the most widespread form of television. On the other hand, new players such as Netflix or Amazon Prime are challenging established companies and media.

In addition to connecting people, the intelligent connection of things via the internet (IoT) offers numerous application and growth opportunities, such as Industry 4.0, connected cars, smart health, smart energy and smart cities. Another trend is the analysis of large quantities of data, which is facilitating new insights as well as new business models.

Demand for mobile data services and increased competition drives market development

With 118 million customers (SIM cards) at the end of September 2017, the German mobile telecommunications market is the largest in the EU. The notional mobile penetration rate was 143%, i.e. each German citizen had an average of 1.4 mobile SIM cards. The customer growth from April to September 2017 was attributable primarily to the more valuable postpaid sector. Overall, postpaid customers accounted for 53.9 % of total connections as of the end of September 2017. This share was 53.0% at the end of September 2016.

The mobile telecommunications market continued to develop dynamically in 2017, driven primarily by the strong demand for attractive smartphones and smartphone tariffs. According to a survey by the industry association Bitkom, 81% of German citizens aged 14 or older currently use a smartphone in 2017. However, a slowdown in the growth of the smartphone device market can be observed, driven by its increasing saturation and the fact that smartphones are being used for longer. According to the German Association for Consumer and Communication

Electronics (gfu), around 15.88 million smartphones were sold in the period from January to September 2017, equating to a drop of 4.5% compared with the previous year. According to the same study the average price of smartphones, in contrast, increased by 6.3% to EUR 428. The driver of this development is the increasing demand for high-quality devices.

Mobile media use resulted in growing mobile data usage. According to the German Association of Providers of Telecommunication and Value Added Services (VATM), 1,350 million GB of data will be transmitted over mobile networks in 2017. This is 50% more than in 2016 (902 million GB).

The increasing penetration of mobile end-devices with internet capability, such as smartphones or tablets, and the increasing use of mobile data services are also evident in the strong growth of revenues from mobile data in the German telecommunications market. According to estimates by Ovum, mobile data revenues increased by 10.5% in 2016 compared with the same period in the previous year; further growth of 13.4% compared with the previous year is expected in 2017. By contrast, revenues from mobile telephony and SMS have fallen, driven by price decline, regulatory effects and changes in customer behaviour.

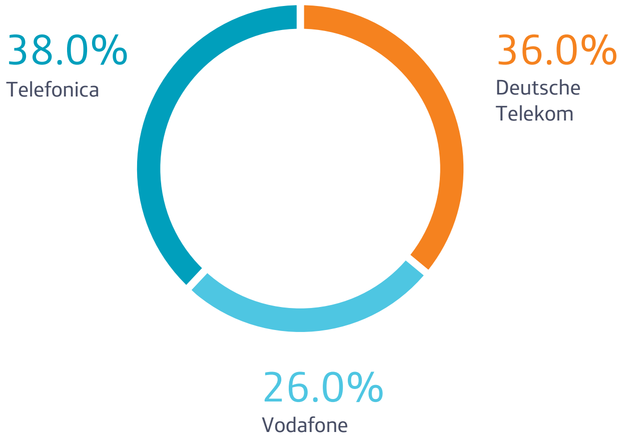
Source: Company Data, Analysys Mason, Bundesbank, Bitkom, VATM, BMWi, Federal Statistical Office, Ovum

The German mobile telecommunications market is an established market

Following the merger of the Telefónica Deutschland Group with the E-Plus Group, the German mobile telecommunications market consists of three network operators and several service providers and mobile virtual network operators (MVNOs). As of the end of September 2017, the Telefónica Deutschland Group had a market share of 38.0% with around 44.8 million connections in total (according to the introduced additional form of counting[4]: 48.4 million). It is therefore the largest German mobile telecommunications network operator in terms of number of customer connections.

[4] At the beginning of the financial year, the Telefónica Deutschland Group introduced an additional form of counting customer accesses based on the customary market calculation for inactivity.

G 05 / Market share in the mobile telecommunications market
per customer (in %)
at the end of September 2017



Source: Company Data/Quarterly Reports

German fixed-line market characterised by strong competition

Intense competition also still prevails on the German market for fixed-line broadband services. The number of connections increased by approx. 3% year-on-year; the customer base is therefore estimated to have grown to 33.0 million by the end of 2017. The growth is mainly driven by cable and VDSL connections, which is in turn based on changed customer behaviour and the increased demand for high speeds. At the end of 2017, 28.2% of fixed line customers used connections of at least 50 Mbit/s; at the end of 2016 this was still at 23.8%. The increased customer demand for more bandwidth is also reflected in the data volume generated per broadband connection and month. According to VATM, this increased by 33.2% in 2017 to an average of 79 GB per connection.

Source: Analysys Mason, VATM

Regulatory Influences on the Telefónica Deutschland Group

As a provider of telecommunications services and an operator of telecommunications networks, the Telefónica Deutschland Group is required to meet certain regulatory requirements. As such, it is subject to supervision by the Bundesnetzagentur (BNetzA – German Federal Network Agency).

The key regulatory events affecting the Telefónica Deutschland Group in the year under review are discussed below.

Frequencies

BNetzA continues with process to provide new frequencies for the further development of digital infrastructures

Telefónica Deutschland Group and other interested parties submitted statements on the points of orientation for the provision of frequencies for the expansion of digital radio infrastructures provided by BNetzA for comment in March 2017. In the further development of the points of orientation, the BNetzA published a position paper on key elements on 27 June 2017 and, at the same time, initiated a procedure for determining the frequency demand for nationwide assignments in the 2 GHz and 3.6 GHz bands. Among other things, for 2 GHz the key elements adhere to the joint award of the frequencies expiring at the end of 2020 and end of 2025; for 3.6 GHz regional assignments for a part of the frequencies are provided for on the one hand, and, on the other hand, mutual co-usage rights between national and regional assignments as well as a demand-based supply with 5G are planned. The holders of national assignments are to be required to share the use of the capacities and services for the provision of as diverse business models as possible without discrimination. For frequencies above 24 GHz, BNetzA intends to initially develop an application process in the frequency band of 26 GHz. Telefónica Deutschland Group reported its frequency demand by 30 September 2017 and commented on the key elements. The results of the frequency demand determination and the first draft decision in this regard are expected in the first quarter of 2018.

Telecommunications market

EU revises legal framework for telecommunications (telecoms review)

On 14 September 2016, the European Commission presented a proposal for a European Electronic Communications Code that would fundamentally revise the legal framework for the communications industry. The core aspects include extending the regulatory targets to include "encouraging investment in very high-capacity networks" and considerations on the regulation of OTT services. The proposal also contains regulations on frequency usage, access regulation and the future institutional framework. Although it sets out a right course of action, the proposal also involves uncertainties, meaning that a conclusive assessment of the opportunities and risks is not yet possible. The EU regulations are expected to be finalized in June 2018 and will then have to be implemented into national law.

EU issues new Payment Services Directive II

The EU has issued a revised Payment Services Directive II. It supersedes the Payment Services Directive I and must be implemented into national law by 13 January 2018. Particularly relevant areas for the Telefónica Deutschland Group are the revised provisions on billing for third-party digital goods via phone bills. In future, the exemption from payment services supervision in this area will apply for amounts only up to EUR 50 per transaction and a maximum of EUR 300 per month where no payment services licence is held. The new legislation also introduces reporting obligations to the German Federal Financial Supervisory Authority. The new regulations were implemented by the Telefónica Deutschland Group.

BNetzA consults specifications on transparency requirements under the Telecoms Single Market Regulation (TSM-R)

Since 30 April 2016, the TSM-R regulations, among other things on transparency in end customer contracts, must be complied with. BEREC, a body of European regulators, published guidelines for implementing the provisions on 30 August 2016. In this connection, after holding hearings for the affected parties on 12 July 2017, BNetzA published a notification on the definition of unspecified legal concepts in the TSM-R for fixed broadband connections for download in the official gazette (Amtsblatt) in order to make it practicable.

The transparency regulation promulgated by BNetzA enters into force

The legal regulation with measures to increase transparency in telephone and internet services in the mobile and fixed-line segments issued by BNetzA to strengthen consumer interest largely entered into force on 1 June 2017; the remaining parts are to follow on 1 December 2017. Among other things, the regulation includes provisions on cost control, the review and documentation of contractually agreed data transfer rates and the provision of information on contract content to customers prior to conclusion. Telefónica Deutschland Group complies with the new regulations.

Amendments to section 111 of the German Telecommunications Act (TKG) in the context of the Act on Improved Information Exchange in Combating International Terrorism have been valid since 1 July 2017

Section 111 of the Telekommunikationsgesetz (TKG – German Telecommunications Act) stipulates which customer data must be collected and stored before a connection is activated. As from 1 July 2017, this section requires the accuracy of the customer data collected to be checked by means of certain identification documents or other methods now determined by BNetzA before a prepaid SIM card is activated. Telefónica Deutschland Group complies with these amendments in its business processes.

Discontinuation of data retention by BNetzA

In December 2015, a law on the reintroduction of data retention was promulgated, according to which the technical and organisational realisation of groundless retention of certain traffic data had to have taken place as of 1 July 2017. In a decision by the Münster Higher Administrative Court for the State of North-Rhine Westphalia in June 2017, the legality of this groundless retention was questioned. Against this background BNetzA published a notification according to which it will refrain from issuing ordinances and taking other measures to enforce the retention obligations in respect of all companies required to do so until the lawfulness of the retention obligations had been legally clarified. For this reason, Telefónica Deutschland Group has temporarily discontinued the retention.

Access and compensation regulation

Roaming surcharges have in principle been abolished since 15 June 2017

The TSM-R, which came into force in November 2015, sets out changes to the existing roaming regulation. Since 15 June 2017 roaming surcharges have therefore, in principle, been abolished for end customers on their respective domestic tariff ("Roam-like-at-home"); surcharges to the value of the maximum wholesale roaming charges, also effective since 15 June 2017, may now only be charged after a fair use limit has been reached. Details of this fair use limit were finally adopted by the EU Commission in December 2016. BEREC, a body of European regulators, published guidelines for implementing the roaming provisions (valid since 15 June 2017) on 27 March 2017. The Federation of German Consumer Organisations (Verbraucherzentrale Bundesverband e.V. – VZBV) issued a warning to Telefónica Germany GmbH & Co. OHG with regard to individual aspects of the implementation of Roam-like-at-home. As the implementation took place by Telefónica Germany GmbH & Co. OHG in line with the specifications of BNetzA, the warning was not agreed to. The VZBV therefore filed an action.

BNetzA issues final approvals for MTR and FTR

By means of the decision dated 6 March 2017, BNetzA issued the final approval for the mobile termination rates (MTR) initially provisionally approved on 30 November 2016. From 1 December 2016, rates of 1.1 euro cents per minute were valid, which dropped to 1.07 euro cents per minute on 1 December 2017; as of 1 December 2018, the rates will drop further to 0.95 euro cents per minute. These rates were symmetrically approved for all mobile operators. They are effective until 30 November 2019. The rates were approved on the basis of the new cost benchmark, pureLRIC. Overall, the reductions were less than initially expected.

The fixed termination rates (FTR) of 0.24 euro cents per minute expired at the end of December 2016. For the period thereafter, BNetzA provisionally approved rates of 0.1 euro cents per minute with its provisional decision dated 25 January 2017 and final decision dated 20 October 2017. These charges were approved symmetrically for all regulated fixed network operators for the period from 1 January 2017 to 31 December 2018. The FTRs of Telekom Deutschland GmbH (Telekom) serve as a reference benchmark for all the other fixed line operators. Telekom has filed an action against their FTR approval.

BNetzA initiates consultation and market studies on fibre optic infrastructures

On 14 March 2017, BNetzA initiated a consultation process entitled "Issues in rates regulation for FttH/B-based wholesale products with a view to the development of fibre optic infrastructures capable of high performance". The study will investigate how the accelerated development of fibre optic networks can be supported by regulations. The consultation deals with the rate-related aspects of regulation. The future could hold a departure from the current cost-based regulation. Any changes to the regulatory standard are expected by the end of 2018 at the earliest. In a parallel process, BNetzA initiated a market study on the requirements for regulation and the existence of significant market power relating to markets 3a (= wholesale local access provided at a fixed location) and 3b (= wholesale central access provided at a fixed location for mass-market products). The key aspect of this study will be the question as to whether FttH/B-based wholesale products will continue to be assigned to the nationwide connection market in which copper-based connections and cable-based connections can also be found. This study is a pre-requisite for any rate regulation. Initial decisions are expected to be made in the second quarter of 2018 at the earliest.

Introduction of a regulated wholesale product "Super Vectoring" by Telekom

Telekom Deutschland GmbH announced that it expects to expand its product offering as part of the regulated wholesale service "Bitstream Access" through "Super Vectoring" connections from August 2018. This would significantly increase the potential bandwidth of VDSL connections compared to today. Telekom is required to offer competitive prices on the wholesale service market; however, it is not yet known what these are. An improvement in Telefónica Deutschland Group's competitive position in the fixed line market is expected due to the planned introduction as competitiveness versus cable network operators and FTTB/H providers can be improved.

Overview of the Financial Year 2017

In a dynamic yet rational environment, the German mobile telecommunications market has increasingly refocussed on larger data bundles since the middle of the year. With its anniversary offer O_2 Free 15 and the update of the O_2 Free portfolio at the beginning of September, Telefónica Deutschland Group was at the forefront of this development. We are hereby setting a new standards for the mobile freedom of our customers. We are focussing on stimulating customer data usage and continue to invest in our core brand O_2, thus strengthening our market positioning.

At the same time, we are progressing according to plan with the integration of Telefónica Deutschland Group and E-Plus. In 2017 we have successfully delivered OIBDA-relevant savings of approx. EUR 160 million and additional capex synergies of approx. EUR 80 million, as per the targets we increased at the beginning of the year. At the same time, our network integrations is making solid progress, with a clear objective to finalise the consolidation by the end of 2018 at the latest. We are now increasingly shifting our focus towards the digital transformation of your company.

As of the end of December 2017, Telefónica Deutschland Group's customer accesses amounted to 47.6 million, a decrease of 3.5% compared to the same period of the previous year. This development was driven particularly by the mobile prepaid business. The number of mobile accesses was 43.2 million at the end of the year, a decrease of 2.6 % compared to the previous year. At the beginning of 2017 we introduced an alternative form of customer access counting based on market standards for the calculation of inactivity. According to this new counting method, we had more than 45.9 million mobile accesses as of the end of December 2017.

The mobile postpaid business continued to provide good momentum with 737 thousand net additions in the financial year 2017. The partner business contributed 55% of gross additions, a reflection of the significant improvements of the pricing environment in the discount segment. At the same time, Telefónica Deutschland maintained its strategic focus on the development of its own customer base and customer retention, leveraging the positive customer response to O_2 Free 15 and the updated O2 Free portfolio. The postpaid customer base increased by 3.6% compared to 31 December 2016 to 21.3 million accesses as at 31 December 2017.

The customer base in the prepaid business decreased by 1,903 thousand accesses and amounted to 21.9 million connections as of end of December 2017, a decrease of 8.0% compared to 31 December 2016. In the second half of the year we saw lower customer demand as a result of the identification requirement for prepaid cards introduced in July 2017 and the related greater complexity in the registration process. The demand for SIM cards used temporarily by travellers from other European countries was influenced by the "Roam-like-home" regulation. In addition, we made a technical customer base adjustment at the end of the year as a consequence of the IT harmonisation associated with the customer migration.

Mobile service revenues amounted to EUR 5,287 million, a decrease of -2.8 % on a reported basis, which was driven by regulatory changes, the ongoing OTT trend, the ongoing tariff rotation of the existing customer base and the higher share of wholesale revenues. Adjusted for regulatory effects from the reduction of termination fees and the European roaming regulation totalling EUR 146 million, MSR was almost flat at -0.1% in the 2017 financial year, compared to the previous year. The sequential improvement of MSR performance hence continued.

Operating income before depreciation and amortisation (OIBDA) amounted to EUR 1,785 million, compared to EUR 2,069 million in the previous year, which included the net gain from the sale of passive tower infrastructure to Telxius. Adjusted for exceptional effects[5] OIBDA in 2017 amounted to EUR 1,840 million, up 2.6% year-on-year, compared to EUR 1,793 million in 2016[5,6]. On this basis, the OIBDA margin[5,6] increased by 1.3 percentage points to 25.2% year on year.

This result is in line with our expectations. OIBDA benefited from additional savings from integration activities of approx. EUR 160 million, primarily driven by the FTE restructuring programme, the network integration and the optimisation of the shop footprint. At the same time, we continued to invest in the O_2 brand and our market positioning.

In line with expectations, capital expenditure (CapEx)[7] decreased by 13.7% year on year to EUR 950 million, with additional synergies of approx. EUR 80 million. Telefónica Deutschland Group focussed on network consolidation and the further LTE rollout.

[5] In the 2017 financial year, exceptional effects include restructuring expenses of EUR 82 million and acquisition-related consultancy costs of EUR 2 million as well as earnings from the sale of assets in the amount of EUR 28 million. In the previous year, exceptional effects included restructuring expenses of EUR 89 million and a net gain on the sale of passive tower infrastructure to Telxius of EUR 352 million.

[6] For comparative purposes, a comparative value for financial year 2016, was calculated for OIBDA adjusted for exceptional effects, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016 as if it had occurred on 1 January 2016.

[7] Including the additions from capitalised financing leases and excluding capitalised borrowing costs for investments in spectrum.

T 01 / Overview of financial year 2017

	Reference value 2016 (Euros in millions)	Original Outlook 2017 (year on year in %)	Updated Outlook 2017 (year on year in %)	2017 financial year (year on year in %)	Evaluation
Mobile service revenues (MSR) adjusted[8]	5,437	Slightly negative to flat year on year	Slightly negative to flat year on year	(0.1%)	As expected
Operating income before depreciation and amortization (OIBDA)[9], adjusted for exceptional effects[10]	1,793	Flat to mid-single-digit percentage growth year on year	Flat to low-single-digit percentage growth year on year	+2.6 %	As expected
Capex[11]	1,102	Around EUR 1 billion	Around EUR 1 billion	EUR 950 million	As expected

Business development is further detailed in the following sections.

Results of Operations

T 02 / Consolidated Income Statement

		1 January to 31 December		
(Euros in millions)	**2017**	2016	Change	% change
Revenues	**7,296**	**7,503**	**(206)**	**(2.8)**
Other income	159	502	(343)	(68.3)
Operating expenses	(5,670)	(5,936)	266	(4.5)
Supplies	(2,396)	(2,452)	56	(2.3)
Personnel expenses	(642)	(646)	4	(0.6)
Other expenses	(2,633)	(2,838)	205	(7.2)
Operating income before depreciation and amortisation (OIBDA)	**1,785**	**2,069**	**(284)**	**(13.7)**
OIBDA margin	**24.5%**	**27.6%**		***(3.1%-p,)***
Depreciation and amortisation	(1,869)	(2,118)	249	(11.8)
Operating income	**(84)**	**(50)**	**(35)**	**69.7**
Financial result	(34)	(36)	3	(7.1)
Loss before tax	**(118)**	**(86)**	**(32)**	**37.4**
Income tax	(262)	(90)	(172)	(191.4)
Profit/(loss) for the period	**(381)**	**(176)**	**(204)**	**116.2**

T 03 / Revenue breakdown

		1 January to 31 December		
(Euros in millions)	**2017**	2016	Change	% change
Mobile business revenue	**6,415**	**6,498**	**(83)**	**(1.3)**
Mobile service revenues	5,287	5,437	(150)	(2.8)
Handset revenues	1,128	1,061	67	6.4
Fixed line/DSL business revenues	**862**	**981**	**(119)**	**(12.2)**
Other revenues	**19**	**23**	**(4)**	**(17.7)**
Revenues	**7,296**	**7,503**	**(206)**	**(2.8)**

8 The impact from regulatory changes in the form of the termination rate effect and the glide path of the European roaming legislation are excluded from the MSR outlook. Altogether, this effect has resulted in a drag on 2017 mobile service revenues of approximately 2.7 % year-on-year.

9 In financial year 2017, exceptional effects accounted for the following: restructuring expenses of EUR 82 million, EUR 2 million in acquisitions-related advisory fees as well as income from the sale of intangible assets of EUR 28 million. In the previous year, exceptional effects included restructuring expenses of EUR 89 million and a net gain on the sale of passive tower infrastructure to Telxius of EUR 352 million.

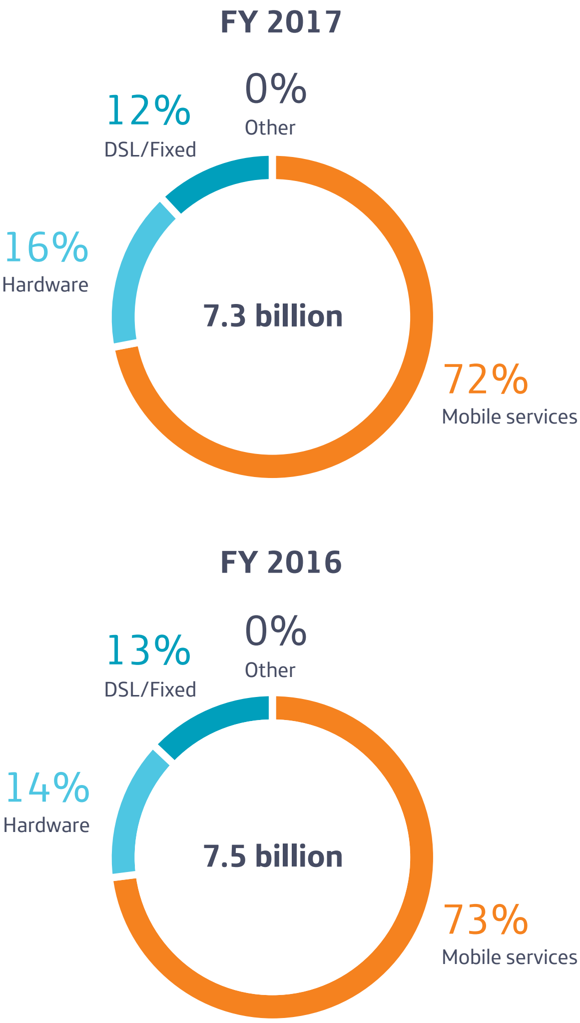
10 For comparative purposes, a comparative value for financial year 2016, was calculated for OIBDA adjusted for exceptional effects, which includes the operating lease-related effects from the sale of Telefónica Deutschland's passive tower infrastructure in April 2016 as if it had occurred on 1 January 2016.

11 Including the additions from capitalised financing leases and excluding capitalised borrowing costs for investments in spectrum.

Decline in revenues

The revenue decrease in financial year 2017 reflects the impact of regulatory effects in form of the reduction of termination rates and the EU roaming legislation on mobile service revenue (>REGULATORY INFLUENCES ON THE TELEFONICA DEUTSCHLAND GROUP), as well as of OTT trends and continuing tariff rotations of existing customers. Furthermore, the reduction in mobile service revenues also reflects the increasingly competitive dynamics and the associated strength of partner business, which resulted in a higher share of wholesale revenues. In contrast, revenues from handsets increased due to the improved demand for handsets. Compared to the same period in the previous year, lower revenues from fixed line/DSL were realised, which is conditioned by the decline in the wholesale business in connection with the planned decommissioning of the ULL infrastructure , as well as a smaller DSL customer base.

G 06 / Revenues (in % and Euros in billions)



Mobile service revenues down slightly

The decline in a still demanding German market characterised by intense competition, was influenced by regulatory effects, continuing OTT trends, the ongoing legacy base rotation, and the higher share of revenues from the wholesale business. Excluding the regulatory effects from termination rates cuts and the EU roaming legislation, mobile service revenues were approximately at the level of the previous year. The Telefónica Deutschland Group operates in a dynamic competitive environment, where the above-mentioned revenue effects continued to outweigh the benefits from the successful marketing of the O_2 Free portfolio to new and existing customers. Customer growth continued particulary in our partner brands. Accordingly, our mobile postpaid customer base increased by 737 thousand net additions to 21.3 million in financial year 2017 (increase in 2016: 1,453 thousand), which lead to an increase of the postpaid share of total mobile customers by

3.0 percentage points to 49.3% year on year. Due to a low price level in our partner business and regulatory effects, the average revenue per user (ARPU) declined accordingly to EUR 9.7 in comparison to the previous year (2016: EUR 10.3). Moreover, the increase in LTE network coverage is progressing continuously. Demand for data services (e.g. mobile internet, service applications and other data content) remained on the rise, boosted by the growing number of LTE-enabled mobile phones combined with the increased usage of mobile audio and video applications. We achieved a monetisation of the mobile data business with our O_2 Free portfolio and our focus on larger data packages in the market. At EUR 2,985 million, revenues from the mobile data business almost stable in financial year 2017 (-0.2% compared with the previous year) despite the ongoing OTT trend, which was made up for by customer demand for larger data packages. Revenues from non-SMS data amounted to EUR 2,411 million as of the end of December 2017 (+4.8% compared with the previous year). The share of data revenues in financial year 2017 therefore increased 1.4 percentage points year on year to 56.5%.

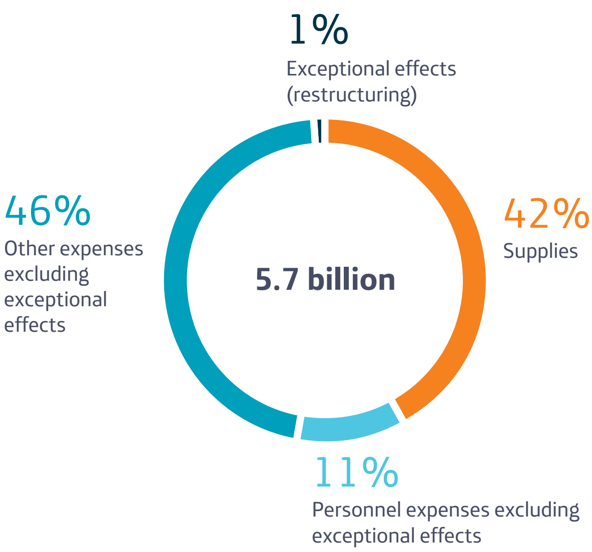
Increased revenues from mobile communication hardware
Mobile communication hardware revenues are generally subject to general fluctuation, as they depend on the launch of new mobile devices. Contrary to the trend of longer replacement cycles and the saturation of the German handset market, which is in line with the general development of the European markets (>OVERALL ECONOMIC AND INDUSTRY CONDITIONS), handset sales – including to mobile service partners – increased year on year due to higher demand for handsets in the second half of the year and to stock clearance activities.

Performance of other income influenced by exceptional effects in the previous year
The reason for this was a one-off exceptional effect from the sale of passive power infrastructure to Telxius, S.A. to the value of EUR 352 million in the first half of 2016 (>CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR 2016, SIGNIFICANT EVENTS).

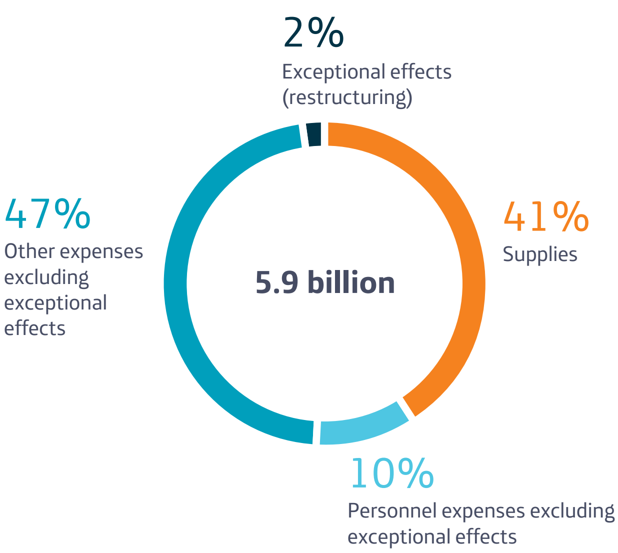
Decline in operating expenses
Primarily, Telefónica Deutschland Group benefits from additional integration synergies from integration projects while investments were simultaneously made in the market. Restructuring costs amounted to EUR 82 million and related mainly to the network consolidation, the optimisation of our shop footprint and the leaver programme.

G 07 / Operating expenses (in % and Euros in billions)

FY 2017



FY 2016



Decline in supplies
Cost for supplies were comparably lower year on year, particularly due to the reduction in mobile termination rates in December 2016 partly offset by higher wholesale costs form outbound roaming. In contrast, hardware cost of sales were up year-on-year driven by higher volumes.

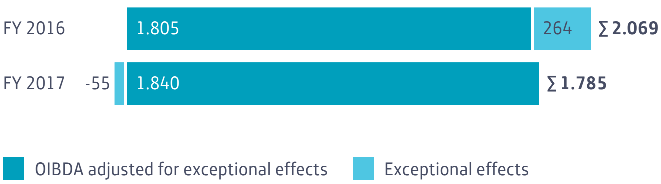
Slight year-on-year decrease in personnel expenses
Excluding restructuring expenses (financial year 2017: EUR 44

million; financial year 2016: EUR 46 million), the decrease amounted to EUR 2 million and reflects the successful implementation of the personnel restructuring programme, despite rising employee numbers. The increase in numbers of employees can be attributed both to the internalisation of previously external employees, in particular in the area of customer service, and to the change in company structure.

Decrease in other expenses
The savings from integration initiatives were partially reduced by higher commercial investments into positioning and marketing of the O_2 Free portfolio in a competitive market environment, as well as by promotions on the occasion of the O_2 brand's 15-year anniversary promotions. In financial year 2017, other expenses included restructuring costs of EUR 38 million (financial year 2016: EUR 43 million) and reduced Group fees of EUR 36 million (financial year 2016: EUR 55 million).

Growth in OIBDA adjusted for exceptional effects confirms successful implementation of synergies as well as investments in the market and regulatory effects
OIBDA came in below the previous year's result, which included an exceptional effect from the sale of passive tower infrastructure in April 2016. The OIBDA adjusted for exceptional effects reflects the reduced cost level as a consequence of the realisation of synergies. Counteracting this were higher commercial costs with the brand positioning of the O_2 core brand.

G 08 / OIBDA (Euros in billions)



Decline in depreciation and amortisation
The decline is the result of the accelerated amortisation of software systems in connection with the IT integration in the previous year, as well as the expiry of the service life of various spectrum licenses in 2016. This effect was partially compensated with the capitalisation of frequency licenses newly brought into use in financial year 2017.

Operating income down
This development is particularly due to the exceptional effect from the net gain on disposal of EUR 352 million realised in the first half of 2016 from the sale of passive tower infrastructure to Telxius S.A. This was offset by the depreciations which were EUR 249 million lower compared to the previous year.

Financial result improves slightly due to lower interest
The financial result improved primarily due to refinancing at lower interest rates.

Income tax
The Telefónica Deutschland Group did not record any positive taxable income in 2017 and will hence not pay any current income taxes, as in previous periods. The tax expense of EUR 262 million in the financial year therefore relates primarily to changes in deferred taxes. In the previous period, deferred taxes resulted in an expense of EUR 90 million.

Financial Position

Principles and goals of financial management

Risk control and a central management are the fundamental principles of financial management at the Telefónica Deutschland Group. The goal of financial management is to continually ensure sufficient financial liquidity and stability. Risk controls are used in order to anticipate potential risks and counteract them using corresponding measures. At present, there are no circumstances which would indicate that Telefónica Deutschland Group cannot meet its financial obligations.

One key performance indicator in this respect is the net leverage ratio (>MANAGEMENT SYSTEM).

Finance

Borrowed capital is procured using credit facilities and capital market instruments.

Placement of a syndicated loan
On 22 March 2016, the Telefónica Deutschland Group agreed a syndicated loan facility of EUR 750 million, which had not been utilised as of 31 December 2017. It serves general business purposes and has an original term of five years. The term of this syndicated loan facility was extended by one year until March 2022 for the first time in February 2017 and can be extended to no later than March 2023.

Financing agreement with European Investment Bank (EIB)
On 13 June 2016, the Telefónica Deutschland Group signed its first financial agreement with the EIB, which amounted to EUR 450 million. The facility is intended to finance the consolidation, modernisation and expansion of the Telefónica Deutschland Group's mobile network after the acquisition of the E-Plus Group and was fully utilised as of 31 December 2017. The funds provided by the EIB have terms of up to eight years.

Promissory notes and registered bonds
On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds with different maturities to 2032 and a total volume of EUR 300 million.

Bond liabilities
In November 2013, O2 Telefónica Deutschland Finanzierungs GmbH placed a bond with a nominal amount of EUR 600 million and a term of five years. In February 2014, this was followed by another bond with a nominal amount of EUR 500 million and a term of seven years. The issuer transferred the net proceeds on the issue of the bond to its shareholder Telefónica Germany GmbH & Co. OHG as a loan. Both of the bonds are guaranteed by Telefónica Deutschland. The details are as follows:

T 04 / Nominal Amount

Nominal amount (in EUR million)	Term from	until	Coupon p.a.
600	22/11/2013	22/11/2018	1.875 %
500	10/02/2014	10/02/2021	2.375 %

New intercompany loan granted
On 31 July 2017, Telefónica Deutschland Group entered into a EUR 500 million bilateral revolving line of credit with the financing company of the Telefónica S.A. Group, Telfisa Global B.V. It serves general business purposes and has a term of one year.

Unused credit facilities provide financial flexibility
The Group's financial flexibility remains secure thanks to the availability of unused credit facilities totalling EUR 2,015 million. This comprises bilateral revolving credit facilities with various banks to the value of EUR 710 million with a remaining term of more than one year, the unutilised syndicated loan facility to the value of EUR 750 million, available overdraft facilities from Telfisa Global B.V. to the value of EUR 55 million, and the unutilised credit facility with Telfisa Global B.V. to the value of EUR 500 million.

Telefónica Deutschland Group continues to benefit from Telefónica, S.A. Group cash pooling
The Telefónica Deutschland Group will continue to participate in the liquidity management system of the Telefónica, S.A. Group. Agreements have been made with Telfisa Global B.V. for deposits and liquidity management. The liquidity of the entire Telefónica, S.A. Group is centralised by means of these agreements. This allows us to benefit from the economies of scale of the entire Telefónica, S.A. Group. The cash pool means that the Group continues to have access to short-term overdraft facilities up to a maximum of EUR 55 million. Telefónica, S.A. has guaranteed the performance of Telfisa Global B.V.'s obligations arising from the cash pooling agreements.

Working capital strengthened by silent factoring
We have entered into factoring agreements with various credit institutions regarding the sale of receivables in order to strengthen our working capital. This mainly relates to factoring transactions for instalment receivables with a total net cash effect of EUR 621 million in financial year 2017. The assigned receivables were derecognised. Further information on silent factoring can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2017 (› NOTE 5.4 TRADE AND OTHER RECEIVABLES).

Increased financial efficiency and payment flexibility due to extension of payment periods
In order to obtain greater financial efficiency and cash flexibility, the Telefónica Deutschland Group has entered into agreements with certain commercial suppliers, agreements were concluded to extend payment periods. The industry-standard payment terms were not exceeded, so that a reclassification is not required and the payments are shown within trade payables.

Finance analysis

Net financial debt inter-alia increased due to dividend payments
Table 5 shows the composition of net financial debt – i.e. the net amount of interest-bearing financial liabilities less any cash and cash equivalents and interest-bearing financial assets and receivables.

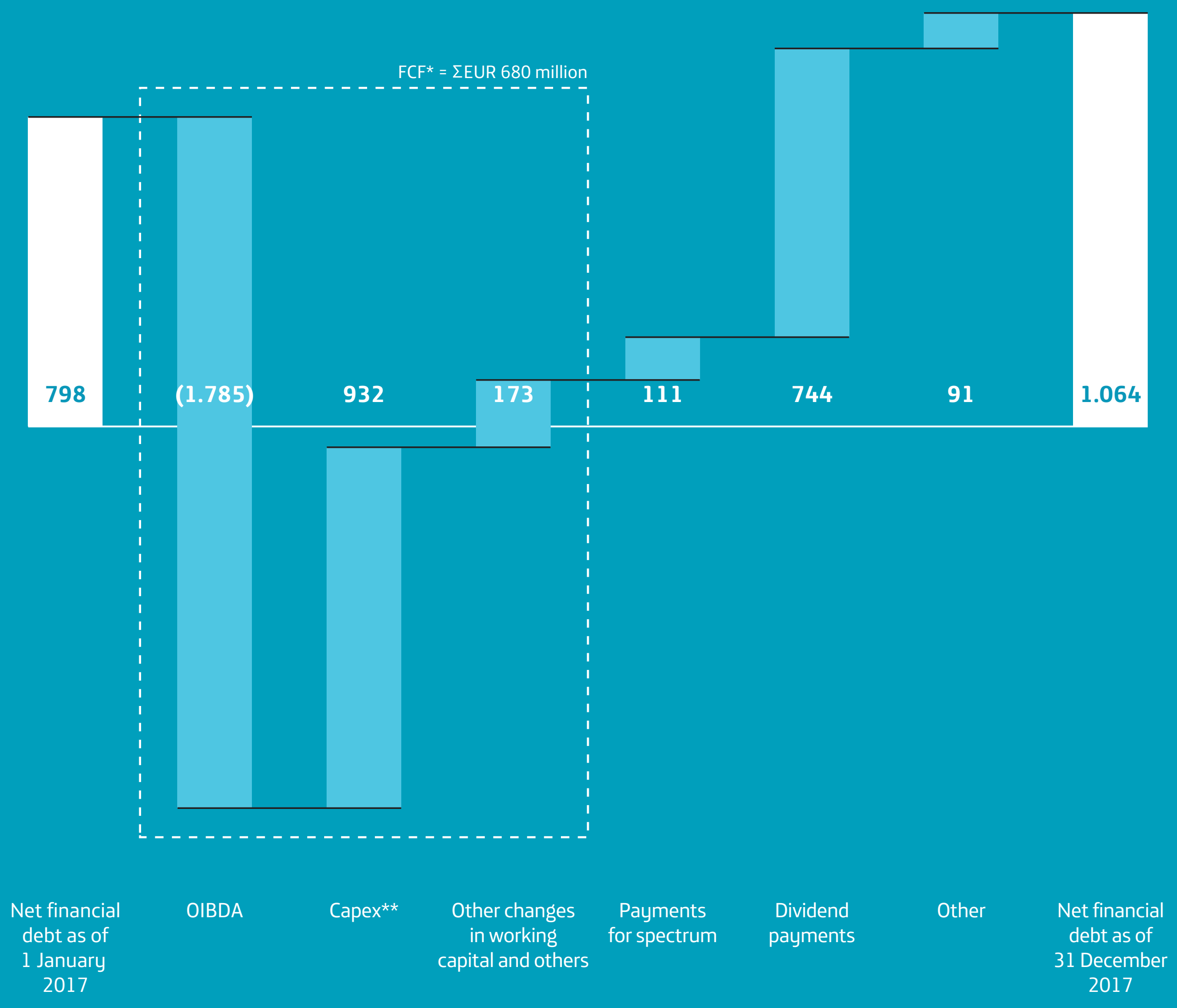
Financial debt as of 31. December 2017 increased by EUR 266 million compared with the previous year to EUR 1,064 million, resulting[12] in a net debt ratio of 0.6x for financial year 2017.

The increase in net financial debt in the 2017 financial year was primarily influenced by the dividend payout for financial year 2016 (EUR 744 million) as well as the free cash flow before dividend and spectrum payments of EUR 680 million.

The graphic below illustrates the performance of net financial debt in the 2017 financial year.

[12] The debt ratio is defined as net debt divided by the OIBDA adjusted for exceptional effects for the LTM (31 December 2017: EUR 1,840 million; 31 December 2016: EUR 1,805 million).

G 09 / Development of net financial debt
(Euros in millions)



* Free cash flow before dividend and spectrum payments
** Excluding additions from capitalised financing leases and capitalised borrowing costs for investments in spectrum

T 05 / Development of consolidated financial debt

As of 31 December

(Euros in millions)	2017	2016	Change	% change
A Liquidity	587	613	(26)	(4.2)
B Current financial assets[1]	177	251	(74)	(29.4)
C Current financial debt[2]	635	31	605	1,978.6
D=C-A-B Current net financial debt	(129)	(833)	704	(84.6)
E Non-current financial assets[1]	75	89	(14)	(15.8)
F Non-current financial debt[2]	1,268	1,721	(453)	(26.3)
G=F – E Non-current net financial debt	1,193	1,631	(439)	(26.9)
H=D + G Net financial debt[3]	1,064	798	266	33.3

[1] Current and non-current financial assets include handset receivables not yet due, the positive performance of the fair value hedge for fixed interest financial debt and loans issued to third parties.

[2] Current and non-current financial debt includes issued bonds, promissory notes and registered bonds, other loans and lease liabilities.

[3] Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing financial liabilities as well as cash and cash equivalents.

Note

Handset receivables are shown under trade receivables in the Consolidated Statement of Financial Position.

Off balance sheet obligations

The operating lease obligations increased by EUR 14 million to EUR 2,779 million, especially due to the increase in future obligations for leased lines. The purchase obligations and other contractual obligations increased by EUR 335 million to EUR 2,203 million, especially due to an increase in purchase orders and hardware commitments. Further information can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2017 (› NOTE 19.1. OPERATING LEASES, PURCHASE AND OTHER CONTRACTUAL OBLIGATIONS).

Liquidity analysis

T 06 / Consolidated Statement of Cash Flows

1 January to 31 December

(Euros in millions)	2017	2016
Cash and cash equivalents at the beginning of the period	**613**	**533**
Cash flow from operating activities	1,702	1,859
Cash flow from investing activities	(1,022)	(455)
Cash flow from financing activities	(706)	(1,323)
Net increase (decrease) in cash and cash equivalents	**(26)**	**80**
Cash and cash equivalents at the end of the period	**587**	**613**

Consolidated Statement of Cash Flows

The following is an analysis of the cash flow development of the Telefónica Deutschland Group in the financial years 2017and 2016.

Cash flows from operating activities below the previous year

This development is primarily due to the change in working capital, which amounted to EUR -26 million in the reporting period and to EUR 165 million in the 2016 financial year. In the previous year, positive working capital mainly resulted from increased voucher sales at the end of the year.

Change in cash flows from investing activities driven by lower cash inflows

Cash inflows of EUR 49 million were EUR 542 million below those of the previous year, which were primarily influenced by the sale of passive tower infrastructure to Telxius, S.A. This resulted in payment inflows of EUR 587 million in financial year 2016.

Cash outflows of EUR 1,070 million were EUR 23 million below those of the previous year. The reason for this was primarily the payments of EUR 29 million made for company acquisitions.

Change in cash flow from financing activities influenced particularly by various transactions

Cash outflows increased by EUR 524 million to EUR 2,697 million and include repayments for the loan from Telfisa Global B.V of EUR 1,125 million, syndicated loan facility of EUR 700 million, as well as dividend payments of EUR 744 million. In comparison, EUR 500 million of the loan from Telfisa Global B.V., EUR 550 million of the syndicated loan facility and EUR 180 million from finance lease agreements were repaid and a dividend payment of EUR 714 million was made in financial year 2016. Furthermore, EUR 119 million of liabilities with payment terms extended in 2015 were compensated in the previous year.

Cash inflows from the assumption of interest-bearing debt increased by EUR 1,141 million compared with the previous year to EUR 1,991 million and were due to the utilisation of the syndicated loan facility with Telfisa Global B.V.

Decrease in cash and cash equivalents

Based on the above-mentioned cash inflows/(outflows), cash and cash equivalents decreased by EUR 26 million compared to the previous year's reporting date and amounted to EUR 587 million as of 31 December 2017 (31 December 2016: EUR 613 million).

Free cash flow before dividend and spectrum payments down on the previous year

Free cash flow before dividend and spectrum payments decreased by EUR 727 million and amounted to EUR 680 million as of 31 December 2017 (2016: EUR 1.408 million).

This was primarily due to the payment received from the purchase price receivable from the sale of passive tower infra-structure to Telxius S.A.in the first half of 2016 to the value of EUR 587 million and furthermore, from the change in working capital. The declining capex had a contrary effect.

T 07 / Calculation of cash flow and OIBDA minus CapEx

			1 January to 31 December	
(Euros in millions)	**2017**	2016	Change	% change
OIBDA	**1,785**	**2,069**	**(284)**	**(13.7)**
- CapEX [1]	(932)	(1,102)	170	(15.4)
= Operating cash flow (OpCF)	**853**	**967**	**(114)**	**(11.8)**
+/- Change in working capital	(132)	237	(369)	(155.6)
+/- Gains/(losses) from sale of assets	(30)	(352)	323	(91.6)
+/- Proceeds from sale of property, plant and equipment, and other effects	31	591	(561)	(94.8)
+ Net interest payments	(27)	(23)	(4)	17.9
+ Taxes paid	–	(0)	0	(100.0)
+/- Proceeds from/payments for financial assets	14	(13)	26	(207.3)
= Free cash flow pre dividends and payments for spectrum[2] as well as pre acquisition of companies, net of cash acquired	**709**	**1,408**	**(698)**	**(49.6)**
+ Acquisition of companies, net of cash acquired	(29)	–	(29)	(100.0)
= Free cash flow pre dividends and payments for spectrum[2]	**680**	**1,408**	**(727)**	**(51.7)**
- Payment for spectrum	(111)	(115)	4	(3.7)
- Dividends paid	(744)	(714)	(30)	4.2
= Free cash flow after dividends and spectrum payments	**(175)**	**578**	**(753)**	**(130.2)**

[1] Excluding the additions from capitalised financing leases and capitalised borrowing costs for investments in spectrum.

[2] Free cash flow pre dividends and payments for spectrum is defined as the sum of cash flow from operating activities and cash flow from investing activities and does not contain interest payments for investments in spectrum.

Net Assets

T 08 / Consolidated Statement of Financial Position

				As of 31 December
(Euros in millions)	**2017**	2016	Change	% Change
Goodwill and other intangible assets	7,445	8,146	(701)	(8.6)
Property, plant and equipment	4,041	4,217	(175)	(4.2)
Trade and other receivables	1,334	1,537	(203)	(13.2)
Deferred tax assets	162	427	(265)	(62.1)
Other financial assets	111	85	26	30.1
Other non-financial assets	315	191	124	65.1
Inventories	105	85	20	23.0
Cash and cash equivalents	587	613	(26)	(4.2)
Total assets = Total equity and liabilities	**14,100**	**15,301**	**(1,201)**	**(7.8)**
Interest-bearing debt	1,905	1,758	147	8.4
Provisions	741	750	(9)	(1.2)
Trade and other payables	2,242	2,303	(61)	(2.6)
Other non-financial liabilities	133	79	54	67.7
Deferred income	782	1,002	(221)	(22.0)
Equity	**8,297**	**9,408**	**(1,111)**	**(11.8)**

Decrease in intangible assets due in particular to amortisation
The year-on-year decline of EUR 1,008 million was due to the scheduled amortisation of intangible assets with a limited useful life. This was offset by the additions to intangible assets of EUR 278 million, which related primarily to investments in software.

During the reporting period, EUR 858 million of the mobile frequencies acquired in 2015 were reclassified from construction in progress/prepayments of intangible assets to service concession arrangements, licences and software due to their active use.

Decrease in property, plant and equipment particularly due to depreciation
The development compared to the previous year is due to scheduled depreciation of EUR 862 million. This is seen alongside additions in the 2017 financial year in the amount of EUR 676 million.

Capital expenditure (CapEx[13]) reduced
Capital expenditure (CapEx) amounted to EUR 950 million in 2017 compared with EUR 1,102 million in the comparative period in 2016. Telefónica Deutschland Group primarily continued to invest in the consolidation of the network as well as in the further expansion of the LTE network.

[13] Including the additions from capitalised financing leases and excluding capitalised borrowing costs for investments in spectrum.

Trade and other receivables down
The reason for the change is mainly due to the decline in handset receivables, primarily caused by the use of silent factoring transactions and the expiry of the handset leasing models.

Deferred tax assets reduced due to strict assessment criteria
Deferred tax assets are mainly reduced as a result of tax-reducing temporary differences which are caused, inter alia, by increased tax depreciations that took place as planned and longer depreciation periods for tax purposes in connection with intangible assets. The carrying amount of deferred tax assets is reviewed at each reporting date and recognised to the extent that it is probable that a sufficient taxable income will in future be available to allow all or part of the deferred tax asset to be utilised. Non-recognised deferred tax assets are included in this review.

Increase in other financial assets
This development primarily reflected the capitalisation of non-pledged refund claims from reinsurance policies. This effect was partially compensated for by a lower security deposit for silent factoring.

Increase in other non-financial assets due to tax receivables
The increase is mainly due to tax receivables of EUR 78 million and prepayments made for the rental of antenna locations and lines.

Inventories of mobile devices increase
The reason for this was the increase in inventories for sales activities for new devices on the market.

Decrease in cash and cash equivalents
The decrease is due to multiple effects (>FINANCIAL POSITION).

Interest-bearing debt up on previous year
This increase is, in particular, due to the utilisation of the financing agreement with the EIB of EUR 200 million. It was offset by the repayment of the syndicated loan in the amount of EUR 50 million and lower obligations from finance leases.

Provisions almost the same as previous year
The change is mainly due to the opposing development of the decrease of EUR 41 million in restructuring liabilities due to utilisation and the increase in pension provisions of EUR 45 million due to the capitalisation of non-pledged refund claims from reinsurance.

Decrease in trade and other payables
This development is, in particular, due to the settlement of the outstanding payment obligation from the mobile phone frequency auction of EUR 111 million.

Decrease in deferred income
The decrease was essentially a result of the utilisation of the 2016 year-end voucher sales. The services rendered in the context of the Mobile Bitstream Access Mobile Virtual Network Operator (MBA MVNO) agreement had the same effect.

Equity declines
The change in equity is due primarily to the dividend payment of EUR 744 million on 12 May 2017 and the result for the period of EUR - 381 million. Further effects captured in equity relate to EUR 7 million in share-based remuneration and EUR 5 million for the revaluation of post-employment benefits.

Employees

Our employees face the challenges of the rapid evolving telecommunications industry which requires the continuous development of new qualifications and key competencies for the digital era. We support the career development of our employees by offering a wide range of training programmes and learning opportunities in areas like digital skills and leadership. We encourage our employees to invest in their career development and dedicate enough time to allow them to succeed. We offer our employees a catalogue of options, such as flexible working hours and the option of working from home, to balance work and personal life, including the time before and during parental leave and their subsequent easing during their return to work. In addition we provide a comprehensive range of services in cooperation with external partners. Hence we support our employees in the search for the right childcare, for care opportunities for relatives, broker for private tuition or household help. All these initiatives are aimed at increasing our employees' satisfaction and further develop their loyalty.

Training and further education are important goals
One of our most important goals in 2017 was to further develop our employees' skills. In 2017 the Telefónica Deutschland Group invested a total of EUR 6.3 million in the training and further education of its employees.

Employee satisfaction and employer attractiveness
We regularly measure employee satisfaction. We conduct an employee survey once a year to measure employee engagement and the general work climate. We use this survey as an important indicator for how we lead and shape the organisation.

Our attractiveness as an employer in the market is reflected in the number of external candidates with 9,415 job applications for 789 jobs advertised – a rate of 11.9 applications per published job advert. In the past year we made 1,405 external hires (2016: 1,657 external hires).

Number of employees
In 2017 the Telefónica Deutschland Group had 9,405 employees (2016: 9,272 employees) based on an average calculation of the number of employees at the end of each quarter in 2017 and 2016, respectively.

As at the reporting date of 31 December 2017, 9,281 staff (2016: 9,476 staff) were employed by our company. The staff turnover rate was 17.4% (2016: 17.9%). The fluctuation during the financial year is primarily caused by the implementation of the restructuring plan. This is offset mainly by the insource of external consultants, particularly in Customer Service.

Framework social plan
After the reduction of around 1,300 FTE´s in 2015 and 2016 in the context of the restructuring programme with a target of 1600 FTE, the remainder of the programme was mostly completed in 2017.

Subsequent Events

Telefónica Germany GmbH & Co. OHG has commissioned the Landesbank Baden-Württemberg (LBBW) and DZ Bank AG to place a promissory note loan consisting of several instalments with terms of up to 15 years and a total target volume of up to EUR 200 million. The placement began in January 2018, and the conclusion of the transaction is planned for the 1st quarter of 2018. The financing agreement will be concluded only upon a successful placement in February; however, the payment will not take place until 28 February or in March.

There were no other reportable events after the end of financial year 2017.

Report on Risks and Opportunities

The Telefónica Deutschland Group anticipates new business opportunities in order to increase the long-term value of the company and to pursue revenue growth. To take advantage of these opportunities and increase efficiency, however, the company also has to take certain risks. Our risk management is designed to recognise these risks at an early stage and actively mitigate them.

Risk Management and Risk Reporting

Fundamental risk management principles

In the course of our business activities, we are confronted with various business, operational, financial and other (global) risks. We provide our services on the basis of the organisational, strategic and financial decisions made and precautions taken by us.

Every business activity involves risks that can prejudice the process of goal-setting and goal fulfilment. These risks arise from the uncertainty of future events – often due to insufficient information – and can result in objectives being missed. If risks are not recognised and dealt with, they can endanger the successful development of the company. In order to respond appropriately to this fact, the company's management has introduced a risk management process. This is intended to guarantee timely and complete transparency with regard to new risks or changes to existing risks.

Risk management is a component of the decision-making processes within the Telefónica Deutschland Group. The procedure ensures that risk evaluations are taken into account in decision-making and measures to minimise and deal with risks are taken at an early stage. This is based on the evaluation, communication and management of risks by all of the company's managers. A lower limit for the recognition of risks is generally not set. The risk management department compiles the company's Risk Register, which also covers the subsidiaries. As part of the creation of the Risk Register, it is ensured that risks of a similar type or of cumulative effect are aggregated and thus provided for overall consideration. In addition, this bottom-up approach, i.e. the identification of risks by the operating units, is complemented by a top-down approach in order to ensure a cross-business risk perspective. The purpose of the top-down approach is to ensure that risks that can only be identified at the highest management level or on the basis of a group-wide consideration, are discussed with the operationally responsible units. This is intended to enable full classification and integrated management as well as the evaluation of relevance for future reporting. Risk management is in continuous contact with all areas of the company and our risk coordinators in order to continuously pursue and evaluate risks and their management and development. Responsible employees are trained individually in order to ensure a uniform, structured process of risk identification and evaluation. In addition, fundamental training is available to all employees in order to raise their general awareness of risk management.

Risks are evaluated with regard to their impact on our business goals from an operational and financial point of view. The Risk Register is supported by a database that contains all identified risks, their status, the measures already taken and defined action plans.

In a formal forward-looking process, the Risk Register of Telefónica Deutschland Group is subject of regular reporting to the Management Board. The Supervisory Board (Audit Committee) is regularly informed about risks and their development.

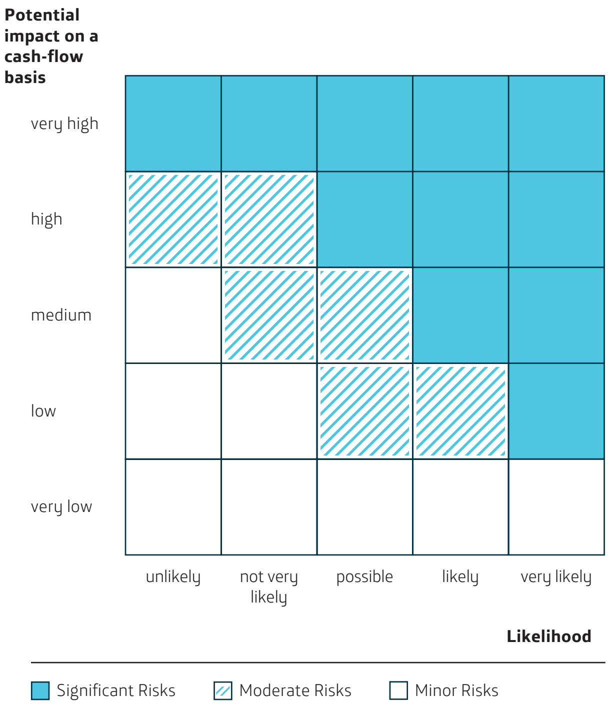
Opportunities are not recorded in the risk management system.

Risk evaluation

The following section illustrates the risks that can substantially impact our financial situation, our competitiveness or our ability to realise our objectives. They are presented in line with the net principle, i.e. risks are described and evaluated net of the risk mitigation measures performed.

To identify the risks illustrated in the following with material influence on business development, we use a 5 × 5 matrix as a starting point, within which the potential level of impact and the relevant likelihood of occurrence are each divided into five categories:

G 10 / Risk profile



Based on the combination of the potential level of impact and the estimated likelihood of occurrence, the individual risks are divided into three categories (significant, moderate and minor risks). All risks with a very high potential level of impact are seen as significant for the company; this does not take into account the estimated likelihood of occurrence. With a growing likelihood of occurrence, risks with a high or medium potential level of impact also fall into this category. Risks with a very low potential impact are assessed as minor risk, regardless of the estimated likelihood of occurrence.

Minor risks are not included in the reporting to the Management Board and therefore are not included in the risk summary in the following section. Such risks are identified, documented and administered by the relevant management levels as part of the risk management process.

For internal use and reporting within the group, risks are divided into business risks, operational risks, financial risks and other (global) risks. This division also forms the basis of this section of the report. The risks are presented in the relevant category in the order of their rating.

In addition, our company can be influenced by other or additional risks of which we are presently unaware or that we do not consider significant based on the current state of knowledge. Moreover, the possibility cannot be precluded that risks currently evaluated as minor will change within the forecast period in such a way as to have a potentially greater effect than the risks currently evaluated as more material.

Risks

Business risks

Competitive markets and changing customer demands
We operate in markets characterised by a high level of competition and continuous technological developments. Our company faces increasing competition from alternative telecommunications service providers – among them cable operators, MVNOs and entertainment electronics companies – and also competes with alternative telecommunications services like OTT (over-the-top). There is the risk that our growth targets and planned revenues will not be reached. In order to prevail against these companies and developments, we must also continue to provide competitive services and successfully market our products in the future. In doing so, we systematically observe new customers' needs, our competitors' business activities, technological changes, and the general economic, political and social conditions and take them into account in our planning. We classify this risk as significant.

Market acceptance and technological transformation
In an environment characterised by major technological transformation, there is the risk that we will not be able to anticipate and implement technical requirements and customers' requirements in time. False interpretations or incorrect decisions could harbour the risk of negatively influencing the acceptance of our products by customers and could lead to us not reaching our growth and earnings targets. We strive to counter this moderate risk by monitoring our gross margin, churn rates and through extensive market research activities.

Regulatory environment
We operate in a strongly-regulated market environment. Decisions made by the regulatory authorities can directly and critically influence services, products and prices.

Licences and frequencies
Our licences and the licence usage rights granted to us are time-limited and depend on prior allocation. If we cannot extend or cannot newly obtain the licences and frequency usage rights necessary for our business or if the financial conditions for the use

of these licenses and rights change significantly, this will lead to higher investment costs than planned. A potential change to the network expansion resulting from this could also have a negative impact on expected revenues. We classify this risk as significant.

Other regulatory influences
Our business activity is subject to significant influences and requirements by regulatory authorities. Any deviations in the interpretation of these requirements may result in fines and therefore have a negative effect on our financial position or reputation.

Price-regulated services include also international roaming of voice, SMS and data services within roaming. With the Telecoms Single Market Regulation (TSM-R), which came into force in November 2015, the European Commission has resolved the gradual removal of roaming charges for end customers on top of their domestic tariff ("*Roam-like-home*") by 15 June 2017 (see *Regulatory influences on the Telefónica Deutschland Group*). Nevertheless, the regulatory authorities could take additional measures at any time in order to curtail roaming tariffs and fixed or mobile telecommunications termination rates even more. They could similarly oblige us to grant third parties access to our networks at reduced prices. There is a moderate risk that measures by regulatory authorities could negatively affect our business activity as well as our financial and earnings position.

Regulatory requirements in connection with the acquisition of the E-Plus Group
In approving the acquisition of the E-Plus Group, the European Commission obligated the Telefónica Deutschland Group to meet various requirements. This includes an obligation to provide frequencies, infrastructure and network capacities to a potential new mobile network operator in exchange for payment. There were no new market participants in the 2015 frequency auction and the Group has not been otherwise called upon to meet this requirement to date. To meet another requirement of the European Commission, we entered into extensive agreements with the Drillisch Group on the provision of network capacities and services. An extensive project was launched to ensure strict compliance with the contracts concluded and hence prevent the possibility of significant fines. We classify this risk as moderate.

Regulatory influences on our transmission power
The electromagnetic compatibility of transmitters could be subject to new regulations due to potential, as yet unproven, health risks. In this case, if the requirements regarding maximum permitted transmission power were changed this would negatively affect the performance and expansion of our mobile network. This risk is classified as moderate.

In order to guard against the stated regulatory risks, the Telefónica Deutschland Group maintains close communications with the decision makers on a national and international level. This allows us to introduce our interests and views to the decision-making process in good time. Moreover, we review and use legal protective mechanisms against decisions of the regulatory authorities in order to actively foster positive changes for us.

Insurances
Considering the existing opportunities and evaluating financial efficiency, the Telefónica Deutschland Group counters risks by concluding comprehensive insurance contracts. In particular, this substantially reduces risks that might arise from the operation of the technical infrastructure as well as from potential violations of the copyrights or patent rights. Despite this, unforeseen events could, inter-alia, result in financial losses if our insurance protection or our provisions should prove to be insufficient. As part of the management of our insurance cover, a regular review takes place in order to achieve the best possible and most economical cover. We classify this risk as moderate.

Operational risks

Service quality
Attracting and retaining customers
The success of our business depends on our ability to attract new customers and retain existing customers. In an environment characterised by continuous further development of products, services and tariffs, we must also keep an eye on the performance of our network and that of our competitors. If our offers are not accepted on the market, we would be behind our competitors in acquiring new customers. We counter this significant risk by intensively monitoring and evaluating customer satisfaction and by extensively monitoring our network elements.

Technical faults
Lasting or repeated disturbances or damages to our mobile telecommunications or fixed networks and in our technical facilities could have a negative influence on customer satisfaction and result in a loss of customers or revenue losses. We implement extensive monitoring of our network elements and systems here, too. In addition, insurable risks are covered by our insurance programme. We classify this risk as significant.

Deterioration in access network quality
The current network consolidations could cause temporary, regional deteriorations. This could lead to higher churn rates and consequently to revenue losses. We rely on the continuous control of quality indicators here. In particular, we focus on customer complaints and provide relevant resources, in particular for major customers. We classify this risk as moderate at this time.

Supplier defaults
As a mobile and fixed network operator and a provider of telecommunications services and products, we are dependent on a few main suppliers in the same way as other companies in the industry. These suppliers provide us with important products and services available that are primarily related to the IT and network infrastructure. If these suppliers do not provide their products and services in time, this could endanger the operation and expansion of the network, which in turn could negatively affect our company and its earnings. The same applies if service providers to whom we award projects for reasons of efficiency do not perform the services in time or with the required quality. As part of our supplier management, we assess the quality of the services provided and any potential risks in this regard on a continuous basis. This allows us to identify weak points at an early stage and to counter them. We classify this risk as moderate.

Dependence on the major shareholder Telefónica S.A. and of KPN
Use of trademark rights
The use of the core brand O_2 in Germany is the subject of a licensing agreement with O_2 Worldwide Ltd., a subsidiary of Telefónica S.A. A long-term agreement regarding the use of the brand BASE in Germany is in place with KPN. The trademark rights are of major significance for our business activity. The loss of a brand in particular could have a negative impact on customer growth, and hence on our revenues. We classify this risk as significant, even if there are no indications of future disruptions to the contractual relationships.

Use of services
Even after its own IPO and the merger with the E-Plus Group, the Telefónica Deutschland Group still obtains material services and inputs from the Telefónica, S.A. Group to a significant extent. There are a range of contracts, particularly in the areas of financial management and IT services. If inputs from the Telefónica, S.A. Group are no longer provided, there is the moderate risk of not being able to procure them on the market, or not at the same favourable conditions. Likewise, there are no indications of future disruptions to these service relationships.

Legal risks
As part of its business activity, the Telefónica Deutschland Group is required to comply with a large number of laws. An infringement of legal provisions poses an intrinsic risk to the business activities, success and reputation of the company.

Data privacy regulations
In the course of our business activities, we also collect and handle customer data and other personal data. There is the risk of misuse or loss of these data. This could represent a breach of the relevant laws and provisions and result in fines, loss of reputation and the migration of customers, and hence the loss of revenues. There may be delays in the implementation of these measures, in particular, in the light of the General Data Protection Regulation and, consequently, we may be obliged to pay a fine. As a result, the risk will no longer be classified as medium; instead, it will now be classified as significant.

Contractual relationships
Contractual penalties or claims could result from contracts with sales partners, suppliers and customers if we do not comply with our contractual or legal obligations or fail to meet agreed purchasing quantities, for example. We classify this risk as moderate.

Violation of customers' rights
Our customer relationships and the contractual terms arising from these relationships are monitored by consumer protection agencies on a continuous basis. Interpretations differing from the company's viewpoint may result in these agencies regarding them as a violation of customers' rights and taking legal actions against us. There is the moderate risk that this could negatively affect our business result or our reputation.

Legal actions in connection with the acquisition of the E-Plus Group
Airdata AG, Stuttgart, and 1 & 1 Telecom GmbH, Montabaur, have withdrawn their action originally filed at the Court of the European Union against the European Commission's decision to approve the merger of Telefónica Deutschland Holding AG and E-Plus on 2 July 2014. The complainants sought the full revocation of the approval decision. Mass Response and Multiconnect have filed actions against the statements by the EU Commission on the extent of our 4G access obligation. However, alternatively, as there are also filing an action against the approval decision as such. As the potential financial consequences associated with the original actions of Airdata AG and 1 & 1 Telecom GmbH have reduced, we no longer classify this risk as significant, but as moderate.

In order to avoid legal risks, particularly from competition and data protection law, the Telefónica Deutschland Group has established a compliance management system. Components of this management system include the applicable business principles, a number of guidelines and ongoing employee training with regard to the main legal provisions and standards, in particular also the new basic data privacy regulation and the topic of information security. In supplement, legal risks are covered by insurance to the extent permitted. The Telefónica Deutschland Group also maintains an internal compliance and legal department, and enters into continuous contact with external law firms, authorities, associations and official groups.

Financial risks

Taxes
Like every company, we are subject to regular tax audits. These include an intrinsic risk that higher subsequent tax payments for prior tax periods may be imposed if the tax authorities have a divergent opinion about the interpretations and calculation principles that form the basis of our tax declaration. Furthermore, changes in tax laws or in the interpretation of existing regulations by courts or tax authorities may also have an adverse effect on our business activities as well as on our financial position and results of operations. We strive to counter this moderate risk by taking part in expert discussions and working groups on a regular basis in order to be able to identify changes regarding the interpretation of the tax laws at an early stage.

Other (global) risks

There were no material other (global) risks at the end of the financial year.

Risk Management and Financial Instruments

General financial market risks
The Telefónica Deutschland Group is exposed to various financial market risks as part of its business activity. In the context of the above-mentioned the risk management process, these risks are regarded as low. Should these financial market risks occur, they could have a negative effect on the net assets, financial position and results of operations of the Group and are therefore presented individually below.

The Telefónica Deutschland Group has developed guidelines for risk management processes and for the use of financial instruments including a clear separation of tasks with respect to financial activities, invoicing, financial reporting and associated controlling. Derivative financial instruments are used solely to manage interest rate and currency risks. The Telefónica Deutschland Group has developed guidelines derived from established standards for the evaluation of risks and monitoring with regard to the use of financial derivatives.

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

Currency risk
The underlying currency of the financial reports of the Telefónica Deutschland Group is the euro. All financial statements of all subsidiaries of the Telefónica Deutschland Group are also prepared in euros; thus the Telefónica Deutschland Group is not subject to any translation risk. The regional focus of the Telefónica Deutschland Group's activities means that the transaction risk arising from the Group's business relationships with its suppliers or business partners in countries with a different national currency than the euro is not material. Because the Telefónica Deutschland Group finances itself exclusively through internally generated cash in euro as well as euro-denominated equity and debt, there is also no exchange rate risk.

The effects before taxes on the Consolidated Income Statement and thus equity of a simultaneous, parallel increase in the euro of 10% as against all foreign currencies in the financial years 2017 and 2016 would have been as follows:

T 09 / Currency Risk

	1 January to 31 December			
	2017		2016	
(Euros in millions)	Risk position	+(-)10 %	Risk position	+/(-)10 %
USD	(5.4)	0.5/(0.5)	(12.4)	(1.1)/1.1
GBP	0.8	0.1/(0.1)	0.6	0.1/(0.1)

Because the Telefónica Deutschland Group did not use cash flow hedge accounting, the effects of the sensitivity analysis only affected the Consolidated Income Statement.

Interest rate risk
Interest rate risk is the risk that the fair value or future cash flow of a financial instrument could fluctuate as a result of changes in market interest rates. The Group manages its interest rate risk by seeking to ensure it has a balanced portfolio of fixed-interest and variable-interest financing instruments. Where necessary, interest rate swaps are used in achieving this aim.

Telefónica Deutschland Group is exposed to interest rate risks as a borrower mainly due to loan agreements at variable interest rates and to interest rate swaps, as well as to the variable interest rate cash pool accounts with Telfisa Global B.V. To reduce the existing interest rate risks, interest rate swaps in connection with the issue of bonds were concluded on a partial amount of the nominal value of the bonds in November 2013 and in February 2014. Under these interest rate swap contracts, the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. These interest rate swaps compensate, to the level of their nominal amounts, the effects of future market interest rate changes on the fair value of the underlying fixed-interest financial liabilities from the bond issues (fair value hedge). Hedge accounting for these hedge relationships complies with IAS 39. The relationship between the hedge instrument and the underlying transaction as well as the goal and strategy of the hedge were documented at the inception of each hedge. A specific allocation of the hedging instrument to the corresponding liability took place and an estimate of the degree of effectiveness of the hedge was made. The existing hedge is continuously monitored for effectiveness.

The net risk position for variable interest for the Telefónica Deutschland Group as of the reporting dates 31 December 2017 and 2016 was EUR - 166 million and EUR-142 million, respectively; these figures are primarily attributable to the revolving credit facility, the interest rate swap and the cash and cash equivalents deposited with Telfisa Global B.V.

The effects before taxes on the Consolidated Income Statement of a change in the interest rates of variable interest-bearing financial instruments of +/-100 basis points as of the reporting dates 31 December 2017 and 2016 are shown below. There is no impact recognised directly in equity. This analysis assumes that all other variables remain unchanged.

	1 January to 31 December	
(Euros in millions)	**2017**	2016
+100bp	2	1
-100bp	4	4

Credit risk

Credit risk describes the risk of financial losses due to the inability of contractual partners to repay or service debts in accordance with the contract. The Telefónica Deutschland Group's maximum credit risk initially corresponds to the carrying amount of its financial assets (excluding any guarantees or securities).

The Telefónica Deutschland Group considers the management of the commercial credit risk to be critical in order to achieve its goals for sustainable growth of the business and the customer base in harmony with its risk management guidelines. Suitable processes have been established for the management and the monitoring of the credit risk. These include the ongoing monitoring of the expected risks and the level of default. Particular attention here is paid to the customer, which could have significant effects on the Consolidated Financial Statements of Telefónica Deutschland Group. For these customers, credit management instruments such as credit insurance or collateral for limiting the default risk are used, depending on the business area and type of business relationship. To control credit risk, the Telefónica Deutschland Group regularly conducts an analysis of the maturity structure of trade receivables and recognises adjustments on doubtful receivables with a credit risk.

In accordance with Telefónica corporate policy, the Telefónica Deutschland Group has concluded cash pooling and deposit agreements with Telfisa Global B.V., a subsidiary of the Telefónica, S.A. Group, with regard to its cash surpluses and deposits its cash surpluses there. Telefónica, S.A. is rated by international rating agencies with an investment grade rating.

The financial assets in which Telefónica, S.A. Group was a contractual partner amounted to EUR 650 million as of 31 December 2017 and to EUR 643 million as of 31 December 2016.

Liquidity risk

Liquidity risk encompasses the risk that the Telefónica Deutschland Group may be unable to sufficiently comply with its financial obligations. To safeguard liquidity, cash inflows and outflows are permanently monitored and controlled centrally on the basis of detailed financial planning. The Telefónica Deutschland Group works on its liquidity management closely with the Telefónica, S.A. Group and, in accordance with the corporate policy, has concluded cash-pooling and deposit agreements with Telfisa Global B.V., Netherlands. In addition to operating liquidity, the opportunities arising on the financial markets are continuously examined with a view to ensuring the financial flexibility of the Telefónica Deutschland Group.

As of 31 December 2017, Telefónica Germany GmbH & Co. OHG had undrawn credit lines from short-term overdraft facilities and revolving credit facilities and loans totalling EUR 2,015 million with a term of over one year; as of 31 December 2016, these undrawn credit lines amounted to EUR 1,675 million.

Cash and cash equivalents amounted to EUR 587 million as of 31 December 2017 and to EUR 613 million as of 31 December 2016.

The following table shows the maturity profile of the financial liabilities of the Telefónica Deutschland Group on the basis of the contractual undiscounted payments (including interest):

T 10 / Maturities of financial liabilities

As of 31 December 2017

(Euros in millions)	Total carrying amount	Gross cash outflow	Remaining term < 1 year	Remaining term 1–5 years	Remaining term > 5 years
Non-current interest-bearing debt	1,268	1,356	–	954	402
Non-current trade and other payables	19	19	–	19	–
Current interest-bearing debt	637	637	637	–	–
Current trade and other payables	2,224	2,224	2,224	–	–
Financial liabilities	**4,147**	**4,236**	**2,861**	**973**	**402**

As of 31 December 2016

(Euros in millions)	Total carrying amount	Gross cash outflow	Remaining term < 1 year	Remaining term 1–5 years	Remaining term > 5 years
Non-current interest-bearing debt	1,721	1,860	79	1,433	348
Non-current trade and other payables	17	17	–	17	–
Current interest-bearing debt	37	37	37	–	–
Current trade and other payables	2,286	2,286	2,286	–	–
Financial liabilities	**4,061**	**4,200**	**2,402**	**1,450**	**348**

Opportunity Management

The consistent use of entrepreneurial opportunities with respect to future revenue and OIBDA potential, as well as their early and continuous identification, analysis and management, are significant tasks of the management of the Telefónica Deutschland Group.

The opportunities and growth potential identified in the strategic goal-setting process are prioritised as part of an annual planning process in close cooperation with the individual business areas and relevant strategic goals are derived from this. To measure the strategic implementation, concrete financial objectives in the form of finance-related key performance indicators (KPIs) are defined at the level of the organisation units.

Opportunity management is a significant component of the entire process for strategic goal setting. It occurs both as part of budget creation for the coming twelve months as well as within long-term planning.

Opportunities are neither recognised in the risk register nor quantified.

Opportunities

High penetration of O_2 Free

In September 2017, we launched our customer offer, O_2 Free. With the new O_2 Free Portfolio, we are increasing the attractiveness of higher-value tariffs. If the customer penetration of the higher tariffs exceeds our expectations, our revenues and operating income could exceed our current forecast.

Greater demand for mobile data and LTE

The development of the German telecommunications market will continue to be driven by mobile data business and the increased use of mobile data devices like smartphones and tablets. Generally, a substantial increase in demand for mobile data is conceivable via various effects. Demand for data will be strengthened through the further roll-out of LTE network and increased penetration of LTE devices and new portfolios with large data packages in the future. The higher transmission rates of LTE in comparison to UMTS are also encouraging customers to make increasing use of data-intensive services such as music streaming and video streaming on mobile devices. As a consequence, LTE customers have higher data consumption than UMTS customers, meaning that LTE customers require a higher data volume in their tariff, which has a positive impact on mobile service revenues. In addition, demand may also be influenced by potential new services, additional devices connected to the internet and the growing popularity of existing data-intensive services.

Should the individual characteristics of the German telecommunications market, such as smart phone penetration, demand for LTE and average monthly data consumption per customer, develop more positively than set out in our outlook, then our revenues and operating income could exceed our current outlook.

Expansion of our LTE network

In 2018 we will progress further with the expansion of our LTE network. The quality of the network will be impacted by the deployment of the LTE 1,800 MHz layer in urban areas, thus increasing the overall capacity. If our expansion of the LTE network proceeds more quickly due to more positive general conditions or if our customers respond to the better LTE network quality more positively than described in our outlook, our share of mobile data business could grow more strongly than predicted and thus our revenues and operating results could exceed our current forecast.

Cooperation with Telekom Deutschland GmbH in the fixed network

Higher availability of high-speed VDSL connections due to a faster than planned roll-out by Telekom Deutschland GmbH or technical advances that increase the maximum transmission rate of this product to over 100 Mbit/s could lead to stronger than anticipated demand for our VDSL products on the basis of the fixed network cooperation. This would have a positive impact on our revenues and OIBDA and lead to us exceeding our forecast. Thanks to our cooperation we can also get involved with new technologies such as super vectoring which Telekom will increasingly implement in its network.

Digital innovation

In order to fully exploit our position on the German market for mobile telecommunications services and to monetise additional opportunities for growth, we have introduced innovative digital products and value added services in various areas such as communication services and financial services. There are also further projects that we plan to introduce. Specifically in relation to the Internet of Things, some analysts expect that demand will grow at double-digit compound annual growth rates in the coming years.

Should the demand for our digital products and services develop better than currently expected, this could positively affect our revenues and operating results and lead to us exceeding our forecast.

Digitalisation of service processes

In many industries, including telecommunications, a trend towards “self-care” can be observed. Processes that were previously performed by customer service employees are now increasingly carried out by customers themselves online or using smartphone apps. Customers are seen in a more active role and are benefiting from immediate visual feedback. Additionally “self-care” solutions are permanently available at any time and on any day of the week, and possible waiting loops are avoided. Therefore, the smartphone is increasingly becoming the centre of everyday digital life.

If this trend continues more strongly than expected, this could result in increased customer satisfaction and cost savings in customer service leading to an increase in OIBDA.

Membership of the Telefónica, S.A. Group

As a part of one of the largest telecommunications corporations in the world, the Telefónica Deutschland Group benefits from economies of scale in the areas of purchasing, cooperation and the development of digital products. Should these economies of scale develop better than currently expected, this could positively affect our revenues and our earnings position and lead to us exceeding our forecast.

Summary of the Risks and Opportunities

Based on our assessment, the intensive competition on the German telecommunications market, the regulatory environment and the need to ensure high-quality service pose our greatest challenges. A new risk arises from the ongoing network consolidations. The most striking positive change is the elimination of the risk from changed regulatory requirements for the collection and validation of customer data pursuant to section 111 TKG after the new law comes into effect in July 2017.

In our estimate, the situation regarding the significant risks and opportunities for the Telefónica Deutschland Group has not changed substantially compared to the previous year, except for the items described above.

We have not identified any risks at this time that could threaten the ability of our company to continue as a going concern, either individually or in the aggregate.

In the coming financial year, we are confident that we will again be able to identify relevant risks at an early stage and take appropriate measures to counter them by continuing to implement the risk management approach applied to date.

We are confident that the profitability of our company serves as a solid basis for our future business development and ensures the resources needed in order to pursue the opportunities presented to the company. Considering our technologically high-value products, our position in the market, our digital innovation power, the fact that we belong to one of the largest tele-communications companies in the world, our committed employees and our structured processes to recognise risks and identify opportunities at an early stage, we are confident that we will be able to successfully meet the challenges arising from the risks and opportunities mentioned above in 2018.

Accounting-Related Internal Control and Risk Management System

related to the group accounting process

The following statements contain information in accordance with section 289 (4) HGB and section 315 (4) HGB.

The primary goal of our accounting-related internal control and risk management system is to ensure proper financial reporting in the sense of ensuring that the Consolidated Financial Statements comply with all relevant provisions.

The risk management system described in the chapter > REPORT ON RISKS AND OPPORTUNITIES also includes an accounting-related perspective with the aim of ensuring the reliability of financial reporting. In addition to the legal requirements of, for example, the German Stock Corporation Act (AktG) and the German Commercial Code (HGB), the ICS introduced by us also complies with the provisions of the US Sarbanes-Oxley Act (SOX). The obligation for the Telefónica Deutschland Group to fulfil these SOX requirements results from the registration of its majority shareholder, Telefónica, S.A., with the US SEC (Securities and Exchange Commission). In addition, the Telefónica Deutschland Group's ICS complies with the global ICS control setup of Telefónica, S.A.

Establishing and effectively maintaining appropriate internal controls for financial reporting is the responsibility of the Management Board of Telefónica Deutschland and is performed taking company-specific requirements into account.

The conceptual framework for preparing the Consolidated Financial Statements primarily comprises the Group-wide uniform accounting guidelines and the chart of accounts. Both of these must be consistently applied by all the companies of the Telefónica Deutschland Group. New laws, accounting standards and other official pronouncements are analysed on an ongoing basis with regard to their relevance and effects on the proper preparation of the Consolidated Financial Statements. The changes resulting from this are taken into consideration by the Finance & Accounting department in our accounting policies and the chart of accounts.

The data basis for the preparation of the Consolidated Financial Statements consists of the financial statement information reported by Telefónica Deutschland, its subsidiaries and joint ventures, which in turn is based on the accounting entries recorded within the companies. The financial reporting of the individual companies is performed either by the Finance & Accounting department or in close cooperation with it. For certain topics requiring specialist knowledge, such as the valuation of pension obligations, we draw upon the support of external service providers. The Consolidated Financial Statements are prepared within our consolidation system on the basis of the reported financial statement information. The steps to be taken when preparing the Consolidated Financial Statements are subject to both manual and system-based controls at all levels.

Employees involved in the financial reporting process are already examined in terms of their professional suitability before they are hired, and are provided with regular training. The financial statement information must go through certain approval processes at every level. Critical task areas in the financial reporting process are divided appropriately in order to ensure the effective separation of duties, and the dual control principle generally applies. Further control mechanisms include target/performance comparisons and analyses of the composition of content and changes in individual items, both in the financial statement information reported by individual group companies and in the Consolidated Financial Statements. The accounting-related IT systems are used to control IT security, change management and IT operations in particular. For example, access authorisations are defined and established in order to ensure that accounting-related data is protected from unauthorised access, use and change.

The appropriateness and effectiveness of the ICS are assessed annually by the Management Board of Telefónica Deutschland. Our Internal Audit department continuously reviews compliance with guidelines, the reliability and functionality of our ICS and the appropriateness and effectiveness of our risk management system and reports on this to the Management Board of Telefónica Deutschland.

The Supervisory Board of Telefónica Deutschland is involved in the ICS in part via the Audit Committee in accordance with section 171 (1) AktG in conjunction with section 107 (3) AktG. In particular, the Audit Committee is responsible for monitoring the accounting process, the effectiveness of the ICS, the risk management and internal audit systems, and the audit of the financial statements. It also reviews the documents for the Annual Financial Statements of Telefónica Deutschland and the Consolidated Financial Statements and discusses the financial statements with the Management Board and the external auditor.

As part of its risk-oriented audit approach, the external auditor expresses an opinion on the effectiveness of the parts of the ICS that are relevant for financial accounting and reports to the Supervisory Board in the course of the discussion of the financial statements.

The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS). If required, e.g. for the purposes of the HGB Annual Financial Statements or for tax purposes, a reconciliation based on the relevant provisions is performed at account level. Accordingly, the correct preparation of the IFRS financial statement information also serves as an important basis for the Annual Financial Statements of Telefónica Deutschland Holding AG. For Telefónica Deutschland Holding AG and other Group companies reporting in accordance with HGB, the conceptual framework described above is supplemented by an HGB chart of accounts.

As the parent company of the German Telefónica Group, Telefónica Deutschland is included in the aforementioned Group-wide accounting-related internal control system. As a matter of principle, the information presented above also applies to the HGB Annual Financial Statements of Telefónica Deutschland Holding AG and the other Group companies reporting in accordance with HGB.

Report on Expected Developments

Economic Outlook

On the whole, the German economy grew by 2.2%, price and calendar adjusted even by 2.5% in 2017. The growth forecasts were essentially confirmed and even beaten. According to calculations by the Federal Statistical Office, gross domestic product (GDP) grew by 0.8% in the third quarter of 2017 – calendar adjusted – compared to the second quarter of 2017. According to the economic institutes, private and public consumer spending will remain the pillars of the German economy in 2018. Main reasons for this are the increasing purchasing power of households as well as a continued positive development in the labour market.

Any escalation at international trouble spots still poses a risk to the consumer economy, and thus also to overall economic development in Germany. It remains to be seen how the planned withdrawal of the United Kingdom from the European Union (Brexit) will affect the European, and above all the German, economy.

Source: Gfk Konsumklima, Bundesbank, BMWi, Statistisches Bundesamt, herbstgutachten der wirtschaftsforschungsinstitute

T 11 / GDP Growth 2016 – 2018
Germany (calendar adjusted)

In %	2016	2017	**2018**
Germany	1.8	2.2	**2.1**

Market Expectations

In addition to connecting people, the intelligent connection of things via the internet (IoT) offers numerous applications and growth opportunities, such as Industry 4.0, connected cars and autonomous driving, smart health, smart energy and smart cities. Another trend is the analysis of large quantities of data, which is facilitating new insights as well as new business models.

Smartphones and tablets are becoming the trailblazers for the digital revolution of an all-round digital lifestyle in Germany. At the same time, the growing proliferation of databased communications services, i.e. "over-the-top" (OTT) applications such as WhatsApp, Skype, Facebook or Apple Facetime, as well as music and video streaming providers, is increasing data usage.

This all means further growth in the transmitted data volume. This means that the monetisation of mobile data business will remain a strong focus of mobile telecommunications providers. Analysts expect that revenues from data will increase by 13 percent in 2018.

At the same time, the negative trend for mobile voice and SMS in the "traditional telecommunications sector" will continue as a result of further price pressure and changing customer behaviour.

Source: Ovum, Analysys Mason, Bitkom, BMWI

Financial outlook 2018[14]: Telefónica Deutschland Group enters next chapter

Telefónica Deutschland Group achieved a solid operational result in 2017, while also progressing with the integration activities according to plan. After a period of significant headwinds to Mobile Service Revenue, Telefónica Deutschland Group achieved flat mobile service revenue (excluding regulatory effects) year-on-year in 2017. The delivery of approx. 75% or EUR 670 million of the total synergy target of cumulated Operating Cash Flow savings of EUR 900 million in 2019 also drove growth of OIBDA (adjusted for exceptional effects) of 2.6% year-on-year. Telefónica Deutschland Group also invested EUR 950 million in CapEx in 2017. The company will continue to build on these achievements in 2018.

In 2017 the German mobile market remained rational, yet dynamic. There was a strong focus on profitable growth by stimulating customer data usage. Telefónica Deutschland Group successfully introduced large data bundles to its O_2 Free portfolio, thereby setting a new standard for mobile freedom. We consider large data bundles as the next logical step in an increasingly digital world and an important driver for data monetisation,

[14] The effects from the implementation of IFRS 15 as of 1 January 2018 and IFRS 16 as of 1 January 2019 are not reflected in the financial outlook.

helping to counteract gradually declining legacy base and OTT effects on mobile service revenue. Telefónica Deutschland Group will continue to invest in the positioning of the O2 brand and the O_2 Free portfolio in the premium segment of the German market in 2018 to maintain a fair market share.

Telefónica Deutschland Group will continue to focus on its successful multi-brand and multi-channel strategy. While we expect pricing to further stabilise in 2018, trading in the partner business will likely remain strong due to a focus on larger data buckets and 4G in this segment also. In the prepaid segment, we saw lower demand from customers in the second half of 2017 driven by the introduction of legitimisation checks and the RLH-regulation. We expect this trend to continue in 2018 and beyond. In reported terms, regulatory changes (termination rate cuts and RLH) remained headwinds for revenue and OIBDA performance in 2017 and will continue to have an impact in 2018.

Telefónica Deutschland Group will also continue to leverage new business opportunities in the areas of Advanced Data Analytics (ADA) and the Internet-of-Things (IoT). In the mid-term, we expect especially the IoT business to generate additional growth opportunities. We expect significant device and sensor growth which we expect to monetise through cross- and upselling into our owned customer base, which includes more than 80% of our total customer base.

We measure the success of these new business areas by their positive contribution to the development of our revenues. Therefore, we have decided to introduce revenues as a key financial performance indicator as of 2018, so as to better reflect the above-mentioned opportunities. Revenues are mainly driven by mobile service revenues. Additionally, revenues include revenues from the sale of mobile handsets as well as from the sale of fixed-line services. For 2018 we expect revenues to remain broadly stable year-on-year, excluding a regulatory drag in the amount of approx. EUR 30-50 million. This drag results mainly from the annualisation effect of the European Roam-like-home regulation in the first half of the year and to a lesser extent the next mobile termination rate cut from EURc 1.1 per minute to EURc 1.07 as of 1 December 2017 and to EURc 0.95 as of 1 December 2018. Handset revenues depend on market dynamics as well as the launch cycles and availability of new device generations. Fixed revenues will continue to show the implications of the progressive decommissioning of our ULL broadband access infrastructure. At the same time, we continue to market fixed broadband and converged products based on our wholesale access to competitors' networks. Our assumptions are based on a sustained rational competitive environment as well as stable economic conditions.

From a strategic perspective, OIBDA adjusted for exceptional effects remains a crucial key financial performance indicator. We re-iterate our cumulated synergy target of approx. EUR 900 million Operating Cash Flow synergies in 2019 and aim to reach a total savings level of approx. EUR 800 million or close to 90% of the total target by year-end 2018. Additional in-year savings of approx. EUR 80 million at OIBDA level are mainly related to savings from the consolidation of our network which we expect to largely complete by the end of 2018, as well as some roll-over effects from the restructuring of 1600 FTE, which we completed with year-end 2017. At CapEx-level we expect additional in-year savings of approx. EUR 50 million as a result of the roll-out of one LTE network. Against this background, we expect OIBDA adjusted for exceptional effects and adjusted for negative regulatory effects in the amount of approx. EUR 40-60 million to remain broadly stable to slightly positive year-on-year. We expect the before-mentioned integration savings to balance our continued market investment. Our estimation of regulatory impacts and market investment needs are based on the expectation of a continued rational customer response to the roaming legislation and a rational market structure. We expect handsets margins to continue to be broadly neutral.

In the context of our focus on revenue as a key performance indicator, we consider the Capex/Sales ratio as the more meaningful indicator in terms of industry standards and comparability. As such, we are replacing total CapEx by C/S as a key performance indicator for the financial year 2018. Telefónica Deutschland Group will continue to focus on network consolidation, the further roll-out and densification of LTE and the digital transformation of our business this year. We expect C/S to come to approx. 12-13% for the financial year 2018.

Our leverage[15] target of at or below 1.0x Net Debt/OIBDA remains unchanged, but will be subject to continual review, as will be the case with the implementation of IFRS16 from 1 January 2019. We maintain a strong confidence in our ability to generate solid Free Cash Flow. We continue to support a high dividend pay-out ratio in relation to Free Cash Flow. We also reiterate our dividend outlook with a projected dividend growth over 3 years (2016-18), including the proposal for a dividend of EUR 0.26 per share for the financial year 2017 to the Annual General Meeting scheduled for May 2018. We remain committed to generating superior shareholder return and aim to maintain a high pay-out ratio in relation to Free Cash Flow.

In 2017 Telefónica Deutschland Group has again proven its execution ability. The company is now looking towards the next chapter: The digital transformation into Germany's Mobile Customer Champion with a clear focus on improving customer

[15] Leverage is defined as net financial debt divided by the OIBDA of the last twelve months before exceptional effects.

experience and making our operations simpler, faster and better for our customers. By 2019 we are building Germany's largest and most modern mobile network, with a focus on access and reliability for the majority of German customers. We will continue to drive data usage in an economically stable environment and a rational, yet dynamic telco market with significant further data and device growth potential. In this environment, we expect to grow our revenues with the market in the mid-term, particularly driven by additional growth opportunities in IoT. Our own customers are our biggest asset and we are looking to reward and develop them, while serving many more customers based on our successful multi-channel, multi-brand approach. We aim to innovate with a fast and flexible go-to-market approach as well as future-proof products, services and solutions across our different business segments. At the same time, we will continue to focus on operational efficiency. We expect the digital transformation to enable us to further reduce cost, while keeping CapEx stable in the mid-term. Finally, we will maintain an attractive shareholder return on the back of a conservative financing profile supported by a solid FCF trajectory.

T 12 / Financial Outlook 2018[16]:

	Actual 2017	Outlook 2018
Revenue	EUR 7,296 million	Broadly stable y-o-y (excl. regulatory drag of EUR 30-50m)
OIBDA adjusted for exceptional effects	EUR 1,840 million	Flat to slightly positive y-o-y (excl. regulatory drag of EUR 40-60)
Capex/Sales ratio	13%	Approx. 12-13%
Dividend	EUR 0.26/share Proposal for FY 2017 to next AGM	Annual dividend growth for 3 years (2016 – 2018)

[16] The effects from the implementation of IFRS 15 as of 1 January 2018 and IFRS 16 as of 1 January 2019 are not reflected in the financial outlook.

Other disclosures

Report on Relations with Affiliated Companies

In the period from 1 January to 31 December 2017, Telefónica Deutschland Holding AG was a directly dependent company of Telefónica Germany Holdings Limited, Slough, United Kingdom, within the meaning of section 312 AktG. In addition, Telefónica Deutschland Holding AG was an indirectly dependent company of O2 (Europe) Limited, Slough, United Kingdom and of Telefónica, S.A., Madrid, Spain, within the meaning of section 312 AktG. There is neither a domination agreement nor a profit and loss transfer agreement between Telefónica Deutschland Group and the aforementioned companies.

Accordingly, the Management Board of Telefónica Deutschland Holding AG has prepared a report on relations with affiliated companies in accordance with section 312 (1) AktG. This report includes the following final declaration:

"Our company has, with regard to the legal transactions listed in the dependency report for the reporting period, and based on the circumstances which were known to us at the time at which the legal transactions were carried out, received adequate compensation for each legal transaction. It has not been disadvantaged as a result of measures being taken or refrained from during the reporting period."

Remuneration Report

The remuneration report describes the structure and design of the remuneration for the Management Board and Supervisory Board of Telefónica Deutschland Holding AG. Furthermore, the remuneration of each member of the Management Board and Supervisory Board is customised for the 2017 financial year and reported according to integral parts.

The report complies with the requirements of the German Commercial Code (Handelsgesetzbuch: HGB) and the International Financial Reporting Standards (IFRS). Furthermore, it takes into account the recommendations of the German Corporate Governance Code.

Remuneration system for the Management Board

On the basis of the resolution of the Shareholders' Meeting dated 5 October 2012, in accordance with section 314 subsection 3 section 1 and section 286 subsection 5 HGB [German Commercial Code] ("Opt-Out Resolution"), Telefónica Deutschland Holding AG did not disclose any additional details for listed companies in accordance with section 314 subsection 1 No. 6a sentence 5 to 8 HGB and section 285 No. 9a sentence 5 to 8 HGB, for the years 2012 to 2016. As no new Opt-Out Resolution was approved in the 2017 Shareholders' Meeting, the disclosures regarding the Management Board's remuneration will be made on an individualized basis in the future.

Management Board member Markus Haas was reappointed as a member of the company's Management Board with effect from 1January 2017 until the end of 31 December 2019 by a resolution of the Supervisory Board dated 11 December 2016. He was appointed as the new CEO of Telefónica Deutschland Holding AG. His employment contract was newly concluded for the term of the new appointment. With a resolution of the Supervisory Board dated 20July 2017, the Management Board members, Markus Rolle, Wolfgang Metze, Alfons Lösing, Guido Eidmann, Valentina Daiber and Nicole Gerhardt were appointed as Management Board members of the Company with effect from 1 August 2017 until the end of 31st July 2020 and the Management Board member, Cayetano Carbajo Martín, with effect from 1 August 2017 until the end of 31 December 2018. Their employment contracts were concluded for the respective term of their appointment.

The Management Board member Thorsten Dirks resigned as CEO and Management Board member effective 31 December 2016. His employment contract ended by mutual agreement at the end of 31 March 2017. Furthermore, the Management Board member, Rachel Empey, resigned from her office as Management Board member with effect from 31 July 2017. Her employment contract ended by mutual agreement at the end of 31 July 2017.

The total remuneration of the Management Board members (including the former Management Board member) comprises a fixed salary, variable cash remuneration and long-term remuneration components, and fringe benefits The fringe benefits comprise a company car, life insurance, D&O and accident insurance, as well as international health insurance, pension contributions, travel allowances, rental allowances, the reimbursement of the cost of social insurance, the reimbursement of moving costs, flights home, employer expenses, tax compensation, school fees, costs of tax or legal advice, committee fees, and compensation for exchange rate losses and differences in the cost of living and expat supplement. Not all Management Board members receive all of these fringe benefits.

The remuneration of the Management Board members includes a fixed component and a variable component.

The percentage of non-performance-related remuneration components and performance-related remuneration components (when 100% target achievement) is as follows:

Non-performance-related components for 2017: 61%, Performance-related components for 2017: 39%, of which 39% one-year variable remuneration and components with a long-term incentive effect 0%.

The fixed component comprises the annual fixed salary, which is paid in twelve equal monthly instalments, and the aforementioned fringe benefits.

The variable component of the remuneration comprises four variable performance-related remuneration components: While Bonus I consists solely of short-term components, Bonus II (Deferred Bonus), Bonus III and PIP consist solely of components with a long-term incentive effect. This is to ensure that variable remuneration oriented towards the company's sustainable development.

1) The first variable remuneration component is a one-year variable remuneration (Bonus I).

   The Bonus I is calculated for the current Management Board members from the 2017 financial year according to the formula, target bonus multiplied by company performance. The target bonus is equivalent to set percentage of the annual fixed salary.

   Two components are critical in company performance. These are based on the success of Telefónica Deutschland Holding AG (Telefónica Deutschland component) to the value of 70% and Telefónica, S.A. (Telefónica, S.A. component) to the value of 30%.

   The parameters for the calculation of the Telefónica Deutschland component, its weighting and the respective target achievement are set by the Supervisory Board on an annual basis. Besides the financial targets, targets directly and indirectly in connection with customer satisfaction were agreed for 2017. If the minimum percentage of the respective target value set annually by the supervisory board is not achieved, the value for the company performance factor is 0% (knock-out). If the target is reached, the factor is 100 %. If the performance target is exceeded, there is an upper limit of 125 %. Intermediate values of target achievement are not linearly interpolated, but calculated according to a payout curve set by the Supervisory Board. The payment curve assigns a corresponding company's performance factor (in %) to the percentage of the target value actually achieved for each parameter determined annually by the Supervisory Board. The sum of the weighted company performance factors determines the Telefónica Deutschland components. The Telefónica, S.A. component is set by the Supervisory Board at its due discretion. This discretionary decision is guided by the business performance of Telefónica, S.A. in the respective year.

2) The second variable remuneration component is participation in the Performance and Investment Plan (PIP). This plan ("Performance and Investment Plan 2014") was adopted by the Annual General Meeting of Telefónica, S.A. on 30 May 2014. There are two versions of the "Performance and Investment Plan 2014", namely the version applicable to members of the ExComm of Telefónica, S.A., Markus Haas, and the version for senior management; the difference between the two versions is that members of the ExComm of Telefónica, S.A. – as described in greater detail below – may be allocated 125% of the performance shares awarded.

   In accordance with the PIP, members of the Management Board are, with the approval of the Supervisory Board, allocated a certain number of performance shares as an award. The number of performance shares is calculated by dividing an amount corresponding to a certain proportion of the fixed annual salary of the relevant Management Board member by the average listed price of Telefónica, S.A. shares (Core Award). After three years, the performance shares give the right to the acquisition of the corresponding number of Telefónica, S.A. shares (free of charge) providing that the beneficiary still employed by a company of Telefónica, S.A. Group at the end of the time period and the price of Telefónica, S.A. shares over the "vesting period" together with the associated dividend distributions (Total Shareholder Return Telefónica, S.A.) during the period corresponds to at least the median of the Total Shareholder Return (share yield) of aa peer group from global telecommunications companies. 30% of the performance shares awarded if Telefónica, S.A.'s Total Shareholder Return corresponds to the median of these companies. The number of shares awarded increases to 100 % if Telefónica, S.A.'s Total Shareholder Return is in the upper quartile of the peer group. If Telefónica, S.A.'s Total Shareholder Return is between the upper quartile and the median, the number of allocated shares is calculated on a linear proportional basis. If Telefónica, S.A.'s Total Shareholder Return is below the median of the peer group then the entitlements are forfeited. On the basis of the "Performance and Investment Plan 2014", members of the ExComm of Telefónica, S.A. receive an allocation of 125 % if Telefónica, S.A.'s Total Shareholder

Return reaches at least the level of Telefónica, S.A.'s Total Shareholder Return for the upper decile of the peer group.

As an alternative to the Core Award, the PIP provides for an Enhanced Award whereby the number of performance shares is increased by 25% in comparison with the Core Award. To be entitle to receive the Enhanced Award, Management Board member must personally own a certain number of shares in Telefónica, S.A. (currently 25% of the Core Award). If the conditions for the Enhanced Award are met, the number of shares to be actually allocated is calculated on the basis of the Enhanced Award rather than the Core Award.

For the financial year 2017, the Executive Committee of Telefónica, S.A. decided not to award any shares from the PIP. Therefore, Supervisory Board of Telefónica Deutschland Holding AG decided that the Management Board members of Telefónica Deutschland Holding AG will not receive any remuneration from the PIP in financial year 2017.

3) The third variable remuneration component is a deferred bonus (Bonus II). Bonus II was put in place to avoid an excessive incentive effect through the PIP, and thus too much of an incentive for the pursue corporate goals. Bonus II provides the Management Board members with an amount equal to a share of Bonus I paid in the following year, the annual fixed salary or a fixed amount as a prospective bonus. The Management Board member has the right to the full amount after a period of three years if the Total Shareholder Return of Telefónica Deutschland Holding AG is in the upper quartile of the Total Shareholder Return of the peer group comprising the DAX 30 companies. Each Management Board member has the right to 50% of Bonus II if the total shareholder return of Telefónica Deutschland Holding AG corresponds to the median of the peer group. If the total shareholder return of Telefónica Deutschland Holding AG lies between the upper quartile and the median, Bonus II is calculated on a linear proportional basis. If the Total Shareholder Return of Telefónica Deutschland Holding AG lies below the median, there is no entitlement to payments.

4) The newly members of the Management Board appointed with effect from 1 August 2017 were offered an additional variable component, Bonus III, consisting of 3 alternatives as from financial year 2018:

First alternative: Bonus III is awarded according to the same rules as Bonus II. The initial value is equal to a certain percentage of the fixed annual salary.

Second alternative: Bonus III is granted according to the following rules. The Management Board member is entitled to receive performance shares as a Core Award and as an Enhanced Award as detailed in a performance and investment plan or a follow-up programme ("PIP") approved by the Annual General Meeting of Telefónica S.A. with an annual initial value as a percentage of the fixed annual salary provided that the company's Supervisory Board has given its prior consent to the award of the performance shares.

Third alternative: Bonus III is granted in accordance with a Long Term Incentive Plan to be adopted by the Company's Supervisory Board, the details of which will be determined by the Supervisory Board. Such Long Term Incentive Plan has a three-year performance period. The initial value is equal to a certain percentage of the fixed annual salary.

5) Furthermore, the Supervisory Board is authorised, at its discretion, to award members of the Management Board a bonus up which may not exceed 100% of their annual fixed salaries for extraordinary merits that are not already rewarded by the regular remuneration and which cause a material economic advantage for the company.

The Telefónica Deutschland Group has not currently granted the members of its Management Board any securities or loans and has not assumed any guarantees on their behalf.

A non-competition covenant and/or post-contractual non-competition covenant has been agreed with the members of the Management Board. During the term of the post-contractual non-competition covenant, members of the Management Board will receive a compensation equal to 50% of the most recently received contractual remuneration. The company shall be entitle to waive compliance at any time.

Members of the Management Board must unrequested return all objects in their possession due to the company, including company cars, upon termination of their employment relationship as well as in the event of dismissals.

Retirement pension

Markus Haas, Markus Rolle, Guido Eidmann, Valentina Daiber, Wolfgang Metze and Nicole Gerhardt will participate in the company's pension plan and Alfons Lösing will receive a fixed contribution for a reinsured commitment of the Essener Verband (EV). The Management Board member Cayetano Carbajo Martín has no commitment regarding company-financed retirement pension from the company, but participates in the Spanish plan for Directors.

The Management Board members, who participate in the company's pension plan, will receive an annual financing contribution in the amount of 20% of the annual fixed salary, which is invested in a reinsured support fund. The Management Board members may choose between 6 specified pension packages, which hedge the risks of surviving dependants' pension, work disability and old-age to varying degrees. Besides the statutory guaranteed interest, there is no further interest guarantee. The Management Board members have the option to choose between a one-off payment, a payment in 3 or 6 instalments or the drawing of a pension. Old-age pension or the payout is received by the Management Board member when they have reached the age limit and left the services of the company.

The Management Board member, who is a member of the Essener Verband (EV), receives a fixed financing amount for the so-called BOLO (contribution-based benefit ordinance of the EV). There is a specific pensionable age. Furthermore, surviving dependants' and work disability pension benefits are granted. The Management Board also receives a pension from Benefit Ordinance B of the EV. Commitments are also provided for retirement, surviving dependants' and work disability pensions. The benefits from the commitments, which are not covered by the pension insurance association are insured within the scope of reinsurance policy.

Death benefit

In the event of the death of a member of the Management Board during the term of the employment contract, such member's widow/widower and children, provided they are under the age of 27, shall be entitled as joint creditors to the continued payment in full of such member's fixed annual salary. Such payment shall be received for the month in which death occurred and the following six months. Such payment shall not exceed the term of the contract.

Termination agreement

On the basis of the termination agreement dated 20 July 2017, the following deviations from the remuneration system described here result for Rachel Empey:

- The former Management Board member receives a pro rata temporis Bonus I for financial year 2017 based on a target achievement of 100%.
- The former Management Board member did not receive any shares or compensation payments for the PIP cycles starting on 1 October 2014, 2015 and 2016.
- The former Management Board member did not receive any payments for the Bonus II cycles starting on 30 October 2014, 1 October 2015 and 1 October 2016.

Total remuneration of the Management Board

Management Board remuneration is disclosed in accordance with two different sets of rules: on the basis of the German Accounting Standard No. 17 - DRS (amended 2010) and the GCGC [German Corporate Governance Code]. This results in deviation for individual remuneration components and total remuneration.

T 13 / Individual remuneration of the Management Board members in accordance with DRS 17 (amended)
(in accordance with section 285 No. 9a sentence 5-8 HGB and § 314 subsection 1 No. 6a sentence 5-8 HGB)

	Non-performance-related components			Performance-related components	Component which offers a long-term incentive				
	Fixed remuneration	Fringe benefits	TOTAL	One-year variable remuneration	Multi-year cash remuneration	Multi-year share remuneration[1] Number	Multi-year share remuneration[1] Fair value	TOTAL components with a long-term incentive effect	**Total[2] remuneration**
Markus Haas	**700,000**	**18,236**	**718,236**	**642,150**	**0**	**0**	**0**	**0**	**1,360,386**
Markus Rolle	**166,667**	**5,003**	**171,670**	**108,333**	**0**	**0**	**0**	**0**	**280,003**
Wolfgang Metze	**166,667**	**5,943**	**172,610**	**108,333**	**0**	**0**	**0**	**0**	**280,943**
Alfons Lösing	**166,667**	**22,336**	**189,003**	**108,333**	**0**	**0**	**0**	**0**	**297,336**
Cayetano Carbajo Martín	**125,000**	**66,108**	**191,108**	**81,250**	**0**	**0**	**0**	**0**	**272,358**
Guido Eidmann	**125,000**	**25,114**	**150,114**	**81,250**	**0**	**0**	**0**	**0**	**231,364**
Valentina Daiber	**125,000**	**5,555**	**130,555**	**81,250**	**0**	**0**	**0**	**0**	**211,805**
Nicole Gerhardt	**125,000**	**4,787**	**129,787**	**81,250**	**0**	**0**	**0**	**0**	**211,037**
Rachel Empey	**350,000**	**159,535**	**509,535**	**228,992**	**0**	**0**	**0**	**0**	**738,527**

[1] The share-based remuneration for the members of the Management Board recorded in accordance with IFRS for the financial year amounted to EUR 85,740. The following amounts were attributable to the Management Board members: Markus Haas EUR 102,141, Rachel Empey EUR -16,401

[2] The disclosure for Markus Haas is for 12 months, and for the other Management Board members on a pro rata temporis basis.

T14 / Pension commitments and other benefits

	Service cost according to IFRS in the 2017 financial year	Service cost according to HGB in the 2017* financial year	Project unit credit value of the pension benefitcommitment according to IFRS	Project unit credit value of the pension benefitcommitment according to HGB
Markus Haas	66,131	65,502	602,284	358,646
Rachel Empey	0	(362)	0	0
Markus Rolle	17,828	31,985	472,009	234,265
Wolfgang Metze	0	10,398	15,945	10,398
Alfons Lösing	80,937	372,877	2,368,472	1,531,102
Cayetano Carbajo Martín	58,550	58,878	847	819
Guido Eidmann	23,646	9,567	47,569	35,228
Valentina Daiber	21,154	24,551	135,610	84,243
Nicole Gerhardt	0	179	2,163	2,159

*) Personnel expenses without interest effect recorded in the financial year

Remuneration of the Management Board in accordance to GCGC
The following tables are made on the basis of sample tables 1 and 2 recommended by the German Corporate Governance Code, which show the total amounts of the remuneration components granted and allocated for the reporting year. The overview of the benefits granted also shows the minimum and maximum achievable values.

In contrast to the benefits granted table, the benefits received table does not show the target value granted for the short-term and long-term variable remuneration components, but instead the value actually received for 2017.

T 15 / Table in accordance to the requirements of the GCGC

	Markus Haas Chief Executive Officer (CEO) Since: 01/01/2017			Markus Rolle Chief Financial Officer Since: 01/08/2017			Wolfgang Metze Chief Consumer Officer Since: 01/08/2017		
Benefits granted	2017	2017 (min)	2017 (max)	2017	2017 (min)	2017 (max)	2017	2017 (min)	2017 (max)
Fixed remuneration	700,000	700,000	700,000	166,667	166,667	166,667	166,667	166,667	166,667
Fringe benefits	18,236	18,236	18,236	5,003	5,003	5,003	5,943	5,943	5,943
Total	**718,236**	**718,236**	**718,236**	**171,669**	**171,669**	**171,669**	**172,609**	**172,609**	**172,609**
One-year variable remuneration	**700,000**	**0**	**875,000**	**108,333**	**0**	**135,417**	**108,333**	**0**	**135,417**
Multi-year variable remuneration	**700,001**	**0**	**875,001**	**109,000**	**0**	**109,000**	**119,167**	**0**	**119,167**
LTI - Bonus II (Plan 2017-2020)	700,001	0	875,001	109,000	0	109,000	119,167	0	119,167
LTI - PIP (Plan 2017 -2020)	0	0	0	0	0	0	0	0	0
Total	**2,118,237**	**718,236**	**2,468,237**	**389,003**	**171,669**	**416,086**	**400,110**	**172,609**	**427,193**
Pension expenses	66,131	66,131	66,131	17,828	17,828	17,828	0	0	0
Total remuneration acc. to GCGC	**2,184,368**	**784,367**	**2,534,368**	**406,831**	**189,497**	**433,914**	**400,110**	**172,609**	**427,193**

	Alfons Lösing Chief Partner and Business Officer Since: 01/08/2017			Cayetano Carbajo Martín Chief Technology Officer Since: 01/08/2017			Guido Eidmann Chief Information Officer Since: 01/08/2017		
Benefits granted	2017	2017 (min)	2017 (max)	2017	2017 (min)	2017 (max)	2017	2017 (min)	2017 (max)
Fixed remuneration	166,667	166,667	166,667	125,000	125,000	125,000	125,000	125,000	125,000
Fringe benefits	22,336	22,336	22,336	66,108	66,108	66,108	25,114	25,114	25,114
Total	**189,002**	**189,002**	**189,002**	**191,108**	**191,108**	**191,108**	**150,114**	**150,114**	**150,114**
One-year variable remuneration	**108,333**	**0**	**135,417**	**81,250**	**0**	**101,563**	**81,250**	**0**	**101,563**
Multi-year variable remuneration	**130,000**	**0**	**130,000**	**97,500**	**0**	**97,500**	**97,500**	**0**	**97,500**
LTI - Bonus II (Plan 2017-2020)	130,000	0	130,000	97,500	0	97,500	97,500	0	97,500
LTI - PIP (Plan 2017 -2020)	0	0	0	0	0	0	0	0	0
Total	**427,336**	**189,002**	**454,419**	**369,858**	**191,108**	**390,170**	**328,864**	**150,114**	**349,177**
Pension expenses	80,937	80,937	80,937	58,550	58,550	58,550	23,646	23,646	23,646
Total remuneration acc. to GCGC	**508,273**	**269,939**	**535,356**	**428,408**	**249,658**	**448,720**	**352,510**	**173,760**	**372,823**

Benefits granted	Valentina Daiber Chief Officer for Legal and Corporate Affairs Since: 01/08/2017			Nicole Gerhardt Chief Human Resources Officer Since: 01/08/2017			Rachel Empey Chief Financial Officer Resignation: 31/07/2017		
	2017	2017 (min)	2017 (max)	2017	2017 (min)	2017 (max)	2017	2017 (min)	2017 (max)
Fixed remuneration	125,000	125,000	125,000	125,000	125,000	125,000	350,000	350,000	350,000
Fringe benefits	5,555	5,555	5,555	4,787	4,787	4,787	159,535	159,535	159,535
Total	**130,555**	**130,555**	**130,555**	**129,787**	**129,787**	**129,787**	**509,535**	**509,535**	**509,535**
One-year variable remuneration	**81,250**	**0**	**101,563**	**81,250**	**0**	**101,563**	**280,000**	**0**	**350,000**
Multi-year variable remuneration	**97,500**	**0**	**97,500**	**82,500**	**0**	**82,500**	**0**	**0**	**0**
LTI - Bonus II (Plan 2017-2020)	97,500	0	97,500	82,500	0	82,500	0	0	0
LTI - PIP (Plan 2017 -2020)	0	0	0	0	0	0	0	0	0
Total	**309,305**	**130,555**	**329,617**	**293,537**	**129,787**	**313,850**	**789,535**	**509,535**	**859,535**
Pension expenses	21,154	21,154	21,154	0	0	0	0	0	0
Total remuneration acc. to GCGC	**330,459**	**151,709**	**350,771**	**293,537**	**129,787**	**313,850**	**789,535**	**509,535**	**859,535**

	Markus Haas Chief Executive Officer (CEO) Since 01/01/2017	Markus Rolle Chief Financial Officer Since: 01/08/2017	Wolfgang Metze Chief Consumer Officer Since: 01/08/2017	Alfons Lösing Chief Partner and Business Officer since 1/08/2017	Cayetano Carbajo Martin Chief Technology Officer since 01/08/2017
Benefits received					
Fixed remuneration	700,000	166,667	166,667	166,667	125,000
Fringe benefits	18,236	5,003	5,943	22,336	66,108
Total	**718,236**	**171,669**	**172,609**	**189,002**	**191,108**
One-year variable remuneration[17]	**594,020**	**91,932**	**91,932**	**91,932**	**68,949**
Multi-year variable remuneration	**0**	**0**	**0**	**0**	**0**
LTI - Bonus II (Plan 2014-2017)	0	0	0	0	0
LTI - PIP (Plan 2014 -2017)	0	0	0	0	0
Other					
Total	**1,312,256**	**263,601**	**264,541**	**280,934**	**260,057**
Pension expenses	66,131	17,828	0	80,937	58,550
Total remuneration acc. to GCGC	**1,378,387**	**281,429**	**264,541**	**361,871**	**318,607**

[17] At the time of preparation of the report, the Supervisory Board had not yet passed a resolution on the payment amounts for the one-year variable remuneration. The one-year variable remuneration for 2017 is reported on the basis of the estimated payout amount.

	Guido Eidmann Chief Information Officer Since: 01/08/2017	Valentina Daiber Chief Officer for Legal and Corporate Affairs Since: 01/08/2017	Nicole Gerhardt Chief Human Resources Officer Since: 01/08/2017	Rachel Empey Chief Financial Officer Left: 31/07/2017
Benefits received				
Fixed remuneration	125,000	125,000	125,000	350,000
Fringe benefits	25,114	5,555	4,787	159,535
Total	**150,114**	**130,555**	**129,787**	**509,535**
One-year variable remuneration[18]	**68,949**	**68,949**	**68,949**	**280,000[18]**
Multi-year variable remuneration	**0**	**0**	**0**	**0**
LTI - Bonus II (Plan 2014-2017)	0	0	0	0
LTI - PIP (Plan 2014 -2017)	0	0	0	0
Other				
Total	**219,063**	**199,504**	**198,736**	**789,535**
Pension expenses	23,646	21,154	0	0
Total remuneration acc. to GCGC	**242,709**	**220,658**	**198,736**	**789,535**

[18] The one-year variable remuneration is a recognised on a pro rata temporis basis, based on 100% target achievement here.

Remuneration of Supervisory Board

The members of the Supervisory Board receive fixed remuneration of EUR 20 thousand annually in accordance with the articles of association, payable at the end of the financial year. The Chairperson of the Supervisory Board receives EUR 80 thousand and the Deputy Chairperson of the Supervisory Board receives EUR 40 thousand. The Chairperson of the Audit Committee receives an additional EUR 50 thousand if the Chairperson of the Supervisory Board or the Deputy Chairperson does not hold the chair in this committee. Supervisory Board members who hold office in the Supervisory Board or the position of Chairperson of the Supervisory Board or Chairperson of a Committee only for a certain part of the financial year receive proportionate remuneration on a pro rata temporis basis.

In addition to the remuneration, the company reimburses the members of the Supervisory Board for the expenses arising in the fulfilment of their duties as Supervisory Board members as well as any value-added tax on their remuneration and their expenses.

Four members of the Supervisory Board who have an executive function in one of the Telefónica S.A. Group companies waived their remuneration for their current term of office up to an amount of EUR 2,000 per year.

Outside of the aforementioned activities of the Supervisory Board and the committees, no services, in particular no consulting or mediation services, were provided.

Name	Member of the Supervisory Board	Remuneration (in EUR)
Eva Castillo Sanz	since 5 October 2012	80,000
Laura Abasolo García de Baquedano	since 12 May 2015	2,000
Angel Vilá Boix	Since 18 September 2012 until 4 October 2017	2000
Patricia Cobian González	since 18 September 2012	2000
Michael Hoffmann	since 5 October 2012	70,000
Enrique Medina Malo	since 18 September 2012	2,000
Sally Anne Ashford	since 18 September 2014	20,000
Peter Erskine	since 19 May 2016	20,000
Julio Linares López	since 16 October 2017	4,219
Christoph Braun	since 01 July 2016	40,000
Thomas Pfeil	since 03 June 2013	20,000
Dr Jan-Erik Walter	since 03 June 2013	20,000
Marcus Thurand	since 03 June 2013	20,000
Christoph Heil	since 03 June 2013	20,000
Claudia Weber	since 03 June 2013	20,000
Joachim Rieger	since 31 October 2014	24,500*
Jürgen Thierfelder	since 31 October 2014	24,500*

*In addition to their remuneration in accordance with section 20 of the Telefónica Deutschland Holding AG's Articles of Association, Mr Joachim Rieger and Mr Jürgen Thierfelder shall receive annual remuneration for their activities as members of the Supervisory Board of the subsidiaries TCGS Essen & Potsdam GmbH and Telefónica Germany Retail GmbH. Such remuneration amounts to EUR 4,500 each and is already included in the table.

The members of the Supervisory Board received remuneration for their activities on the Supervisory Board of Telefónica Deutschland Holding AG of EUR 382 thousand in 2017 and EUR 372 thousand in 2016.

As of 31 December 2017, the Telefónica Deutschland Group has not granted the members of its Supervisory Board any securities or loans, and has not assumed any guarantees on their behalf.

Management Declaration

The Company has published this declaration in accordance with section 315d HGB in conjunction with section 289f HGB, which also contains the declaration of compliance pursuant to section 161 AktG, section 76 (4) and section 111 (5) AktG, on its website **(www.telefonica.de/management-declaration-2017)**.

Separate non-financial combined report

Telefónica Deutschland will publish a separate, non-financial, combined report which contains the information for both Telefónica Deutschland Group and Telefónica Deutschland, at the following website address: **www.telefonica.de/nfe.** This non-financial report in accordance with section 315 (5) HGB in conjunction with section 289a HGB is part of this combined management report.

Disclosures

in accordance with section 315a and section 289a HGB

Composition of subscribed capital

The registered share capital of Telefónica Deutschland amounts to EUR 2,974,554,993, which is consistent with the prior year. The share capital is divided into 2,974,554,993 no-par value registered shares, each with a proportionate interest in the share capital of EUR 1.00 ("shares"). The registered share capital is fully paid. As of 31 December 2017 and at the time this Management Report was prepared, Telefónica Deutschland did not hold any of its own shares. In accordance with section 6 para. 2 of the articles of association, the shareholders do not have the right to securitise shares. In general, each no-par-value share grants one vote at the Annual General Meeting. The shares are in general freely transferable.

Voting restrictions and restrictions on the transferability of shares

There are no general limitations on voting rights. We are not aware of any contractual agreements with Telefónica Deutschland or other agreements about limitations on voting rights or the transferability of shares. In addition to the statutory provisions on insider trading and the prohibition on trading in accordance with the Market Abuse Regulation, the Company informs the relevant parties about "silent periods" of 30 days prior to the publication of financial data with corresponding recommendations to refrain from trading in this period. Other than this, there are no internal governance provisions providing for restrictions on the purchase and sale of shares by Management Board members or employees.

Participation in the share capital of more than 10 % of the voting rights

As of 31 December 2017, Telefónica Germany Holdings Limited, Slough, United Kingdom, holds approximately 69.2 % of the shares of Telefónica Deutschland Holding AG and the same amount of voting rights. Both O2 (Europe) Limited, Slough, United Kingdom, and Telefónica, S.A., Madrid, Spain, indirectly hold more than 69.2 % of the shares in Telefónica Deutschland via Telefónica Germany Holdings Limited. Other than this, we were not informed of any participation in the share capital of Telefónica Deutschland of more than 10 % of the voting rights and we are not aware of any such participations.

Shares with special rights

There are no shares with special rights, and in particular no shares with rights that grant control.

Control of voting rights when employees hold stakes in the share capital

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

Appointment and dismissal of Management Board members

Pursuant to section 7 of the articles of association and section 84 AktG, the Supervisory Board determines the number of members of the Management Board and is responsible for their appointment and dismissal as well as for the appointment of the Chair of the Management Board (Chief Executive Officer, CEO). Deputy members of the Management Board may be appointed.

As of 31 December 2017, the Management Board of Telefónica Deutschland Holding AG consisted of eight members. Since 1 August 2017, the Management Board has been comprised of eight members (>MANAGEMENT DECLARATION), from 1 January 2017 until 31 July 2017, it was comprised of two members.

Management Board members are appointed by the Supervisory Board for a term of no more than five years. They can be re-appointed and their term can be extended provided one period of office does not exceed a period of five years. The Supervisory Board may dismiss a Management Board member in the event of good cause, such as a gross breach of duties or if the Annual General Meeting adopts a no-confidence resolution in relation to the respective Management Board member. Other reasons for dismissal – such as mutual termination – remain unaffected.

Telefónica Deutschland is subject to the provisions of the German Co-Determination Act (Mitbestimmungsgesetz – MitbestG).

Pursuant to section 31 MitbestG, a majority of two-thirds of the votes of Supervisory Board members is required for the appointment and dismissal of Management Board members. If this majority is not reached in the first round of voting by the Supervisory Board, the appointment or dismissal may occur on the recommendation of the Mediation Committee, which is to be formed in accordance with section 27 (3) MitbestG, in a further round of voting with a simple majority of the votes of the Supervisory Board members. If the mandatory majority is still not achieved, a third round of voting must take place which again requires a simple majority; for this round of voting, however, the Chair of the Supervisory Board has two votes.

If a required Management Board member is missing, the Munich Local Court must appoint the member on application by a party concerned pursuant to section 85 (1) AktG in urgent cases.

Changes to the articles of association

In accordance with section 179 (1) sentence 1 AktG, any change to the articles of association of Telefónica Deutschland Holding AG requires a resolution of the Annual General Meeting. In accordance with section 27 of the articles of association together with section 179 (2) sentence 2 AktG, resolutions of the Annual General Meeting of Telefónica Deutschland regarding changes to the articles of association are passed with a simple majority of the votes cast and a simple majority of the share capital represented at the passing of the resolution. If the law requires a higher majority of votes or capital, this majority must be applied. In connection with changes that only affect the wording of the articles of association, the Supervisory Board is entitled to make changes in accordance with section 179 (1) sentence 2 AktG in conjunction with section 17 (3) of the articles of association.

Authorisation of the Management Board to issue shares

The powers of the Management Board are governed by sections 76 et seqq. AktG in conjunction with section 8 et seqq. of the articles of association. In particular, the Management Board runs the company and represents it in and out of court.

The authorisation of the Management Board to issue shares is governed by section 4 of the articles of association in conjunction with the statutory provisions. As of 31 December 2017, the following authorisations of the Management Board for the issuing of shares exist:

Authorised capital
As of 31 December 2017, the Management Board is authorised, with the approval of the Supervisory Board, to increase the share capital of the company in the period until 18 May 2021, on one or more occasions, by a total of EUR 1,487,277,496 by issuing up to 1,487,277,496 new no-par value shares in exchange for cash and/or non-cash contributions (Authorised Capital 2016/I). The authorisation stipulates that shareholder subscription rights can, in certain cases, be completely or partially excluded (section 4 (3) of the articles of association). This was resolved by the Shareholders' Meeting on 19 May 2016, which at the same time cancelled the existing Authorised Capital 2012/I.

Conditional capital
For the purpose of the issue of registered no-par value shares to the holders or creditors of bonds, the share capital of the company is conditionally increased by up to EUR 558,472,700 by issuing 558,472,700 new registered no-par value shares (Conditional Capital 2014/I).

Authorisation of the Management Board to buy back shares
The authorisation of the Management Board to buy back own shares is governed by section 57 (1) sentence 2 and sections 71 et seqq. AktG. The Shareholders' Meeting on 19 May 2016 cancelled the existing authorisation to buy back own shares dated 5 October 2012 and resolved a new authorisation in accordance with section 71 (1) 8 AktG to buy back own shares of up to a total of 10% of the share capital on the resolution date or, if lower, on the date on which the authorisation is exercised.

Change of control/compensation agreements
Telefónica Deutschland's significant agreements containing a change-of-control clause relate to financing.

In the event of a change of control, the rating of Telefónica Deutschland or of the outstanding non-current liabilities within the Group will be examined with regard to capital market liabilities. In the event of a deterioration in the rating as contractually defined, the contracts grant O2 Telefónica Deutschland Finanzierungs GmbH as the issuer the option to terminate the financing early at a redemption amount of 101 % of the nominal amount plus accrued interest. Otherwise, the interest is increased by 1.25 % p.a. until the end of the term.

A small number of other contracts grant the contracting partners the right of termination in the event of a change of control in accordance with normal practice; this would result in an obligation to fulfil all outstanding obligations.

The service contracts of the Management Board members of Telefónica Deutschland grant the right to terminate these contracts in the event of a takeover offer by a third party with three months' notice to the end of the month; however, this termination must occur within six months of a change of control. In this case, the relevant Management Board member is entitled to a one-off compensation to the value of one fixed annual salary plus the last annual bonus received. However, the compensation may not exceed the remuneration that would have been payable by the end of the contract.

Business development of Telefónica Deutschland Holding AG

The annual financial statements of Telefónica Deutschland Holding AG were prepared in accordance with the German Commercial Code (HGB).

Telefónica Deutschland acts as a holding company and as a service provider, it is responsible for the management and strategic orientation of the Telefónica Deutschland Group and its operating activities. As such, its opportunities and risks, post-reporting date events and the outlook for the coming financial year are the same as for the Telefónica Deutschland Group. As at 31 December 2017, Telefónica Deutschland has no employees.

Results of Operations

Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its operating business activities as a service provider and holding company. Telefónica Deutschland generates its revenues from compensation for services, which it provides for its subsidiaries.

Recharging of these management costs resulted in revenues in the amount of EUR 15 million in the 2017 financial year. This slightly exceeded the expectation of the Company from the previous years for the revenue development.

Revenue and expenses increased compared to the previous year and resulted in an annual net loss in the amount of EUR 2 million, which was at the same level as the previous year. The prior year forecasted break-even was nearly achieved.

Revenues slightly above previous year
In the financial year, revenues in the amount of EUR 15 million (2016: EUR 12 million) were generated. The revenues were essentially comprised of charging on the costs for the remuneration of Management Board members, as well as additional administration costs, which are assumed by Telefónica Germany GmbH & Co. OHG for compensating management services. Furthermore, invoiced management services are included in the amount of EUR 240 thousand, which Telefónica Deutschland Holding AG provides for Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH.

Personnel expenses above previous year's level
Personnel expenses primarily included the remuneration of the Management Board including social expenses and amounted to EUR 6 million during the financial year (2016: EUR 4 million). The increase of 61% compared to the previous year is a result of the changed composition of the Management Board.

Other operating expenses slightly above the previous year's level
The other operating expenses are slightly above the previous year's level, with EUR 11 million. They essentially included legal and consulting expenses from external service providers.

Net loss for the year at the previous year's level
As in 2016, the Company in 2017 generated a net loss for the year in the amount of EUR 2 million.

T 16 / Profit and Loss Statement
Profit and Loss Statement

(Euros in millions)	2017	2016	1 January to 31 December Change	% change
Revenues	**15**	**12**	**3**	**28**
Other income	1	0	1	100
Operating expenses	(18)	(13)	(4)	31
Personnel expenses	(6)	(4)	(2)	61
Other expenses	(11)	(10)	(2)	18
Operating income	**(2)**	**(2)**	**0**	**–**
Financial result	0	0	0	–
Loss before tax	**(2)**	**(2)**	**0**	**–**
Income tax	0	0	0	–
Profit/(loss) for the period	**(2)**	**(2)**	**0**	**–**

Financial Position and Net Assets

Principles and goals of financial management

As a service provider, Telefónica Deutschland Holding AG is responsible for the management of the Telefónica Deutschland Group and its operating business activities. It mainly finances itself with equity capital and generates an operating cash flow from charging on these management services to Telefónica Germany GmbH & Co. OHG and Telefónica Germany Management GmbH. Furthermore, Telefónica Deutschland Holding AG is integrated into the Group-wide financial management of the Telefónica Deutschland Group and is therefore able to fulfil its payment obligations at all times.

In this respect, the further remarks apply from the Financial situation of the Group section.

Loan to Telefónica Germany GmbH & Co. OHG

In the 2016 financial year, Telefónica Deutschland Holding AG granted Telefónica Germany GmbH & Co. OHG a loan in the amount of EUR 110 million for financing the general business activities. The loan was fully repaid in 2017.

Bond for corporate financing

In November 2013/February 2014, O2 Telefónica Deutschland Finanzierungs GmbH issued two bonds with a nominal value of EUR 600 million and EUR 500 million and a term of five to seven years.

The bonds were provided to Telefónica Germany GmbH & Co. OHG within the scope of a loan for general corporate financing.

Within the scope of the Group-wide financial management of the Telefónica Deutschland Group , Telefónica Deutschland Holding AG guarantees the punctual payment of interest, principal and other additional amounts, which are payable under the bond.

Investment projects

After the acquisition of E-Plus, good progress was made in the integration with the result of that the focus was increasingly on the digital transformation. There is currently no extensive investments planned at the level of Telefónica Deutschland Holding AG.

Financial assets almost at the previous year’s level

Financial assets in the amount of EUR 10,113 million (2016: EUR 10,747 million) were comprised of the shares in Telefónica Germany GmbH & Co. OHG, Munich. On the basis of a shareholders’ resolution dated 25 April 2017, a withdrawal totalling EUR 634 million took place in the financial year from Telefónica Deutschland, in accordance with section 4 subsection 3 of the articles of association, this led to a corresponding reduction of the investment book value.

The book value of the shares in Telefónica Germany Management GmbH, Munich were unchanged in comparison to the previous period, at EUR 10 million.

Repayment of loan leads to a decline in receivables due from affiliated companies

The decline in receivables due from affiliated companies mainly resulted from the repayment of the loan by Telefónica Germany GmbH & Co. OHG Munich in the amount of EUR 110 million. In addition, cash pool receivables due from Telfisa Global B.V., Amsterdam of EUR 7 million in 2016 fell to EUR 4 million in 2017.

Slight increase in provisions

Due to the expansion of the Management Board the provisions for pensions increased slightly.

The rise in other provisions from EUR 6 million in 2016 to EUR 7 million at the end of the reporting period mainly resulted from increased provisions for outstanding invoices for consulting services.

Liabilities exceed previous year
Trade payables, liabilities to affiliated companies and other liabilities exceed those of the previous year at EUR 3 million. This was essentially a result of increased VAT liabilities.

Decline in equity capital
In financial year 2017, equity capital decreased by EUR 745 million or 6.8% to EUR 10,125 million (2016: EUR 10,870 million). The changes to equity capital mainly results from the dividend payment dated 12 May 2017 in the amount of EUR 744 million and from the periodic result of EUR -2 million.

T 17 / Balance Sheet

	As of 31 December			
(Euros in millions)	2017	2016	Change	% change
Fixed assets				
Financial assets				
Shares in affiliated companies	10,124	10,757	(634)	(6)
Current assets				
Receivables from affiliated companies	12	121	(109)	(90)
Other assets and miscellaneous assets	1	0	1	100
Total assets	**10,136**	**10,879**	**(742)**	**(7)**
Equity	**10,125**	**10,870**	**(746)**	**(7)**
Provisions	**9**	**7**	**2**	**28**
Liabilities	**3**	**1**	**1**	**124**
Total equity and liabilities	**10,136**	**10,879**	**(742)**	**(7)**

Employees

Telefónica Deutschland Holding AG had no employees in financial year 2017, as in 2016.

Subsequent Events

There were no significant events after the end of the 2017 financial year.

Risks and opportunities

The business development of Telefónica Deutschland Holding AG is basically subject to the same risks and opportunities as those of the Telefónica Deutschland Group. Telefónica Deutschland Holding AG basically participates in the risks of its subsidiaries and participating investments in the proportion of its respective ownership interest.

For further information > RISK AND OPPORTUNITIES MANAGEMENT.

Telefónica Deutschland Holding AG, as the parent company of the Telefónica Deutschland Group, is integrated in the Group-wide risk management system. For further information > RISK MANAGEMENT AND RISK REPORTING.

The required description of the internal control system in accordance with section 289 subsection 5 HGB for Telefónica Deutschland Holding AG takes place in > INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM BASED ON THE CONSOLIDATED FINANCIAL REPORTING PROCESS.

Outlook 2018

Telefónica Deutschland Holding AG functions as a management and holding company. The long-term future development is therefore crucially based on the development of the operating companies of the Telefónica Deutschland Group, particularly Telefónica Germany GmbH & Co. OHG. With regard to the financial and market development, as well as the expected development of important key figures at the Telefónica Deutschland Group level, we refer to the > FORECAST REPORT.

In view of the existing contracts in relation to the remuneration of management services, we expect the revenues of Telefónica Deutschland Holding AG to be slightly above the level of financial year 2017. For the 2018 financial year, Telefónica Deutschland Holding AG expects a result in a similar amount to 2017.

Management Declaration

The Company has published this declaration, which also contains the declaration of compliance pursuant to section 161 AktG, section 76 (4) and section 111 (5) AktG, and the statements on the diversity concept for the Supervisory Board and Management Board on its website **(www.telefonica.de/management-declaration-2017)** and in the Corporate Governance/ Compliance Statement of the annual report. This management declaration in accordance with section 315d HGB in conjunction with section 289f HGB forms part of this combined management report.

Munich, 12 February 2018

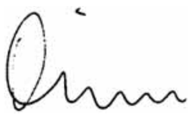
Telefónica Deutschland Holding AG

The Management Board

Markus Haas

Markus Rolle

Valentina Daiber



Guido Eidmann

Nicole Gerhardt

Alfons Lösing

Cayetano Carbajo Martín

Wolfgang Metze

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Consolidated Statement of Financial Position

Assets (Euros in millions)	Notes	**As of 31 December 2017**	As of 31 December 2016
A) Non-current assets		**11,940**	**13,055**
Goodwill	[4.1]	1,960	1,932
Other intangible assets	[4.2]	5,485	6,215
Property, plant and equipment	[4.3]	4,041	4,217
Trade and other receivables	[4.4]	69	77
Other financial assets	[4.5]	94	60
Other non-financial assets	[4.6]	129	128
Deferred tax assets	[5.7]	162	427
B) Current assets		**2,160**	**2,246**
Inventories	[4.7]	105	85
Trade and other receivables	[4.4]	1,265	1,460
Other financial assets	[4.5]	17	25
Other non-financial assets	[4.6]	186	63
Cash and cash equivalents	[4.8]	587	613
Total assets (A+B)		**14,100**	**15,301**

Equity and Liabilities (Euros in millions)	Notes	**As of 31 December 2017**	As of 31 December 2016
A) Equity		**8,297**	**9,408**
Subscribed capital	[4.9]	2,975	2,975
Additional paid-in capital	[4.9]	4,800	4,800
Retained earnings		523	1,634
Total equity attributable to owners of the parent		8,297	9,408
B) Non-current liabilities		**2,141**	**2,637**
Interest-bearing debt	[4.10]	1,268	1,721
Trade and other payables	[4.11]	19	17
Provisions	[4.12]	599	561
Deferred income	[4.11]	255	338
Deferred tax liabilities		1	–
C) Current liabilities		**3,662**	**3,256**
Interest-bearing debt	[4.10]	637	37
Trade and other payables	[4.11]	2,224	2,286
Provisions	[4.12]	142	190
Other non-financial liabilities	[4.6]	132	79
Deferred income	[4.11]	527	664
Total equity and liabilities (A+B+C)		**14,100**	**15,301**

Consolidated Income Statement

		1 January to 31 December	
(Euros in millions)	Notes	**2017**	2016
Revenues	[5.1]	7,296	7,503
Other income	[5.2]	159	502
Supplies		(2,396)	(2,452)
Personnel expenses	[5.3]	(642)	(646)
Other expenses	[5.4]	(2,633)	(2,838)
Operating income before depreciation and amortisation (OIBDA)		**1,785**	**2,069**
Depreciation and amortisation	[5.5]	(1,869)	(2,118)
Operating income		**(84)**	**(50)**
Finance income		5	11
Exchange gains		1	1
Finance costs		(39)	(48)
Exchange losses		(1)	(1)
Financial result	[5.6]	**(34)**	**(36)**
Loss before tax		**(118)**	**(86)**
Income tax	[5.7]	(262)	(90)
Profit/(loss) for the period		**(381)**	**(176)**
Profit/(loss) for the period attributable to owners of the parent		**(381)**	**(176)**
Profit/(loss) for the period		**(381)**	**(176)**
Earnings per share	[8]		
Basic earnings per share in EUR		**(0.13)**	**(0.06)**
Diluted earnings per share in EUR		**(0.13)**	**(0.06)**

Consolidated Statement of Comprehensive Income

		1 January to 31 December	
(Euros in millions)	Notes	**2017**	2016
Profit/(loss) for the period		**(381)**	**(176)**
Other comprehensive income/(loss)			
Items that will not be reclassified to profit/(loss)		**5**	**(25)**
Remeasurement of benefits after termination of employment	[4.12]	8	(36)
Income tax impact	[5.7]	(3)	11
Other comprehensive income/(loss)		**5**	**(25)**
Total comprehensive income/(loss)		**(375)**	**(201)**
Total comprehensive income/(loss) attributable to owners of the parent		(375)	(201)
Total comprehensive income/(loss)		**(375)**	**(201)**

Consolidated Statement of Changes in Equity

(Euros in millions)	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Total equity attributable to owners of the parent	Equity
Financial position as of 1 January 2016		**2,975**	**4,800**	**2,546**	**10,321**	**10,321**
Profit/(loss) for the period		–	–	(176)	(176)	(176)
Other comprehensive income/(loss)		–	–	(25)	(25)	(25)
Total comprehensive income/(loss)		**–**	**–**	**(201)**	**(201)**	**(201)**
Dividends	[4.9]	–	–	(714)	(714)	(714)
Other movements		–	–	2	2	2
Financial position as of 31 December 2016		**2,975**	**4,800**	**1,634**	**9,408**	**9,408**
Financial position as of 1 January 2017		**2,975**	**4,800**	**1,634**	**9,408**	**9,408**
Profit/(loss) for the period		–	–	(381)	(381)	(381)
Other comprehensive income/(loss)		–	–	5	5	5
Total comprehensive income/(loss)		**–**	**–**	**(375)**	**(375)**	**(375)**
Dividends	[4.9]	–	–	(744)	(744)	(744)
Other movements		–	–	7	7	7
Financial position as of 31 December 2017		**2,975**	**4,800**	**523**	**8,297**	**8,297**

Consolidated Statement of Cash Flows

		1 January to 31 December	
(Euros in millions)	Notes	2017	2016
Cash flow from operating activities			
Profit/(loss) for the period		**(381)**	**(176)**
Adjustments to profit/(loss)			
Financial result	[5.6]	34	36
Gains on disposal of assets	[7]	(30)	(352)
Net income tax expense	[5.7]	262	90
Depreciation and amortisation	[5.5]	1,869	2,118
Change in working capital and others			
Other non-current assets	[4.4], [4.5], [4.6], [4.7]	7	111
Other current assets	[4.4], [4.5], [4.6], [4.7]	58	85
Other non-current liabilities and provisions	[4.11], [4.12]	(116)	(188)
Other current liabilities and provisions	[4.11], [4.12]	24	157
Others			
Taxes paid		–	(0)
Interest received		9	16
Interest paid		(36)	(39)
Cash flow from operating activities		**1,702**	**1,859**
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets	[7]	31	591
Payments on investments relating to mobile phone frequency auctions		–	(4)
Payments on investments in property, plant and equipment and intangible assets	[4.2], [4.3]	(1,037)	(1,030)
Acquisition of companies, net of cash acquired	[6]	(29)	–
Proceeds from financial assets		18	–
Payments for financial assets		(4)	(13)
Cash flow from investing activities		**(1,022)**	**(455)**
Cash flow from financing activities			
Payments on investments relating to frequency auctions		(111)	(111)
Proceeds from interest-bearing debt	[4.10]	1,975	850
Payments made for the repayment of interest-bearing debt[1]	[4.10]	(1,843)	(1,348)
Dividends paid		(744)	(714)
Other payments made relating to financing activities		16	–
Cash flow from financing activities		**(706)**	**(1,323)**
Net increase/(decrease) in cash and cash equivalents		**(26)**	**80**
Cash and cash equivalents at the beginning of the period	[4.8]	**613**	**533**
Cash and cash equivalents at the end of the period	[4.8]	**587**	**613**

[1] Payments made for the clearance of payments that include interest-bearing debt related to finance leases of EUR 17 million for the twelve months ended 31 December 2017 and EUR 180 million for the twelve months ended 31 December 2016.

Notes to the Consolidated Financial Statements

for Financial Year 2017

1. Reporting Entity

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared as of and for the year ending 31 December 2017 and are comprised of Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland") and its subsidiaries as well as joint operations (together referred to as the "Telefónica Deutschland Group" or the "Group").

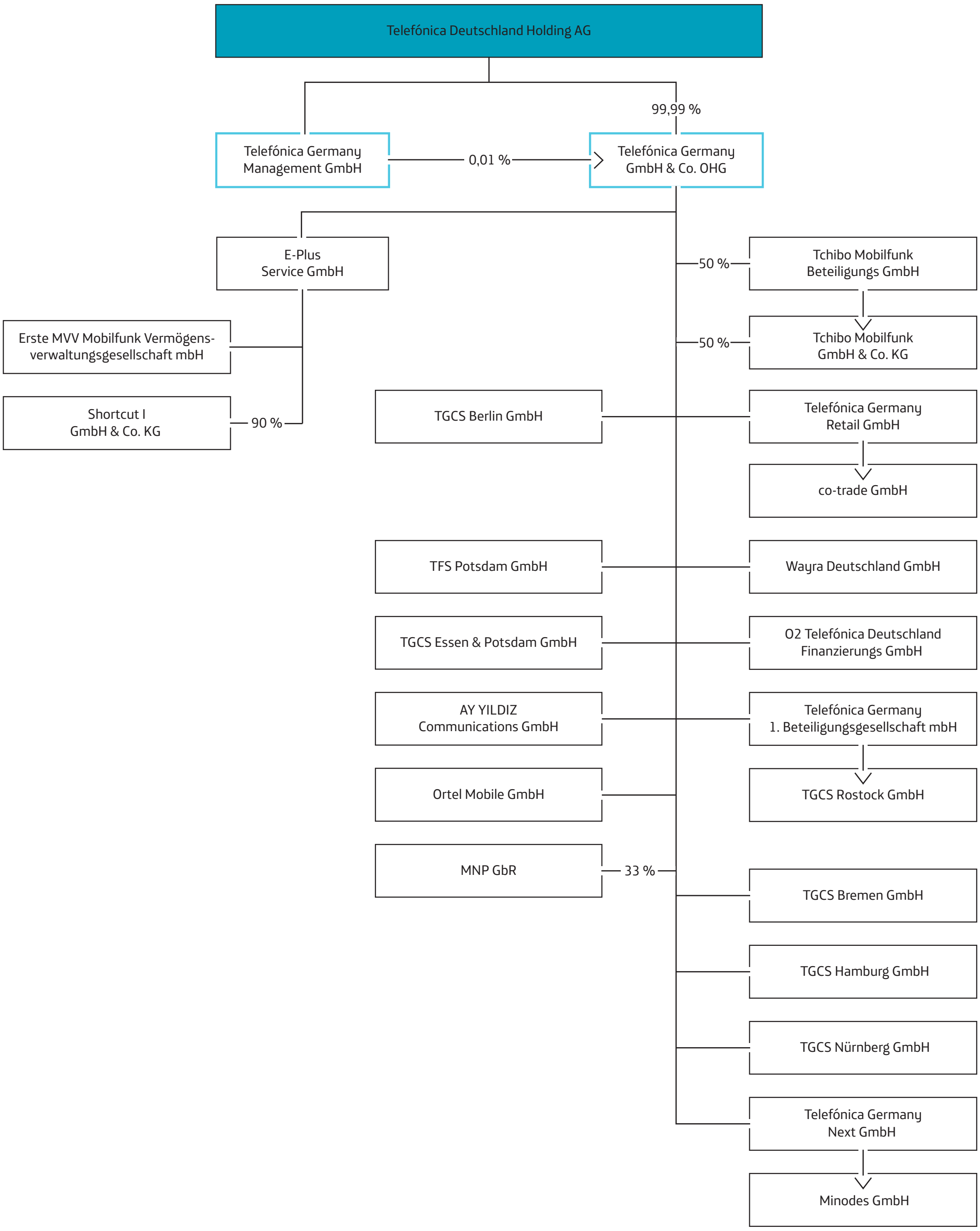
The Telefónica Deutschland Holding AG is a stock corporation (AG) incorporated under German law and is listed on the regulated market of the Frankfurt Stock Exchange.

The company's name is "Telefónica Deutschland Holding AG". The company's registered office is located in Munich, Germany. Telefónica Deutschland Holding AG is registered in the commercial register of the local court in Munich under registration number HRB 201055. The company's business address is Georg-Brauchle-Ring 23–25, 80992 Munich, Germany (telephone number: +49 (0)89 2442-0; **www.telefonica.de**). Telefónica Deutschland Holding AG was established for an indefinite period.

The financial year is the calendar year (1 January to 31 December).

Since the acquisition of the E-Plus Group, the Telefónica Deutschland Group has been one of the three leading integrated network operators in Germany. The Telefónica Deutschland Group offers private and business customers voice, data and value added services in mobile and fixed-line networks. In addition, the Telefónica Deutschland Group ranks among the leading wholesale providers in Germany. Wholesale partners are offered access to the Group's infrastructure and services. The Telefónica Deutschland Group is part of the Telefónica, S.A. Group, one of the biggest telecommunications corporations in the world.

As of 31 December 2017, the companies included in the Consolidated Financial Statements of the Telefónica Deutschland Group were organised as shown in the following organisation chart:



Unless stated otherwise, the ownership interests amount to 100 %.

2. Basis of Preparation

The Consolidated Financial Statements of Telefónica Deutschland Holding AG are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

In addition, the accounting policies are in line with the previous year's disclosures in the published Consolidated Financial Statements for the financial year ending 31 December 2016. Exceptions are the amendments to the IFRS and the measurement changes as presented in Note 3 (letter n) and p) Accounting Policies). Furthermore, the Group applied the additional requirements of German commercial law pursuant to section 315e (1) of the German Commercial Code (HGB).

The Consolidated Financial Statements of Telefónica Deutschland Holding AG were approved by the Supervisory Board on 19 February 2018.

Functional currency and presentation currency
These Consolidated Financial Statements are presented in euros, which is the functional currency of the Telefónica Deutschland Group and all the Telefónica Deutschland Group companies.

Unless stated otherwise, the figures in these Consolidated Financial Statements are presented in millions of euros (EUR million). The figures in the following have been rounded in accordance with established commercial practice. Figures or additions within a table may therefore result in different sums from those shown in the same table.

3. Accounting Policies

The principal accounting policies used in preparing the accompanying Consolidated Financial Statements are as follows:

a) Business combinations

Business combinations are accounted for in accordance with the purchase method. The costs of an acquisition are measured according to the fair values of the assets transferred and the liabilities incurred or assumed on the acquisition date.

Transaction costs are recognised in other expenses at the date they are incurred. Telefónica Deutschland initially recognises identifiable assets acquired in a business combination and the liabilities assumed, including contingent liabilities, at fair value at the acquisition date.

b) Goodwill

For business combinations, goodwill represents the excess of acquisition costs over the fair values of identifiable assets acquired and liabilities assumed at the acquisition date. Cost of acquisition is the sum of the fair value of consideration delivered and the value attributed to existing non-controlling interests. For each business combination, the Telefónica Deutschland Group determines the value of non-controlling interests at either their fair value or their proportional part of the net identifiable assets acquired.

For business combinations that occurred after 1 January 2004, goodwill represents the excess of the acquisition costs including transaction costs over the acquirer's interest, at acquisition date, in the fair values of the identifiable assets, liabilities and contingent liabilities of the acquired business.

After initial measurement, goodwill is carried less any accumulated impairment losses.

Goodwill is not amortised on a scheduled basis but subjected to an annual impairment test. In addition, an impairment test is carried out if events or circumstances indicate that the carrying amount is higher than the recoverable amount (see Note 4.1 Goodwill).

c) Other intangible assets

Other intangible assets are carried at acquisition or production cost, less any accumulated amortisation and any accumulated impairment losses. Subsequent expenditure is capitalised only for existing other intangible assets if it increases the future economic benefit embodied in the asset to which it relates. All other expenditures on internally generated goodwill and brands are recognised in the Consolidated Income Statement as incurred.

Borrowing costs within the scope of IAS 23 that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as a component of the cost of the respective asset.

The useful lives of other intangible assets either finite or indefinite are determined individually. The Telefónica Deutschland Group has not recognised other intangible assets with indefinite useful lives. Other intangible assets with finite useful lives are amortised on a scheduled basis over the economic useful life and are assessed for impairment if events or circumstances indicate that their carrying amount may not be recoverable. Other intangible assets that are not yet available for use are also tested for impairment annually. Residual values of assets, useful lives and amortisation methods are reviewed annually at year-end and, when appropriate, adjusted prospectively.

Licences
This category comprises, in the main, the acquisition costs for the agreements in which various authorities grant licences to provide telecommunication services. It also includes the values assigned to the licences held by particular companies at the time they were incorporated into the Telefónica Deutschland Group.

These licences will be amortised on a straight-line basis beginning with the period of commercial use throughout their terms (mostly between ten and 17 years).

Customer base
This primarily refers to the distribution of acquisition costs incurred as a result of the customers gained through mergers, as well as the acquisition value of these types of assets gained through acquisitions which led to a consideration for a third party. Amortisations take place on a straight-line basis for the estimated duration of the customer relationship (essentially nine and ten years).

Software
Software is classified as an acquisition and/or production cost and will be amortised on a straight-line basis over its period of use. The estimated period of use is generally between two and five years.

Brand names
This category is for brand names which were acquired through company transactions, and hence they were capitalised. Brand names will be amortised on a straight-line basis over the period of their expected useful lives (as a rule, between three and 20 years).

d) Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any accumulated impairment losses. Land is not depreciated.

Cost includes external and internal costs comprising warehouse material used, direct labour used in installation work and the allocable portion of indirect costs required for the related investment. The latter two items are recorded as revenues in Other Income – Own Work Capitalised.

Cost includes in addition, when appropriate, the estimate of the costs at initial recognition for dismantling and removing the item and restoring the site on which it is located and the obligation which the entity incurs either when the item is acquired or as a consequence of having used it. Any corresponding valuation changes in subsequent years are allocated to the respective asset.

The costs of expansion, modernisation, or improvement leading to increased productivity, capacity and efficiency or to an extension of the useful lives of assets are capitalised when the recognition criteria are met.

Upkeep and maintenance costs are expensed as incurred.

If an asset within property, plant and equipment consists of multiple components with different useful lives, each part of the asset having a significant acquisition value is assessed and depreciated separately over the term of the useful life of the individual component (component approach).

The Telefónica Deutschland Group depreciates its property, plant and equipment once they are in full working condition using the straight-line method based on the following estimated useful lives of the assets. The useful lives are reviewed periodically and, where appropriate, updated based on technological advances and the rate of dismantling:

	Estimated useful life (in years)
Buildings	5 – 20
Plant and machinery (incl. telephone installations, networks and subscriber equipment)	5 – 20
Furniture, tools and other items	2 – 10

The estimated residual values of assets and depreciation methods are also regularly reviewed and, where appropriate, adjusted prospectively at each financial year-end.

e) Impairment of property, plant and equipment, goodwill and other intangible assets

Goodwill and intangible assets which have not yet been placed in service are tested for impairment annually at the reporting date or if there are any indications. Property, plant and equipment and intangible assets with a finite useful life are tested for impairment only if any indications of impairment exist at the reporting date. Assets are tested for impairment either individually or at the level of the cash-generating unit to which the asset belongs; goodwill is always tested at the level of a cash-generating unit to which it was allocated. As of 31 December 2017, the Telefónica Deutschland Group comprises one single cash-generating unit, the reportable segment Telecommunications. An impairment is required if the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

As a matter of principle, the Telefónica Deutschland Group determines the recoverable amount of a cash-generating unit based on its fair value less costs to sell. The fair value is determined based on the market capitalisation of Telefónica Deutschland Holding AG as of the reporting date. Costs to sell contain costs such as legal and consulting fees that can be directly allocated to the sale of the cash-generating unit.

If the recoverable amount of a cash-generating unit to which goodwill is allocated is less than the carrying amount of the unit, an impairment loss shall be recognised corresponding to the difference. If the impairment loss exceeds the carrying amount of the goodwill, the remainder shall be allocated pro rata on the basis of the respective carrying amounts of the other assets.

If the carrying amount of an asset exceeds its recoverable amount, the carrying amount written down to its recoverable amount and the resulting loss is recognised in the Consolidated Income Statement. Future depreciation or amortisation charges are adjusted for the asset's new carrying amount over its remaining useful life.

If the requirements for impairments recorded in earlier periods no longer apply, the relevant assets (with the exception of goodwill) are written up through profit and loss.

f) Inventories

Inventories are stated at the lower of cost and net realisable value and are written down, if necessary. Cost is determined on the basis of weighted average cost and comprises direct materials and, where applicable, direct labour cost that has been incurred in bringing the inventory to its present location and condition. Estimates of the net realisable value are based on the most reliable evidence available and are based on the amount the inventories are expected to sell. These estimates take into consideration the fluctuations of sales prices or costs, as well as the purpose for which the inventory is held.

If the circumstances that previously caused inventories to be written down to an amount below cost no longer exist, the amount of the write-down is reversed, so that the new carrying amount is the lower of cost and revised net realisable value.

The Group's inventory mainly consists of merchandise intended for sale to end customers. At the time of the sale or transfer of the risk to the customer, inventory is expensed through cost of sales. The change in inventories is recorded in the item Cost of materials and purchased services.

g) Cash and cash equivalents

Cash and cash equivalents are defined as short-term, highly liquid financial investments with a maximum term of three months, which can be converted into cash at any time and are not materially impacted by the risk of a change in values.

h) Financial instruments

A financial instrument, according to IAS 39, is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments are used as soon as Telefónica Deutschland Group becomes a contractual party to the financial instrument provisions. All purchases and sales of financial assets customary to the market are recognised on the trading day, i.e. the date on which the Telefónica Deutschland Group commits to purchase or sell the financial asset. Upon initial recognition, financial instruments are measured at fair value. Transaction costs directly attributable to the acquisition or issuance are considered in determining the carrying amount if the financial instruments are not measured at fair value through profit or loss.

For the purpose of subsequent measurement, financial instruments are allocated to the following categories:

- financial assets or financial liabilities at fair value through profit or loss
- held-to-maturity investments
- loans and receivables
- available-for-sale financial assets
- financial liabilities measured at amortised cost

The Telefónica Deutschland Group did not allocate any financial instruments to the category held-to-maturity during the reporting period.

The company classifies *derivative financial instruments* as held for trading unless they are designated as hedging instruments (hedge accounting) (see Note 4.10 Interest-bearing debt). The fair value is calculated using standard financial valuation models, such as discounted cash flow or option price models. Derivatives are presented as assets if their fair value is positive and as liabilities if their fair value is negative. Changes in the fair value of derivative financial instruments are recognised periodically in the Consolidated Income Statement. In the current financial year, the Telefónica Deutschland Group has two interest rate swaps (derivative financial instrument) to hedge interest-rate risks.

Hedging transactions: If the effectiveness of a hedging relationship can be demonstrated and documented accordingly, the Telefónica Deutschland Group designates a hedging relationship consisting of the underlying transaction and the corresponding hedging transaction.

If the company hedges a fair value (fair value hedges), the portion of profit or loss attributable to the hedged risk is allocated to the carrying amount of the hedged item. The carrying amount of the hedged item is increased or decreased by the profit or loss that is attributable to the hedged risk. For hedged items that are recorded at amortised cost, the increase or decrease of the carrying amount is completely released at maturity of the hedged item.

From the date the hedging instrument expires, or is sold, terminated, or exercised, the accounting of the hedging relationship also ends. The same applies if there is no longer a hedging transaction within the meaning of IAS 39 or the Telefónica Deutschland Group ends the designation.

Effective interest method : The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the interest rate that exactly discounts the estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period to the net carrying amount on initial recognition. The interest income or expense is recognised on an effective interest basis.

Financial assets

Financial assets mainly include trade and other receivables, other financial assets as well as cash and cash equivalents.

Financial assets measured at fair value through profit and loss

This category includes derivatives in the form of interest rate swaps that qualify for hedge accounting and have positive market values at the reporting date. Changes to the fair values recorded after the initial recognition are also recognised in profit or loss at the remeasurement date.

Telefónica Deutschland Group does not make use of the option of designating financial assets on first recognition at fair value through profit and loss ("fair value option").

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market (such as trade and other receivables). After the initial recognition, loans and receivables are subsequently carried at amortised cost using the effective interest method less any impairment losses. Gains and losses are recognised in the Consolidated Income Statement when the loans and receivables are written off or impaired. Interest effects from the application of the effective interest method are also recognised in profit or loss.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale or that cannot be classified in any of the other categories. These include equity instruments (participations in start-ups). As there is no active market for these participations and their fair value cannot be reliably determined, they are measured at acquisition cost in accordance with IAS 39.46c.

Impairment of financial assets

At each reporting date, the carrying amounts of financial assets other than those measured at fair value through profit or loss are assessed to determine whether there is objective evidence of an impairment. Objective evidence may, for example, exist if a debtor faces serious financial difficulties or is unwilling to pay.

Loans and receivables

The amount of impairment loss on loans and receivables is measured as the difference between the carrying amount of the asset and the present value of the expected future cash flows (excluding expected future credit losses that have not been incurred), discounted at the original effective interest rate of the financial asset. The amount of the impairment is recognised in the Consolidated Income Statement. If, in a subsequent reporting period, the amount of impairment loss decreases and the decrease can be attributed objectively to an event occurring after the impairment was recognised, the impairment loss recorded in prior periods is corrected and recognised in the Consolidated Income Statement. The impairment losses of loans and receivables (e.g. trade receivables) are recorded using allowance accounts. When receivables are assessed as uncollectible, the impaired asset is derecognised.

Available-for-sale financial assets

If an available-for-sale financial asset is impaired, the difference between its cost and its fair value (less any impairment loss previously recognised in the Consolidated Income Statement) is reclassified from other comprehensive income/loss to the Consolidated Income Statement.

For financial assets classified as available-for-sale, objective evidence of an impairment exists if there is a significant (> 20 %) or other than temporary decline (over a period of six months) in the fair value of the instrument.

Financial liabilities
Financial liabilities include primarily trade and other liabilities and interest-bearing debt (including bonds).

Financial liabilities at fair value through profit or loss
A financial liability is measured at fair value through profit or loss if it is held for trading or is designated as fair value through profit or loss on initial recognition. They are presented as current or non-current liabilities or debt depending on their maturity.

Financial instruments included in this category are recorded at fair value on initial recognition and on every subsequent reporting date. Any realised and unrealised gains or losses are recognised in the Consolidated Income Statement. Telefónica Deutschland Group does not make use of the option of designating financial liabilities on first recognition at fair value through profit and loss ("fair value option").

Financial liabilities at amortised costs
After initial recognition, financial liabilities are subsequently remeasured at amortised cost using the effective interest method.

Liabilities to members of partnerships with puttable shares are initially, and for the subsequent valuation, recognised at the present value of the buyout obligation.

Derecognition of financial assets and liabilities
Financial assets are derecognised when the rights to receive cash flows from the assets expire or the financial assets are transferred and the Telefónica Deutschland Group has transferred substantially all the risks and rewards of ownership of the financial assets.

On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of consideration received including the cumulative gains or losses that had been recognised directly in equity, is recognised in the Consolidated Statements of Comprehensive Income. If the Telefónica Deutschland Group does not retain or transfer substantially all risks and rewards, and retains control, it continues to recognise the transferred asset to the extent of its continuing involvement.

Financial liabilities are derecognised when the underlying obligation is settled, cancelled, or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss.

i) Provisions

Pension obligations
The Telefónica Deutschland Group's obligations under defined benefit pension plans are determined using the projected unit credit method and are recognised as personnel expenses unless otherwise stated below.

The Telefónica Deutschland Group determines the net interest expense recognised in the financial result (net interest income) by multiplying the net defined benefit liability (asset) at the beginning of the period by the interest rate used to discount the defined benefit obligation at the beginning of the period.

The discount rate is determined using market yields at the end of the reporting period on fixed-interest high-quality corporate bonds.

The net defined benefit liability (asset) is determined at every reporting date on the basis of an actuary report based on assumptions that are explained as follows. If the plan assets less the defined benefit obligation results in a surplus, then the level of the reported net defined benefit asset is limited to the present value of economic benefits associated with the plan asset surplus in the form of refunds from the plan or on the basis of reduced future contributions. In addition, in the event of a surplus of the plan, the new valuation components include the change in the net defined benefit asset from the application of the asset ceiling, to the extent not taken into account in the net interest component.

Assets incurred by the Telefónica Deutschland Group to meet its pension obligations, which do not qualify as plan assets in accordance with IAS 19, are reported under other financial assets.

As part of the determination of the present value of economic benefits associated with the plan asset surplus, any existing minimum funding requirements are taken into account.

The remeasurement component includes on the one hand the actuarial gains and losses from the valuation of the defined benefit obligation and on the other hand the difference between the actual return on plan assets and the amounts contained in the net interest on net defined benefit liability (assets).

The company recognises all remeasurement effects in other comprehensive income, whereas the remaining components of the net pension expense (service cost and net interest) are recognised in the Consolidated Income Statement.

In the case of defined contribution plans, the relevant company pays contributions to special purpose pension institutions that are presented in personnel expenses.

Other provisions including termination benefits
Provisions are recognised when the Telefónica Deutschland Group has a present (legal or constructive) obligation, as a result of a past event that can be estimated reliably and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. If the effect of the time value of money is material, provisions are discounted and the corresponding increase in the provision due to the passage of time is recognised as interest expense. For the purpose of discounting, the group applies non-risk market interest rates before tax which are matched to the duration. This does not apply to other long-term employee benefits (partial retirement obligations), for which the discount rate is determined on the same basis as for pension obligations. Potential risks are fully taken into account in determining the settlement amount. When the Telefónica Deutschland Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented, if applicable net of any reimbursement, in the Consolidated Income Statement.

Other provisions also include partial retirement obligations, to which the block model applies. Under this model, an outstanding settlement amount is incurred on the part of the employer during the employment phase that equates to the as yet uncompensated portion of work. After the end of the employment phase and during the reporting periods of the second block of the model (time-off phase), in which the employee receives part-time consideration without performing work, the liability is amortised accordingly.

Top-up amounts are accumulated in the amount of the present value of all future payments over a certain time period. The period over which the top-ups are earned extends to the end of the employment phase for all payments. The provision for partial retirement is allocated to other long-term employee benefits.

Provisions for death benefit obligations are recognised on the basis of actuarial reports based on the same parameters as those for pension obligations.

Provisions for restructuring including termination benefits are recognised if there is a detailed, formal plan that provides for the individual measures and has been adopted by the appropriate managing bodies. In addition, implementation is expected to begin as soon as possible and a valid expectation has been raised in those affected that the restructuring will be carried out.

The provisions for restructuring include only those expenses necessary and directly attributable to the respective measures.

Provisions for the costs of decommissioning or dismantling and retirement are recognised if the Telefónica Deutschland Group has a legal or constructive obligation to dismantle the relevant items after their utilisation. The estimated costs are recognised as an asset and a provision. Changes in the timing or estimation of the costs are reflected in the asset and in the provision, respectively.

Asset retirement obligation
The estimated costs of dismantling the network and interest rate movements are evaluated annually.

j) Revenues and expenses

Revenues and expenses are recognised in the Consolidated Income Statement in line with the accrual basis of accounting (i.e. when the goods are delivered or services are rendered) regardless of when actual payment or collection is made. Revenues are recognised if the amount can be measured reliably and the economic inflow of benefits from the transaction is classified as probable. Discounts, such as rebates, represent a reduction of revenues.

The revenues of the Telefónica Deutschland Group include all income attributable to the company's typical business activity.

The Telefónica Deutschland Group mainly realises revenues from the provision of the following telecommunication services: voice traffic, connection fees, regular (normally monthly) network usage fees, interconnection services, network and device leases, handset sales and value added services (e.g. text and data messages) and maintenance. Products and services may be sold separately or in promotional packages (bundled services).

Voice traffic, connection fees and network usage fees
Revenues from calls carried on the Telefónica Deutschland Group networks (voice traffic) include an initial connection fee plus a variable call rate, which is based on the length and distance of the call and type of service. Both fixed line and mobile voice traffic revenues are recognised at the time the service is rendered. For prepaid calls, the unused credit generates deferred revenues that are recognised in deferred income in the Consolidated Statement of Financial Position. Revenues from unused credits are recognised when the company is no longer obligated to provide a service or utilisation is no longer likely, whichever occurs first. Revenues from voice traffic sales and other services generated at a fixed rate over a specified period of time (flat rate) are recognised on a straight-line basis over the term that is covered by the customer's payment.

Initial connection fees are recognised in deferred income and are subsequently realised in profit or loss over the average estimated term of the customer relationship, which may vary depending on the type of service. All related costs, with the exception of expenses for the network expansion and general administration costs and overheads, are recognised in profit or loss for the period in which they were incurred.

Interconnection services
Interconnection revenues from fixed line to mobile calls and vice versa, as well as other customer services are recognised in the period in which the calls are made.

Handset sales
Revenues from handset and equipment sales are recognised once the sale is considered complete, i.e. generally at the time of delivery to the end customer. Revenues from instalment sales are recognised at the amount of the discounted future receipts. The amount is discounted based on an interest rate derived from market interest rates.

Network and equipment leasing
Leases are classified according to the principles described under l) Leases.

Leases from operating lease agreements with customers and income from the leasing of equipment and other services are recognised in profit or loss as the income is earned or the service is provided and therefore on a straight-line basis over the contract term.

Multiple element arrangements
The Group offers bundled packages which combine multiple elements from the fixed line, mobile and internet businesses. They are evaluated to identify the separate units of accounting and allocated the corresponding revenues to each element. Total package revenues are allocated to the individual identifiable elements based on their respective fair value (i.e. the fair value of each element in relation to the fair value of the package).

As connection fees or initial activation fees, or upfront non-refundable fees, are not separately identifiable elements in these types of packages, any revenues received from the customer for these items are allocated to the remaining elements. However, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

The Group sells multiple element arrangements primarily through the sale or lease of handsets combined with a new mobile service contract. The purchase price is allocated based on the sales price of the items, if they were sold separately, and is recognised in the Consolidated Income Statement. Therefore, revenues for the handset are recognised upon delivery to the customer, while revenues for the mobile services are recognised pro rata over the contract term. However, if a subsidized handset is provided to the customer in connection with a bundled offer, the recognition of revenues related to the handset is limited. Additional payments which are dependent on further mobile services are not included herein.

All expenses related to bundled promotional packages are recognised in the Consolidated Income Statement as incurred.

Customer acquisition and retention costs
The Telefónica Deutschland Group pays commission to retailers and intermediaries for customer acquisition and retention. These payments are recognised into expense when the related services are rendered.

k) Income tax

Income taxes include both current and deferred taxes. Current and deferred tax are recognised in the Consolidated Income Statement unless they relate to business combinations or items directly recognised in equity or in other comprehensive income. To the extent that deferred taxes relate to items recognised directly in equity or in other comprehensive income, these are also recognised in equity or in other comprehensive income.

Current tax assets and liabilities for the current period and prior periods are measured at the amount expected to be recovered from, or paid to, the tax authorities. To calculate the amount, tax rates and tax laws applicable or enacted on the reporting date are used.

Deductible temporary differences and tax losses carried forward result in deferred tax assets in the Consolidated Statement of Financial Position. Taxable temporary differences give rise to deferred tax liabilities in the Consolidated Statement of Financial Position. Temporary differences arise due to the difference between the tax bases of the assets and liabilities and their respective carrying amounts.

The Telefónica Deutschland Group determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability is settled. Tax rates and tax laws that are enacted (or substantively enacted) at the reporting date are used.

Deferred tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred tax assets is reviewed at each reporting date and recognised to the extent that it is probable that a sufficient taxable income will be available to utilise the deferred tax asset in the future. Unrecognised deferred tax assets are included in this review.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint operations are not recognised if the parent company is in a position to control the timing of the reversal and if the reversal is unlikely to take place in the foreseeable future. Cases in which no deferred tax liabilities were recognised for subsidiaries are of minor significance in terms of amount.

Deferred tax assets and liabilities arising from the initial recognition of the purchase price allocation of business combinations impact the amount of goodwill. However, subsequent changes in tax assets acquired in a business combination are recognised as an adjustment to profit or loss.

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same tax authority.

Uncertain income tax items are accounted at the estimated amount of corresponding tax payments.

l) Leases

The accounting of a lease is based on the substance of the agreement and requires an assessment of whether the fulfilment of the agreement is dependent on the use of a specific asset and whether the agreement grants the Telefónica Deutschland Group a right to use the asset.

Leases where the lessor does not transfer substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense or as income on a straight-line basis over the term of the lease in the Consolidated Income Statement.

Leases are classified as finance leases when the terms of the lease transfer substantially all risks and rewards incidental of ownership of the leased item to the Telefónica Deutschland Group or from the Telefónica Deutschland Group to the end customer. Leases are recorded at the inception of the lease, in accordance with their nature and the associated liability or receivable from financing leases, at the lower of the present value of the minimum lease payments or the fair value of the leased object. Lease payments are quantified at the principal and interest of the lease liability in order to apply a consistent effective interest rate over the outstanding balance over the term of the lease. Finance costs and income are recognised over the term of the lease in the financial result in the Consolidated Income Statement. Liabilities and receivables from financing leases are recalculated when estimates are changed.

If a lease includes a renewal option, the Group considers if these renewals are likely at the time of entering into the agreement. If the original estimate, as it relates to potential renewals, changes over the life of the lease, the Group will adjust the estimated future lease payments for operating leases accordingly.

In sale and leaseback transactions resulting in a finance lease, the asset sold is not derecognised and the funds received are considered financing for the asset during the term of the lease. Any excess of the sales proceeds over the carrying amount is accrued and distributed through profit and loss over the term of the lease. If the corresponding assets are leased on under a finance lease, the asset is immediately derecognised through profit and loss.

However, when the sale and leaseback transaction results in an operating lease, and it is clear that both the transaction and subsequent lease income are established at fair value, the asset is derecognised and any gain or loss generated on the transaction is recognised.

m) Use of estimates, assumptions and judgements

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the Consolidated Financial Statements within the next financial year are discussed below. The estimates and associated assumptions are based on historical experience as well as other factors considered to be relevant.

A significant change in the facts and circumstances on which these estimates and related judgements are based could have a material impact on the Telefónica Deutschland Group's net assets, financial position and results of operations.

Unforeseeable development outside management's control may cause actual amounts to differ from the original estimates. In this case the underlying assumptions and, if necessary, the carrying amounts of the pertinent assets and liabilities will be adjusted accordingly.

Changes in estimates are recognised in the period in which they occur, and also in subsequent periods if the changes affect both the reporting period and the subsequent periods.

Pensions / defined benefit plans
The determination of the present value of defined benefit obligations involves the application of actuarial assumptions.

To determine the interest rate for the defined benefit pension plans, the “bond universe” is first established on the basis of the AA corporate bonds available on the reporting date. On the basis of these bonds a yield curve is calculated. Then a uniform average interest rate is calculated with a cash flow that corresponds to the duration of the Telefónica Deutschland Group. This latter interest rate is the actuarial discount rate used.

The determination of the expected increase in pensions is aligned with the long-term inflation expectations in the euro area.

The assumption on the fluctuation of the respective employees is based on historical experience. The mortality rate underlying the calculation of the present value of the defined benefit obligation is based on official statistics and mortality tables.

Property, plant and equipment, intangible assets and goodwill

Accounting for investments in property, plant and equipment and intangible assets involves the use of estimates to determine the useful life for depreciation and amortisation purposes and to assess the fair value of assets acquired in a business combination at the acquisition date.

Determining the useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgement involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognised in the Consolidated Income Statement for the period. The decision to recognise an impairment loss involves estimates of the timing of the expected use and the amount of the impairment, as well as an analysis of the reasons for the potential loss. Furthermore, additional factors, such as technical obsolescence, the suspension of certain services and other circumstantial services are taken into account.

The Telefónica Deutschland Group evaluates the recoverable amount of its cash-generating unit regularly to identify potential goodwill impairment. Determining the recoverable amount of the cash-generating unit to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgement. The fair value is determined based on the market capitalisation of Telefónica Deutschland Holding AG as of the reporting date.

Deferred income taxes

The Telefónica Deutschland Group assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Telefónica Deutschland Group’s ability to generate taxable income over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of the taxable income, which are based on internal projections and updated to reflect the latest trends and estimates. In the past, time horizons of five to seven years have been used to measure loss carry forwards and temporary differences. The time horizons used have not changed since the previous year.

The recognition of tax assets and liabilities depends on a series of factors, including estimates with respect to timing and the realisation of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments of the Telefónica Deutschland Group could differ from the estimates made by the Telefónica Deutschland Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balance.

Provisions

Both the recognition and the valuation of provisions involve judgements to a high extent. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the reporting date, including the opinions of independent experts such as legal counsel or consultants.

Given uncertainties inherent in the estimates used to determine the amount of provisions, the actual outflows of resources may differ from the amounts recognised originally on the basis of the estimates.

Termination benefits

If employees are offered voluntary severance, the benefits are measured on the basis of the number of employees expected to accept the offer. Benefits attributable to a period of more than twelve months after the reporting date are recognised at present value.

The amount for termination benefits is determined on the basis of various assumptions, which also require judgements and estimates and can therefore entail uncertainties. These primarily include the assumed salary, length of employment and gardening leave period until the date of departure.

Revenue recognition

Revenues from equipment leasing

The determination of minimum lease payments should in some cases account for future fair values determined by the Group on the basis of past and current transactions.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognised.

Connection fees
Initial connection fees are deferred and recognised as revenues over the average estimated term of the customer relationship.

The estimate of the average customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of future recognition of revenues.

Bundled offers
Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. The total package revenues are allocated among the identified elements based on their respective fair values.

Determining fair values for each identified elements requires estimates that vary from case to case.

A change in the estimates of the fair value could affect the allocation of revenues among the elements and, as a result, the date at which the revenues are recognised.

Joint operations
TCHIBO Mobilfunk Beteiligungs-GmbH and TCHIBO Mobilfunk GmbH & Co. KG were classified as joint operations under application of IFRS 11.17, taking into account the specific facts and circumstances. In particular, the fact that the contractual partners have rights to the entire production output generated by both companies supports our assessment that the arrangement constitutes joint operations.

Contingent Assets and Liabilities
Within the scope of determining the contingent assets and liabilities, (see Note 17 Contingent assets and liabilities), estimates, assumptions and discretionary decisions are also used.

These relate, inter alia, to risks from the assertion of patent infringements and participations in judicial and extra-judicial proceedings within the scope of ordinary business.

n) Significant changes of estimates, assumptions and judgements

Amended network planning
As the network consolidation progresses, original assumptions must be adjusted. These adjustments will lead to longer, as well as shorter, useful lives of certain network elements.

The useful lives of the non-current assets attributable to this part of the network were adjusted to reflect the new assumptions after the decision to amend the planned network.

Due to the offsetting effects, there were no significant impacts on the financial year under review or on future financial years.

Trade payables
Trade payables are reclassified to other financial liabilities when extended payment terms are agreed to which bear interest and which exceed standard industry terms. This reclassification reflects the changed nature of these liabilities.

o) Consolidation methods

The consolidation methods applied are as follows:

- Full consolidation method for companies where the Telefónica Deutschland Group has control. Control is assumed if the Telefónica Deutschland Group has power over an investee and is exposed to variable returns or has rights to these returns. In addition, the ability must exist to use its power over the investee to affect the returns.

- Proportionate consolidation of the attributable assets, liabilities, expenses and income for companies jointly controlled with third parties (joint operations), so that the corresponding share of total assets, liabilities, expenses, income and cash flows of these companies is integrated in the corresponding items in the Consolidated Financial Statements.

All material receivables and liabilities and transactions between the consolidated companies were eliminated in consolidation. The returns generated on transactions involving goods that may be capitalised or services by subsidiaries with other Telefónica Deutschland Group companies were also eliminated in consolidation.

The financial statements of the consolidated companies are prepared using the same accounting policies and have the same financial year-end as the parent company's individual financial statements. In the case of Group companies whose accounting and valuation methods differ from those of the Telefónica Deutschland Group, adjustments are made in consolidation in order to present the Consolidated Financial Statements on a consistent basis.

The Consolidated Income Statement and Consolidated Statement of Cash Flows include the revenues and expenses as well as the cash flows of companies that are no longer in the Telefónica

Deutschland Group up to the date on which the related investment was sold or the company was liquidated.

Revenues and expenses as well as the cash flows of new Group companies are included from the date on which the investment was acquired or the company was established until the end of the year.

p) Standards and IFRIC interpretations issued and effective as of 31 December 2017

The standards mandatory for application in the EU for the first time as of 1 January 2017 had no significant effects on the Consolidated Financial Statements.

Amendments to IAS 7: Disclosure Initiative
The IASB added an initiative to improve disclosure (disclosure initiative) to its work programme in 2013, which is made up of a number of smaller projects. The aim is to optimise and simplify the presentation and disclosure requirements in existing standards. As part of the project, the IASB issued amendments to IAS 7 Statement of Cash Flows on 29 January 2016. In the future, disclosures must be made regarding the development of borrowing costs during the reporting period, whereby payment transactions were reported or must be reported in the Statement of Cash Flows under cash flow from financing activities. The amendments have to be applied for financial years beginning on or after 1 January 2017.

q) New standards and IFRIC interpretations issued, but not yet effective as of 31 December 2017

At the time of publication of the Consolidated Financial Statements, the following standards and interpretations were published, but their application was not yet mandatory.

Standards, interpretations and amendments		Mandatory application for financial years beginning on or after
Annual Improvements to IFRSs 2014 – 2016 Cycle	Amendments to IFRS 12	1 January 2017[1]
Annual Improvements to IFRSs 2014 – 2016 Cycle	Amendments to IFRS 1 and IAS 28	1 January 2018[1]
Amendments to IAS 40	Transfers of Investment Property	1 January 2018[1]
IFRIC 22	Foreign Currency Transactions and Advance Consideration	1 January 2018[1]
Amendments to IFRS 2	Classification and Measurement of Share-based Payment Transactions	1 January 2018[1]
IFRS 15	Revenue from Contracts with Customers	1 January 2018
Clarifications to IFRS 15	Identifying Performance Obligations, Principal versus Agent Considerations, Licensing	1 January 2018
Amendments to IFRS 4	Application of IFRS 9 in the Context of IFRS 4 (Insurance Contracts)	1 January 2018
IFRS 16	Leases	1 January 2019
IFRIC 23	Uncertainty over Income Tax Treatments	1 January 2019[1]
Amendments to IFRS 9	Assessment Criteria for the Classification of Financial Assets	1 January 2019[1]
Amendments to IAS 28	Application of IFRS 9 in the Context of IAS 28	1 January 2019[1]
IFRS 17	Insurance Contracts	1 January 2021[1]
Amendments to IFRS 10 and IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	[2]

[1] Endorsement by EU still outstanding, information for first-time adoption under IASB.

[2] First-time adoption postponed indefinitely in accordance with IASB resolution of 17 December 2015.

IFRS 15: Revenue from Contracts with Customers
On 28 May 2014, the IASB issued IFRS 15 – *Revenue from Contracts with Customers* with the aim of enshrining regulations from various standards and interpretations in a single standard for all industries. Consequently, IFRS 15 will replace, in particular, Standard IAS 18 – *Revenue* and Standard IAS 11 – *Construction contracts*. IFRS 15 provides for a comprehensive framework to determine whether revenue is reported, the amount of the revenue and the time said revenue is reported.

As a core principle IFRS 15 rules that revenue should be recognised for the amount which is the expected equivalent value of the performance obligation.

The new standard employs a five-step model framework for determining the amount and timing of revenue in order to implement this principle:

- Identify the contract(s) with the customer,
- Identify the performance obligations in the contract,

— Determine the transaction price,

— Allocate the transaction price to the performance obligations in the contract,

— Recognise revenue when (or as) the entity satisfies a performance obligation.

Furthermore, the standard contains some additional clarifications regarding detailed questions and no longer includes certain currently applied accounting rules. For example for the allocation of the transaction price it is no longer of importance whether the supply of goods or the provision of services take place in the future. Moreover, under certain conditions, IFRS 15 governs that customer acquisition costs directly attributable to a contract, such as commissions, are capitalised and allocated over the estimated customer retention period. Due to the customary fixed-term contracts, the first-time application starting from 1 January 2018 requires an analysis of the contracts concluded in previous financial years that were not yet completed as of the time of first application. The standard provides for two options of transition regulations of the entity applying the standard:

— full retrospective method taking into account certain practical relief measures,

— recognition of the effects from IFRS 15 through accumulated adjustments in equity at the beginning of the reporting period.

The Telefónica Deutschland Group will apply the modified retrospective method, according to which the cumulative adjustment amounts as of 1 January 2018 are recognised in the transition to IFRS 15, in its consolidated financial statements. Consequently, the Group will not apply the requirements of IFRS 15 to each comparative period presented.

As a rule, IFRS 15 requirements shall apply to every individual contract. This standard also makes it possible to apply the accounting standards to a portfolio comprising similarly structured contractual agreements provided that in doing so no material impact is expected as when compared with such application to an individual contract. Telefónica Deutschland Group has analysed its existing contracts and aggregated them to portfolios. The Group will apply IFRS 15 to these predefined portfolios.

It was necessary to adjust certain accounting processes with the introduction of IFRS 15. In particular, the requirements for the analysis of customer contracts during the product creation process had to be further specified to meet IFRS 15 requirements. An IT tool was also introduced to calculate the adjustments within the scope of IFRS 15.

As of 1 January 2018, the estimated impact on company equity as a result of applying IFRS 15 is based on current evaluations and is explained in the following paragraphs. The actual effects resulting from the application of this standard as of 1 January 2018 may deviate from the evaluations. The reasons for this are as follows:

— Telefónica Deutschland has not fully completed testing and evaluations of the security of its new IT systems and

— the new reporting and accounting methods may be subject to change when the first Consolidated Financial Statements are published in line with the initial application of the standard.

The total estimated adjustment of equity (before tax) in the Telefónica Deutschland Group's opening balance sheet of 1 January 2018 is between EUR 400 million and EUR 420 million. The largest impact of the estimated adjustments stems here from the capitalisation of customer acquisition costs, for which an amount will be capitalised as of 31 December 2017 that ranges from EUR 415 million to EUR 430 million. Counteracting effects will also arise from accounting changes for bundled mobile device and mobile service contracts when the relative individual sales prices of the contracts' contractual obligations are used.

In essence, the following topics were analysed and identified:

<u>Revenue from Service Contracts and Multi-component Contracts</u>
Telefónica Deutschland Group provides both mobile and fixed-line services which are performed over a specified period of time. According to IFRS 15, progress is measured using output-based methods. On the basis of such methods, sales are recorded based on the value of satisfied performance obligations towards the customer in relation to the remaining contractually agreed services to be performed. Unsteady discounts on services are recorded and amortised on a straight line basis throughout the term of the contract. As the straight line amortisation of these occasional discounts already occurred under IAS 18, Telefónica Deutschland Group does not anticipate a material impact on measuring progress.

In addition to uniquely service-based contracts, Telefónica Deutschland Group also offers its customers products through multi-component contracts. Specifically, they provide discounts on mobile services when the purchase of mobile services occurs in connection with the purchase of a mobile device. In application of IAS 18, a discount had already been provided for both components, i.e. part of the sale of the mobile device was recognised at a later accounting period. According to IFRS 15 discounts will continue to be allocated, whereby all contractual components that influence the transaction price of a contract will be taken into account when calculating the allocation factor. According to IAS 18, these additional contractual elements are not factored into such allocation; instead, they are accrued individually. As a result, both the allocation of sales revenue between mobile services and mobile devices and the time sales are recorded will change. No material effect on equity is expected when the standard is first applied.

In addition to shifts between types of sales revenue, changes to accrual periods will also have an impact. For example, according to IAS 18 connection fees are accrued individually throughout the average customer retention period and recognised as sales revenue, whereas IFRS 15 dictates that, within the scope of an overall assessment, they will be included in the allocation of contractual components and recorded accordingly as sales revenue for the duration of the underlying contract term. No material effect on equity is expected when the standard is first applied.

Significant financing components must be accounted for when determining the transaction price in accordance with IFRS 15. To align with the standard, Telefónica Deutschland Group does not take these financing components into account, as the analysis of the underlying contracts concluded that they are insignificant.

Deviating from industry practice, Telefónica Deutschland Group will not recognise any contract asset value owing to classification of part of the transaction price for mobile devices that were provided free of charge or at a significantly reduced price, as almost no subsidized devices were offered in the past.

Capitalisation of Customer Acquisition Costs
Expenses are recognised in profit or loss when the underlying service is performed. This also applies to customer acquisition costs, which are by their nature incurred in connection with contract conclusion. In contrast, IFRS 15 requires the capitalisation of customer acquisition costs that can be directly attributed to contracts with customers. Amortisation depends on how the performance obligations to which the costs relate are transferred to the customer under the relevant contract or over the estimated customer lifetime. In the future, capitalised customer acquisition costs will be recognised on a straight line basis in profit or loss under this system over the underlying amortisation period. However, assuming an even accurance of costs over time, a smoothing effect in the Income Statement is to be expected. Within the scope of this capitalisation, Telefónica Deutschland Group makes use of the practical expedients defined in the standard and only capitalises those contract acquisition costs whose underlying amortisation period is more than one year.

In addition to capitalisation of customer acquisition costs, the standard also regulates capitalisation of contractual fulfilment costs. The analysis of the underlying contracts concludes that there are no contractual fulfilment costs which Telefónica Deutschland Group has to capitalise.

Accounting for Contract Modifications
According to IFRS 15, there are more detailed and in some cases more complex requirements with regard to the recognition of contractual amendments compared to the existing regulations. In some cases, contractual amendments are prospectively listed as a separate contract on the balance sheet; in other cases the contractual amendment results in an adaption of the existing contract. As a result, accumulated income may be adjusted. Based on the analysis that was conducted, Telefónica Deutschland Group does not however anticipate any material impact.

Identification of the Principal and the Agent
According to IFRS 15, the judgement as to whether Telefónica Deutschland Group is the principal or the agent in the provision of service is based on whether the Group has control of particular goods before they are transferred to the end customer. According to IAS 18, however, it is Telefónica Deutschland Group's potential exposure to significant risks and opportunities in connection with the purchase of goods that is relevant. The analysis of essential services rendered by third parties concludes that no significant changes have occurred with regard to the assessment vis-a-vis IAS 18.

Licences
Telefónica Deutschland Group does not grant licences to customers who are to be considered within the scope of IFRS 15.

Consequently, based on Telefónica Deutschland Group's evaluation of these transactions, no material impact is expected on the Consolidated Financial Statements.

IFRS 9 and amendments to IFRS 7: Financial Instruments
On 24 July 2014, the IASB issued IFRS 9 on the accounting treatment of financial instruments. It replaces IAS 39. The new IFRS combines the three aspects of classification and measurement, impairment and hedging. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, but also permits early application. With the exception of hedge accounting, retrospective application is mandatory, but providing comparative information is not compulsory. The regulation applies to hedge accounting from the time of application, although with limited exceptions.

The Telefónica Deutschland Group plans to implement the standard as of the mandatory effective date and thereby waives to provide comparative information. In the past financial year, the Telefónica Deutschland Group carried out an extensive analysis of the effects of the three phases of IFRS 9. The analysis is based on all the available information and could therefore still be subject to subsequent adjustments. On the whole, the Group does not expect any significant effects on the Statement of Financial Position or on equity with the exception of the new requirements for determining impairments for contract assets newly introduced under IFRS 15, which are subject to the impairment regulations under IFRS 9. Furthermore, Telefónica Deutschland expects an adjustment to the risk provision as detailed below. The Telefónica Deutschland Group will also reclassify certain financial instruments.

Classification and Measurement

The Telefónica Deutschland Group does not currently expect a significant change to the Statement of Financial Position or to equity based on the introduction of IFRS 9. Rather, it is expected that the financial instruments accounted for at fair value will continue to be accounted for accordingly.

Available for sale financial assets which are currently measured at amortised cost due to the absence of other reliable measurement are, with the implementation of this standard, to be accounted at fair value through profit and loss.

Both loans issued and trade receivables are in general held in order to collect the contractual cash flows; these consist of interest and repayment of principal. Therefore the Group meets the criteria for measurement at amortised cost in accordance with IFRS 9; corresponding financial instruments therefore do not need to be reclassified.

Debt instruments in connection with factoring are measured at fair value and recognised directly in equity in accordance with IFRS 9, as it is expected that, in addition to collecting the contractual cash flows, the Telefónica Deutschland Group intends to sell the financial assets, and to do so on a regular basis.

Impairment

In accordance with IFRS 9, the Telefónica Deutschland Group in general has to determine all the expected credit losses from debt instruments either on a twelve-month basis or on a lifetime basis. For this purpose, the Telefónica Deutschland Group applies the simplified approach with respect to trade receivables and measures these business transactions on the basis of the lifetime. The Telefónica Deutschland Group does not expect any significant effects on the risk provision, with the exception of the new requirements for determining impairments for contract assets newly introduced under IFRS 15, which are subject to the impairment regulations under IFRS 9. Likewise, no significant effects result from any other financial assets.

Hedge Accounting

All existing hedge relationships currently designated in effective hedging relationships continue to qualify as such under IFRS 9. Furthermore, the regulations for the accounting treatment of hedges do not change under IFRS 9; there may possibly only be new options for presenting hedges as hedging relationships.

The effect on equity as of 31 December 2017 relating to the implementation of the standard is in the low six-digit range.

IFRS 16: Leases

On 13 January 2016, the IASB issued IFRS 16 – Leases, which will replace IAS 17 and other existing interpretations. Under IFRS 16, the lessee must account for all contracts identified as leases such that the associated right of use is recognised as an asset. The current distinction between finance leases and operating leases according to IAS 17 will cease to apply in the future. Accordingly, the present value of the lease liability must be recognised as a liability and a right of use in the same amount recognised as an asset. The lease liability and the right of use asset are subsequently reduced by lease payments and depreciation over the lease period. As a rule, the resulting interest effects lead to higher expenses at the commencement of the lease. Exceptions are possible for leased low value assets or short-term contracts. IFRS 16 requirements for lessors are similar to the current standard IAS 17.

In addition to the aforementioned systematic change, IFRS 16 includes further amendments and new requirements such as the definition of leases, accounting for sale and leaseback transactions and subleases, disclosure in the Statement of Financial Position and the scope of disclosures required in the notes.

Implementation of the standard is mandatory for financial years beginning on or after 1 January 2019, although early application is permitted.

The Group acts as a lessee on a very significant number of lease agreements over different assets, such as towers, cables, office buildings and stores and land where the towers are located, mainly. A significant portion of these contracts is accounted for as operating lease under the current lease standard, with lease payments being recognised generally on a straight-line basis over the contract term.

The Telefónica Deutschland Group is currently analysing the standard for its potential impact. The Telefónica Deutschland Group has set up a project to analyse and evaluate these and other potential effects in detail.

This analysis includes the estimation of the lease term, based on the non-cancellable period and the periods covered by options to extend the lease, when the exercise depends only on Telefónica and where such exercise is reasonably certain, considering the specific facts and circumstances by class of assets in the telecom industry (technology, regulation, competition, business model). In addition to this, the Group will make assumptions to calculate the discount rate, which will mainly be based on the incremental borrowing rate of interest for the estimated term. On the other hand, the Group is considering not to separately recognise non-lease components from lease components where non-lease components are not material with respect to the total value of the lease. In addition to the mentioned estimations, the standard allows for two transition methods for lessees: retrospectively for all periods presented, or using a modified retrospective approach where the cumulative effect of adoption is recognised at the date of initial application. The Group has tentatively decided to adopt the latter transition method; therefore the Group would recognise the cumulative effect of initial application as an adjustment to retained earnings in the year of initial application.

Also, certain practical expedients are available on first-time application in connection with the right of use asset measurement, discount rates, impairment, leases that finish within the twelve months subsequent to the date of first application, initial direct costs, and term of the lease. The Group is evaluating which of these practical expedients will be adopted. In this regard, the Group is considering opting for the practical expedient that allows not reassessing whether a contract is or contains a lease on the date of initial application of IFRS 16 but to directly apply the new requirements to all those contracts which under current accounting were identified as a lease.

On the basis of an initial, qualitative high-level assessment, the Group anticipates the following effects:

— In view of the number of available options, the complexity of required estimates as well as the high number of leasing agreements, the Group has not yet completed the implementation process and is currently unable to estimate the impact of the new requirements.

— Upon implementation of IFRS 16, payment obligations from contracts classified as operating leases must be recognised as right-of-use assets or liabilities. Accordingly, lease liabilities, non-current assets and net financial liabilities are expected to increase significantly. Future payments of all lease liabilities will be shown within cash flow from financing activities with a corresponding increase in cash flow from operating activities.

— Future depreciation and interest expense on right-of-use assets and liabilities will replace lease expense in the Income Statement. Accordingly, operating income before depreciation and amortisation (OIBDA) is expected to benefit to the detriment of depreciation and amortisation and the financial result.

As part of this project, all the requirements for timely implementation of IFRS 16 shall be met.

Additional disclosures

Telefónica Deutschland Group expects to adopt all required amendments. Except as disclosed otherwise, the Group does not expect the new and revised standards to have a material impact on the net assets, financial position and results of operations, as a result of the application of future standards, interpretations and amendments.

4. Selected Explanatory Notes to the Consolidated Statement of Financial Position

4.1. Goodwill

(Euros in millions)	2017	2016
Carrying amount of goodwill at 1 January	**1,932**	**1,955**
Additions due to acquisition	28	–
Disposal of Telxius Towers Germany GmbH	–	(23)
Carrying amount of goodwill at 31 December	**1,960**	**1,932**

The increase of EUR 28 million resulted from the acquisition of two companies. Further information can be found in Note 10 Group Companies of the Telefónica Deutschland Group.

The impairment test for goodwill, which was carried out at the level of the Telecommunications cash-generating unit, did not result in an impairment in fiscal year 2017 for goodwill because the recoverable amount of EUR 12,373 million (2016: EUR 12,028 million), which is based on the fair value less costs to sell, exceeded the carrying amount of the cash-generating unit. Furthermore, the Group did not recognise an impairment charge in financial year 2016.

The impairment test is described in Note 3 Accounting Policies.

4.2. Other intangible assets

(Euros in millions)	Service concession arrangements and licences	Customer base	Software	Thereof own work capitalised	Brand names	Others	Construction in progress/ prepayments on intangible assets	Other intangible assets
Cost								
As of 1 January 2016	**10,888**	**3,075**	**1,176**	**147**	**104**	**45**	**1,201**	**16,487**
Additions	0	–	348	30	–	0	17	366
Disposals	(175)	–	(391)	(29)	–	–	–	(566)
Reclassifications	10	–	2	–	–	–	(12)	(0)
As of 31 December 2016	**10,722**	**3,075**	**1,136**	**148**	**104**	**45**	**1,206**	**16,288**
As of 1 January 2017	**10,722**	**3,075**	**1,136**	**148**	**104**	**45**	**1,206**	**16,288**
Additions	–	1	279	28	–	0	(1)	278
Disposals	(6)	–	(40)	(2)	(2)	(1)	–	(50)
Reclassifications	858	–	5	(1)	–	–	(863)	–
As of 31 December 2017	**11,574**	**3,076**	**1,379**	**173**	**101**	**44**	**342**	**16,516**
Accumulated amortisation								
As of 1 January 2016	**(8,211)**	**(534)**	**(638)**	**(91)**	**(23)**	**(22)**	**–**	**(9,428)**
Additions	(437)	(328)	(423)	(38)	(18)	(4)	–	(1,210)
Disposals	175	–	391	29	–	–	–	566
Reclassifications	–	–	–	–	–	–	–	–
As of 31 December 2016	**(8,473)**	**(862)**	**(670)**	**(100)**	**(41)**	**(26)**	**–**	**(10,072)**
As of 1 January 2017	**(8,473)**	**(862)**	**(670)**	**(100)**	**(41)**	**(26)**	**–**	**(10,072)**
Additions	(412)	(328)	(245)	(23)	(15)	(8)	–	(1,008)
Disposals	6	–	40	2	2	1	–	50
Reclassifications	–	–	–	0	–	–	–	–
As of 31 December 2017	**(8,879)**	**(1,190)**	**(875)**	**(121)**	**(54)**	**(33)**	**–**	**(11,030)**
Net book value								
As of 31 December 2016	**2,249**	**2,213**	**466**	**48**	**62**	**19**	**1,206**	**6,215**
As of 31 December 2017	**2,695**	**1,886**	**504**	**52**	**48**	**11**	**342**	**5,485**

Licences

As of 31 December 2017, licences consist primarily of the licences listed below:

In August 2000, Telefónica Germany GmbH & Co. OHG acquired a UMTS licence (3G) that will expire on 31 December 2020. In May 2010, Telefónica Germany GmbH & Co. OHG acquired frequency usage rights in the 2.0 GHz band that will expire in December 2025. As part of the E-Plus Group acquisition on 1 October 2014, another UMTS licence, which will expire on 31 December 2020, as well as additional frequency usage rights in the 2.0 GHz band that will expire in December 2025, were acquired. The carrying amount as of 31 December 2017 amounted to EUR 646 million (2016: EUR 853 million). The 3G licences are amortised on a straight-line basis over the respective useful life. The residual lives are three to eight years.

In May 2010, Telefónica Germany GmbH & Co. OHG also acquired frequency usage rights used for LTE (4G), among others, that will expire in 2025. With the acquisition of E-Plus on 1 October 2014, additional frequency usage rights were acquired by the Telefónica Deutschland Group that can be used for LTE and run until December 2025. In June 2015, Telefónica Germany GmbH & Co. OHG won an auction for two paired blocks in the 1.8 GHz range, which will be used from 1 January 2017 and are limited until December 2033. Furthermore, LTE licences exist with terms until December 2025/December 2033. The carrying amount of the usage rights as of 31 December 2017 amounted to EUR 1,686 million (2016: EUR 1,396 million). The 4G licences are amortised on a straight-line basis over the respective useful life. The residual lives are eight to sixteen years.

In June 2015, Telefónica Germany GmbH & Co. OHG won an auction for two paired blocks in the 900 MHz range (2G), which will be used from 1 January 2017 and have a term until December 2033. The carrying amount of the usage rights as of 31 December 2017 amounted to EUR 363 million.

Customer base

The customer base is primarily a result of the acquisition of the E-Plus Group by Telefónica Deutschland. The customer base acquired in the E-Plus acquisition on 1 October 2014 is amortised mainly over a remaining period of six to seven years.

Software
Software mainly includes licences for IT and office applications. In financial years 2017 and 2016, additions related mainly to CRM and billing systems as well as data warehouse and enterprise resource planning systems. Software disposals primarily relate to software that reached the end of its useful life.

Brand names
The brand names acquired in the E-Plus Group acquisition on 1 October 2014 are amortised over a remaining period of 17 years.

Construction in progress/prepayments on intangible assets
In financial year 2015, the Telefónica Deutschland Group acquired additional frequencies that were reported in construction in progress/prepayments on intangible assets. At the mobile phone frequency auction, the Telefónica Deutschland Group acquired two paired blocks in the 700 MHz range, two paired blocks in the 900 MHz range and two paired blocks in the 1.8 GHz range. The acquired frequencies at 900 MHz and 1.8 GHz could already be used starting 1 January 2017. During the reporting period, due to the active use, a total of EUR 863 million were reclassified from construction in progress/prepayments on intangible assets to service concession arrangements, licences and software due to their active use. The use of the acquired frequencies at 700 MHz is dependent on the broadcasting companies, among other things.

4.3. Property, plant and equipment

(Euros in millions)	Land and buildings	Plant and machinery	Furniture, office equipment tools and other items	PP&E in progress	Property, plant and equipment
Cost					
As of 1 January 2016	**738**	**8,216**	**231**	**68**	**9,252**
Additions	7	650	34	51	742
Disposals	(10)	(649)	(19)	(0)	(678)
Reclassifications	(6)	10	(0)	(4)	–
Other	18	140	–	–	158
As of 31 December 2016	**747**	**8,366**	**245**	**114**	**9,473**
As of 1 January 2017	**747**	**8,366**	**245**	**114**	**9,473**
Additions	10	581	46	39	676
Disposals	(25)	(165)	(33)	–	(223)
Reclassifications	(4)	10	1	(7)	0
Other	(6)	18	–	–	12
As of 31 December 2017	**722**	**8,809**	**260**	**146**	**9,938**
Accumulated depreciation					
As of 1 January 2016	**(526)**	**(4,071)**	**(147)**	**–**	**(4,745)**
Additions	(61)	(816)	(32)	–	(908)
Disposals	9	368	19	–	397
Reclassifications	5	(6)	1	–	0
As of 31 December 2016	**(573)**	**(4,525)**	**(159)**	**–**	**(5,256)**
As of 1 January 2017	**(573)**	**(4,525)**	**(159)**	**–**	**(5,256)**
Additions	(59)	(766)	(37)	–	(862)
Disposals	24	164	33	–	222
Reclassifications	0	(0)	–	–	–
As of 31 December 2017	**(607)**	**(5,127)**	**(163)**	**–**	**(5,896)**
Net book value					
As of 31 December 2016	**174**	**3,841**	**87**	**114**	**4,217**
As of 31 December 2017	**114**	**3,683**	**98**	**146**	**4,041**

Property, plant and equipment primarily comprise land and buildings, technical equipment and machinery, furniture, tools and other items in progress.

The additions to property, plant and equipment related to the decommissioning and asset retirement obligations increased by EUR 16 million, mainly due to the higher cost estimates based on new insights as well as changing interest rates. In the previous year, the decommissioning and asset retirement obligations increased by EUR 158 million mainly due to changed costs estimates.

Property, plant and equipment from finance leases amounted to EUR 124 million as of 31 December 2017 and EUR 163 million as of 31 December 2016. The change of EUR 39 million resulted primarily from depreciation. The most significant finance leases are disclosed in Note 4.10 Interest-Bearing Debt, Finance leases.

PP&E in progress resulted mainly from the expansion of the network.

4.4. Trade and other receivables

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade receivables	76	1,272	84	1,591
Receivables from related parties (Note 12 Related Parties)	–	77	–	42
Other receivables	–	58	–	19
Allowances for bad debts	(7)	(142)	(7)	(192)
Trade and other receivables	**69**	**1,265**	**77**	**1,460**

With respect to trade and other receivables, there are no indications that lead us to conclude that there is any impairment requirement beyond the existing impairment.

The breakdown of trade receivables is as follows:

Trade receivables include receivables from finance leases. For further information refer to Note 4.10 Interest-Bearing Debt, Finance leases.

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Non-current	Current	Non-current	Current
Trade receivables billed	76	715	84	975
Trade receivables unbilled	–	557	–	615
Trade receivables	**76**	**1,272**	**84**	**1,591**

The following table shows the development of the allowances for the years ending as of 31 December 2017 and 2016.

	2017		2016	
(Euros in millions)	Non-current	Current	Non-current	Current
1 January	**(7)**	**(192)**	**(13)**	**(194)**
Additions	–	(73)	–	(83)
Release	–	–	–	–
Utilisation	–	123	6	86
31 December	**(7)**	**(142)**	**(7)**	**(192)**

In 2017 and 2016, the Telefónica Deutschland Group sold instalment receivables in order to optimise the working capital and to access an alternative source of funding. The nominal value of the transaction is concluded in 2017 amounted to EUR 624 million (2016: EUR 517 million), with the carrying amount being EUR 618 million (2016: EUR 511 million). The buyer of the receivables bears the risk of these receivables. The receivables sold were derecognised in full at the time of the sale.

The allowance includes guarantees granted in the amount of the fair value of EUR 3 million (2016: EUR 2 million).

4.5. Other financial assets

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Non-current	Current	Non-current	Current
Investments in start-ups	18	–	21	–
Interest rate swaps	6	4	12	2
Reimbursement rights	57	–	9	–
Silent factoring deposit	10	12	17	19
Deposits	0	–	1	–
Loans	2	1	–	4
Other financial assets	**94**	**17**	**60**	**25**

Current other financial assets primarily include the current portion of the security deposit for silent factoring.

This silent factoring deposit was pledged as collateral to cover the maximum risk to be borne by the Telefónica Deutschland Group and the guarantee of the servicing of the receivables over the term of the sold receivables. The Telefónica Deutschland Group receives fixed interest on the deposit. If the underlying receivables fail, a certain amount must be reimbursed.

Interest rate swaps relate to the two issued bonds (for further information see Note 4.10 Interest-Bearing Debt).

The reimbursement claims arose to cover the pension and partial retirement obligations, but do not represent plan assets in accordance with IAS 19. The recognised fair values are based on the values received from the insurance company, which are based on the insurance company's internal calculation models.

The loan mainly include loans to start-ups, which include options for conversion to equity instruments and transaction costs that are directly attributable to the acquisition of a credit facility.

For further information on the investments in start-up companies, see Note 9 Measurement Categories of Financial Assets and Financial Liabilities.

With regard to other financial assets, there were no indications of impairment as at 31 December.

4.6. Other non-financial assets and other non-financial liabilities

Other non-financial assets were comprised as follows as at 31 December 2017:

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Non-current	Current	Non-current	Current
Prepayments	129	107	128	61
Prepayments to related parties	–	0	–	1
Other tax receivables	–	79	–	1
Other non-financial assets	**129**	**186**	**128**	**63**

Non-financial assets primarily relate to prepayments for fees charged for leased lines and VAT. For prepayments to affiliated companies, please refer to Note 12 Related Parties.

Other non-financial liabilities were comprised as follows as at 31 December 2017:

(Euros in millions)	As of 31 December 2017 Current	As of 31 December 2016 Current
Payroll taxes and social security	10	13
Current tax payables for indirect taxes	119	64
Other current taxes	3	3
Other non-financial liabilities	**132**	**79**

4.7. Inventories

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Merchandise	109	89
Allowances	(4)	(4)
Inventories	**105**	**85**

Inventories comprise smartphones and accessories in particular.

The total cost of inventories recognised as an expense in the Consolidated Income Statement in financial year 2017 was EUR 1,145 million (2016: EUR 1,070 million).

Consistent with common industry practices, the suppliers of inventories retain the title until the items are paid for in full.

4.8. Cash and cash equivalents

Cash and cash equivalents mainly includes deposits in connection with cash pooling agreements with Telfisa Global B.V., Amsterdam, Netherlands (Telfisa Global B.V.), receivables from banks with an original term of up to three months and cash in hand.

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Cash at bank and in hand	14	13
Cash pooling	573	600
Cash and cash equivalents	**587**	**613**

There were no indications of impairment as of 31 December 2017.

4.9. Equity

Subscribed capital
As of 31 December 2017, Telefónica Deutschland Holding AG had share capital of EUR 2.975 million, which is consistent with the prior year and is divided into 2,974,554,993 no par value registered shares, each accounting for a pro rata amount of share capital of EUR 1.00. In general, each no par value share has one vote at the Annual General Meeting. The registered share capital is fully paid.

As of 31 December 2017, Telefónica Deutschland Holding AG did not hold any of its own shares.

In accordance with section 6 para. 2 of the articles of association, the shareholders do not have the right to securitise shares. In general, each no par value share grants one vote at the Annual General Meeting. The shares are freely transferable.

Authorised capital
Telefónica Deutschland Holding AG had authorized capital 2016/I of EUR 1,487,277,496 as of 31 December 2017.

Conditional capital
The share capital of Telefónica Deutschland Holding AG is conditionally increased by up to EUR 558,472,700 by issuing up to 558,472,700 new non-par value registered shares (Conditional Capital 2014/I).

Additional paid-in capital
As a result of cash and non-cash capital increases in connection with the acquisition of the E-Plus Group, which were entered in the commercial register on 18 September and 7 October 2014, additional paid-in capital increased in 2014 by EUR 4,800 million (unchanged) as of 31 December 2017, in the amount of EUR 4,800 million.

Retained earnings
Legal reserve
Retained earnings contain a legal reserve in accordance with section 150 (2) of the German Stock Corporation Act (Aktiengesetz – AktG) of EUR 0.014 million (2016: EUR 0.014 million).

Proposed dividend for financial year 2017 to be paid in 2018
On 24 October 2017, the Management Board of Telefónica Deutschland resolved to propose a total cash dividend of EUR 773 million or EUR 0.26 per share at the next Annual General Meeting, which is scheduled for 17 May 2018.

Dividend distribution in the financial year
On 9 May 2017, the Annual General Meeting of Telefónica Deutschland resolved to distribute a dividend of EUR 0.25 for each no par value share for financial year 2016, in total around EUR 744 million.

Dividend distribution in the previous year
On 19 May 2016, the ordinary Annual General Meeting of Telefónica Deutschland resolved to distribute a dividend of EUR 0.24 for each no par value share for financial year 2015, in total around EUR 714 million.

4.10. Interest-bearing debt

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Non-current	Current	Non-current	Current
Bonds	504	613	1,107	12
Promissory notes and registered bonds	299	4	299	4
Loans	450	0	298	0
Finance leases	15	19	17	15
Contribution and compensation obligations	–	2	–	6
Interest-bearing debt	**1,268**	**637**	**1,721**	**37**

For the maturity profile of the listed liabilities, see the disclosures in the Management Report, Risk Management and Financial Instruments. Long-term interest-bearing debt with a remaining term greater than 5 years remains in the amount of EUR 402 million.

Bonds
This item includes two bonds for which interest rate swaps were recognised in the reporting year and in the previous year and were reported under other financial assets (see Note 4.5 Other financial assets).

These bonds (except for EUR 350 million of the nominal value) are accounted for by using the effective interest method after deduction of the disagio and transaction costs. EUR 350 million of the nominal value of the bonds is accounted for as a fair value hedge with interest rate swaps.

The senior unsecured seven-year bond issued on 10 February 2014 has a nominal value of EUR 500 million. The bond will mature on 10 February 2021 and was issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich. The coupon for the fixed interest bond is 2.375 % and the issue price 99.624 %. The issue spread was 100 basis points over the seven-year euro mid-swap rate, resulting in a yield of 2.434%. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. An interest rate swap was concluded for a partial amount of EUR 150 million of the bond's nominal value. On the basis of this interest rate swap contract, the Telefónica Deutschland Group pays a variable interest rate based on the three-month Euribor on a nominal amount and receives a fixed interest rate of 1.268% on the same amount in return.

In November 2013, the Telefónica Deutschland Group, via its subsidiary O2 Telefónica Deutschland Finanzierungs GmbH, Munich, issued an unsecured five-year bond (Senior Unsecured Bond) with a nominal value of EUR 600 million and a maturity on 22 November 2018. The annual nominal interest rate of the bond is 1.875 %. Based on the issue price of 99.162 %, the bond yields an annual return of 2.053 %. O2 Telefónica Deutschland

Finanzierungs GmbH, Munich, has transferred the net issuing proceeds of the bond to Telefónica Germany GmbH & Co. OHG, Munich, in the form of a loan. An interest rate swap was concluded for a partial amount of EUR 200 million of the nominal value of the bond. On the basis of this interest rate swap contract, the Telefónica Deutschland Group pays a variable interest rate based on the three-month Euribor on a nominal amount and receives a fixed interest rate of 0.927 % on the same amount in return.

All factors that market participants would normally consider, are included in the measurement of the fair value of the interest rate swaps, including the credit risks of the contract parties. The fair value of the interest swaps results from discounting of the expected future payments over the remaining term of the contract using current market interest rates and yield curves.

The adjustments to the carrying amount of the non-current financial liabilities result in a cumulative loss of EUR 8 million (EUR 12 million cumulative loss in 2016 and EUR 4 million profit in 2017), while the corresponding clean prices of the interest rate swaps result in a cumulative profit of EUR 8 million (EUR 12 million cumulative profit in 2016 and EUR 4 million loss in 2017). Under the interest rate swaps, the Telefónica Deutschland Group pays a variable quarterly interest rate amounting to the three-month Euribor and receives fixed interest rates of 0.927% and 1.268%. The hedged nominal value of the financial liabilities amounts to EUR 350 million. Thus, 19% (2016: 19%) of the bonds of the company were switched from fixed interest to variable interest. The fair value of the dirty prices from the interest rate swaps that secure financial debt amounted to EUR 10 million as at 31 December 2017 (2016: EUR 14 million) and was recognised as a financial asset. The fair value of the bonds is determined by discounting the expected future cash flows at currently applicable interest rates with comparable conditions and residual terms.

Promissory notes/registered bonds
On 13 March 2015, the Telefónica Deutschland Group completed an initial placement of promissory notes and registered bonds with a volume of EUR 300 million.

The promissory notes placed with a volume of EUR 172 million have unsecured tranches with terms of five, eight and ten years, with both fixed and floating interest rates. The average interest rate of tranches with a fixed interest rate was 1.38% p.a. The interest on the variable tranches is based on Euribor money market terms plus an agreed margin.

The registered bonds placed have terms of 12, 15 and 17 years and a fixed interest rate. The tranches amount to EUR 3 million, EUR 33 million and EUR 92 million, respectively, and bear interest at 2.000%, 2.250% and 2.375%.

All tranches were issued at par.

Loans
The Group signed a EUR 750 million revolving credit facility (RCF) on 22 March 2016. The term of this credit facility was extended by one year until March 2022 for the first time in February 2017. The RCF can therefore still be extended by a maximum of one further year. The RCF bears a variable interest rate at Euribor money market conditions plus an agreed margin. As of 31 December 2017, the credit facility had not been used.

On 13 June 2016 the Group signed a financing agreement with the European Investment Bank (EIB) to the value of EUR 450 million. As of 31 December 2017, this loan had been utilised in the form of two fixed-interest tranches totalling EUR 450 million. The funds provided by the EIB are due by December 2024 and May 2025 and will be repaid in equal instalments starting in December 2019 and May 2020 respectively. The benchmark interest rate for the fixed-interest tranches is determined according to the principles defined by the bodies of the EIB for loans of the same type.

On 31 July 2017, the Telefónica Deutschland Group concluded a bilateral revolving credit facility with Telfisa Global B.V., which amounted to EUR 500 million. It serves general business purposes and has a term of one year. As of 31 December 2017, the credit facility had been fully repaid.

Finance leases
The obligations arising from finance leases mainly result from agreements for network elements concluded under sale and leaseback transactions and classified as finance leases in accordance with their contract design as well as agreements for the leasing of IT equipment.

In connection with these finance leases, the Telefónica Deutschland Group recognised the assets attributable to the network elements under property, plant and equipment in the Consolidated Financial Statements as of 31 December 2017 and in the previous year (for further information see Note 4.3 Property, plant and equipment).

The breakdown of minimum lease payment obligations is as follows:

As of 31 December 2017

(Euros in millions)	Future minimum lease payment obligations	Unamortised interest expense	Present value of future minimum lease payment obligations
Due within one year	19	1	19
Due between 1 and 5 years	15	0	15
Due in more than 5 years	–	–	–
Total	**34**	**1**	**33**

As of 31 December 2016

(Euros in millions)	Future minimum lease payment obligations	Unamortised interest expense	Present value of future minimum lease payment obligations
Due within one year	16	1	15
Due between 1 and 5 years	17	0	17
Due in more than 5 years	–	–	–
Total	**33**	**1**	**32**

Receivables from finance leases

The Telefónica Deutschland Group subleases mobile phones to its end customers through a lease agreement. The Group thus acts as a lessor to the customers. The customer contracts included fixed lease payments over a term of two years. As of 31 December 2017, receivables exclusively comprise receivables from existing contracts. New contracts are no longer being concluded for this lease model.

The following table shows the expected minimum lease payments by end customers:

As of 31 December 2017

(Euros in millions)	Future minimum lease payments	Unrealised interest income	Present value of outstanding minimum lease payments
Due within one year	8	0	8
Due between 1 and 5 years	–	–	–
Due in more than 5 years	–	–	–
Total	**8**	**0**	**8**
Accumulated allowance			(2)
Total after accumulated allowance			**6**

As of 31 December 2016

(Euros in millions)	Future minimum lease payments	Unrealised interest income	Present value of outstanding minimum lease payments
Due within one year	99	0	99
Due between 1 and 5 years	8	0	8
Due in more than 5 years	–	–	–
Total	**107**	**0**	**107**
Accumulated allowance			(10)
Total after accumulated allowance			**97**

The allowance of receivables from finance leases is recognised as an expense. The credit risk is determined on the basis of past experience.

Renewal and purchase options expected to be exercised are included in the calculation of the minimum lease payments to be made and those expected.

The receivables from finance leases are included in the trade receivables.

Contribution obligations

This item includes contribution obligations to partners in investments in start-ups that hold puttable shares.

Transition of debt movements to cash flow from financing activities

(Euros in millions)	As of 31 December 2016	Cash flow from financing activities	Acquisitions	Fair Value Amendments	Other movements	As of 31 December 2017
Bonds	1,119	–	–	(4)	2	1,117
Promissory notes and registered bonds	303	–	–	–	0	303
Loans	298	150	0	–	2	450
Finance leases	32	(17)	18	–	–	33
Contribution and compensation obligations	6	–	–	–	(4)	2
Interest-bearing debt	**1,758**	**133**	**18**	**(4)**	**0**	**1,905**
Financing as part of frequency auctions	111	(111)	–	–	–	–
Total	**1,869**	**22**	**18**	**(4)**	**0**	**1,905**

4.11. Trade and other payables and deferred income

(Euros in millions)	As of 31 December 2017		As of 31 December 2016	
	Non-current	Current	Non-current	Current
Trade payables to third parties	–	733	–	897
Accruals	17	842	15	783
Payables to related parties (Note 12 Related Parties)	–	374	–	425
Trade payables	**17**	**1,989**	**15**	**2,105**
Other creditors non-trade	1	125	2	81
Other payables to related parties (Note 12 Related Parties)	–	40	–	41
Other payables	–	69	–	58
Other payables	**1**	**235**	**2**	**181**
Trade and other payables	**19**	**2,224**	**17**	**2,286**
Deferred income	**255**	**527**	**338**	**664**

In financial year 2017, payables from silent factoring totalling EUR 64 million are now shown under Other creditors non-trade instead of Trade payables to third parties. In the prior year liabilities from Silent Factoring totalled EUR 48 million.

Accruals relate mainly to outstanding invoices for goods and services and for non-current assets.

Other creditors non-trade mainly consists of liabilities due to personnel and payables from silent factoring.

Other liabilities mainly comprise debtors with credit balances.

For the maturity profile of the listed liabilities, see the disclosures in the Management Report, Risk Management and Financial Instruments.

Deferred income primarily includes advance payments received for prepaid credit and other advance payments received for future service performance. It also includes the payment from MS Mobile Service GmbH (Drillisch) received in connection with the Mobile Bitstream Access Mobile Virtual Network Operator (MBA MVNO) agreement.

Other advance payments received for future service performance and the payment received from Drillisch are broken down by maturity according to their expected utilisation. Advance payments received for prepaid credit are classified exclusively as current.

4.12. Provisions

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Non-current	Current	Non-current	Current
Pension obligations	151	–	106	–
Restructuring	43	64	20	127
Asset retirement obligation	378	73	400	57
Other provisions	28	6	35	5
Provisions	**599**	**142**	**561**	**190**

Pension obligations

The Telefónica Deutschland Group has defined benefit plans. These primarily include defined benefit rights against an external provident fund (Gruppen-Unterstützungskasse), which is managed in accordance with its articles of association, and direct commitments.

The overriding investment policy and strategy for the defined benefit plans are based on the goal of generating returns from the plan assets as well as from the reimbursement rights deriving from insurance policies which, together with the contributions, are sufficient to meet the pension obligations.

The plan assets are invested in insurance policies that are taken out directly by the Telefónica Deutschland Group or indirectly by the provident fund. The reimbursement rights from insurance policies result from those insurance policies, which were not pledged to the employees.

The requirements for the financing of pension obligations arise from the financing strategy of the provident fund and are anchored in its guidelines. The guidelines define that the expected defined benefit obligation will be settled by the provident fund. They are fully financed by the Telefónica Deutschland Group. The Telefónica Deutschland Group provides the provident fund with the necessary financial resources.

However, under its articles of association, the fund must cease or reduce its payments if the company does not make, or no longer makes, the necessary financial resources available to the fund. In this case, the employees can bring their legal right to post-employment benefits against the Telefónica Deutschland Group.

The amount of the committed benefits for the defined benefit pension plans essentially depends on the basic salary of the individual employee during the period of employment. The benefits paid include old age pensions, payments for the inability to work and benefits in the event of death to surviving relatives.

In order to minimise the biometric risks of the committed benefits (such as an early benefits claim through invalidity or death of the beneficiary), the pension or promised retirement capital is covered to the full extent (congruent) or in part by insurance policies. In addition, the pledging of the insurance policies to the pension beneficiary acts as security for the claims of the beneficiary in the event of the insolvency of the sponsoring company.

This defined benefit plan is subject to actuarial and financial risks such as life expectancy and interest rate risk as well as inflation risk. In addition, all reinsurance policies are essentially with an insurance company.

In financial year 2017, the employer’s share of the statutory pension insurance amounted to EUR 39 million (2016: EUR 41 million).

Telefónica Deutschland Group has additional defined contribution plans. The expense for defined contribution plans recognised for the period amounted to EUR 2 million (2016: EUR 3 million).

The following table contains the key data for the defined benefit plans:

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Present value of defined benefit obligation from funded plans	(108)	(168)
Present value of defined benefit obligation from unfunded plans	(128)	(65)
Present value of defined benefit obligation	**(235)**	**(233)**
Fair value of plan assets	84	128
(Deficit)/Surplus	**(151)**	**(106)**
Net benefit provision	**(151)**	**(106)**
Reimbursement rights	**57**	**8**

The development of the present value of the defined benefit obligations in 2017 and 2016 was as follows:

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Present value of the defined benefit obligation as of 1 January	**(233)**	**(198)**
Current service costs (personnel expenses)	(9)	(6)
Interest expense (financial result)	(4)	(5)
Remeasurement of defined benefit obligation	8	(31)
thereof: actuarial gains/(losses) arising from changes in financial assumptions	*5*	*(31)*
thereof: experience adjustments	*3*	*1*
Benefits paid	3	3
Other	–	3
Present value of the defined benefit obligation as of 31 December	**(235)**	**(233)**

The development of the fair value of the plan assets was as follows in 2017 and 2016:

(Euros in millions)	2017	2016
Fair value of plan assets as of 1 January	**128**	**122**
Return on plan assets excluding amounts included in interest income (expense)	0	(2)
Interest income (financial result)	2	3
Employer contributions	6	9
Benefits paid	(2)	(2)
Other	(50)	(2)
Fair value of plan assets as of 31 December	**84**	**128**

The fair value of the reimbursement rights from insurance contracts developed in 2017 and 2016 as follows:

(Euros in millions)	2017	2016
Fair value of reimbursement rights from insurance contracts as of 1 January	**8**	**8**
Return on reimbursement rights excluding amounts included in interest income (expense)	(0)	(0)
Interest income	0	0
Employer contributions	0	0
Benefits paid	(0)	(0)
Other	50	(0)
Fair Value of reimbursement rights from insurance contracts as of 31 December	**57**	**8**

The amounts recognised under "Other" in 2016 for defined benefit obligations and the plan assets originate from the transfer of pension obligations and the related plan assets.

The amounts listed under 'Other' in 2017 for plan assets and for reimbursements rights are a result of the ban on set offs reimbursement rights that have not been pledged against plan assets.

In 2017, as in the previous year, there was no asset ceiling.

The main actuarial assumptions on which the determination of the present value of the defined benefit obligation as of the reporting date is based are provided in the following table (factors represent averages).

	As of 31 December 2017	As of 31 December 2016
Discount rate	1.75%	1.65%
Nominal rate of pension payment increase	1%; 1.75%	1%; 1.75%
Fluctuation rate	(0% – 20%)	(0% – 20%)

The mortality tables on which the actuarial calculation of the DBO as at the reporting date is based are the Heubeck Mortality Tables 2005G (Heubeck Richttafeln 2005G).

(In years)	**As of 31 December 2017**	As of 31 December 2016
Life expectancy at age 65 for a retiree currently	21	21
Life expectancy of a currently aged 40 deferred member at age 65	24	24

An increase or decrease in the main actuarial assumptions would have had the following effects on the present value of the defined benefit obligations as of 31 December 2017:

(Euros in millions)	Increase in parameters	Decrease in parameters
Discount rate (+0.25%/-0.25%)	(13)	14
Pension increase (+0.50%/-0.50%)	10	(9)
Turnover rate (+1.00%/-1.00%)	(0)	0
Life expectancy (+1 year)	8	–

Increases and reductions in the discount rate and increases to pension payments do not have the same impact on the determination of the DBO due to the interest rate effects. If several assumptions are changed at the same time, the overall effect will not necessarily correspond to the sum of the individual effects due to the changes in the assumptions. In addition, the sensitivity of a change in the DBO only reflects each specific order of magnitude in the change of assumptions (for example 0.25%). If the assumptions change by a different order of magnitude, the effect on the DBO does not necessarily have to be linear.

The following table contains information regarding the analysis of the due date of expected payments:

(Euros in millions)	1 January to 31 December 2017	1 January to 31 December 2016
Benefits expected to be paid within year 1	2	2
Benefits expected to be paid within year 2	3	2
Benefits expected to be paid within year 3	3	3
Benefits expected to be paid within year 4	3	3
Benefits expected to be paid within year 5	3	3
Benefits expected to be paid within 6 to 10 years	24	22

The average expected term of the defined benefit obligation for the 2017 financial year is 22.8 years (2016: 23.2 years).

The best estimate of the contributions that will be paid into the plans in the financial year ending 31 December 2017 amounts to EUR 9 million (2016: EUR 9 million) .

Other provisions

(Euros in millions)	Restructuring	Asset retirement obligation	Others	Total
As of 1 January 2017	**147**	**457**	**40**	**644**
Additions	86	21	5	112
Utilisation	(123)	(29)	(9)	(160)
Release	(4)	–	(5)	(9)
Reclassifications	1	–	2	3
Accrued interest	–	1	–	1
As of 31 December 2017	**106**	**450**	**33**	**590**
thereof non-current	*43*	*378*	*28*	*448*
thereof current	*64*	*73*	*6*	*142*

The provision for restructuring primarily includes measures resulting from the transformation of the Telefónica Deutschland Group in connection with the integration of E-Plus that aim to increase profitability through synergies. The amount of EUR 106 million as of 31 December 2017 (2016: EUR 147 million) is allocated to personnel adjustments, the deactivation of a part of the mobile network, the suspension of contracts with sales representatives and other measures.

The majority of the provision recognised as of 31 December 2017 is attributable to severance payments in connection with personnel adjustments.

Furthermore, a decline resulted from the scheduled utilisation of EUR 123 million, which was partly offset by additions of EUR 86 million. As in the previous year, these additions are recognised in other expenses and personnel expenses (for further information see Note 5.3 Personnel expenses and 5.4 Other expenses).

The provisions for asset retirement obligations include the calculated costs for the dismantling and removal of assets (e.g. mobile equipment such as operating facilities and technology), largely based on the agreements with service providers.

The timing of utilisation and the associated outflow of cash depends on the implementation of the current network consolidation strategy.

5. Selected Explanatory Notes to the Consolidated Income Statement

5.1. Revenues

	1 January to 31 December	
(Euros in millions)	**2017**	2016
Rendering of services	6,149	6,419
Other revenues	1,147	1,084
Revenues	7,296	**7,503**

Revenues from the rendering of services include mobile service revenues as well as revenues from fixed line/DSL business. The other revenues include handset revenues and miscellaneous other revenues.

None of the Telefónica Deutschland Group's customers' accounts for more than 10 % of total revenues.

The breakdown of revenues according to mobile business and fixed line/DSL business is shown in the following table:

	1 January to 31 December	
(Euros in millions)	**2017**	2016
Mobile business	6,415	6,498
Mobile service revenues	5,287	5,437
Handset revenues	1,128	1,061
Fixed line/DSL business revenues	862	981
Other revenues	19	23
Revenues	**7,296**	**7,503**

Mobile service revenues
The mobile service revenues are largely based on basic fees and the fees levied for voice (including incoming and outgoing calls), messaging (including SMS and MMS) and mobile data services as well as the revenues from service contracts. Alongside roaming revenues, mobile service revenues include access and interconnection fees that are paid for by other service providers for calls and SMS messages delivered via our network.

Handset revenues
Handset revenues include the income from the sale of mobile phones as part of the "O_2 My Handy" model, the hardware portion of bundled packages (hardware bundled offerings) for the former E-Plus brands and cash sales. In addition, handset revenues include further components from mobile business such as activation fees and accessories.

With the "O_2 My Handy" model, the customer can choose whether to pay the entire price of the mobile phone up front or to make an initial payment to start with and pay the remaining purchase price in twelve or 24 monthly instalments. Revenues from the "O_2 My Handy" model are discounted according to their term.

Regarding the hardware bundled offers provided by the former E-Plus brands, the customer was able to choose between the purchase or lease of a device.

Fixed line/DSL business revenues
Fixed line/DSL business revenues comprise mainly revenues from DSL services for private customers, DSL activation fees for private customers, revenues from DSL products and non-recurring items (e.g. fees for change of address, number transfers, etc.), revenues from wholesale ULL (also known as wholesale DSL), revenues from the sale of the company's own DSL network, from services and from hardware to other service providers who re-bundle these and sell them on to end customers, and data traffic revenues from carriers in connection with the sale and trade of minutes between carriers to connect

their customer calls via the networks of other operators. DSL revenues also include fixed line revenues.

Other revenues
Other revenues relate to new business, such as advertising and financial services, e.g. the mobile service offering "O_2 More Local", O_2 banking and new innovative products from the Telefónica NEXT business field.

5.2. Other income

(Euros in millions)	2017	2016
		1 January to 31 December
Own work capitalised and ancillary income	128	146
Gain on disposal of assets	31	356
Other income	**159**	**502**

Own work capitalised includes direct labour costs as well as the allocable portion of indirect costs in connection with investments in non-current assets.

The gains on the disposal of assets in financial year 2016 resulted from the sale of passive tower infrastructure to Telxius S.A. For further information, see Note 7 Disposal Groups.

5.3. Personnel expenses

In financial year 2017, personnel expenses amounted to EUR 642 million (2016: EUR 646 million). Of these, EUR 552 million related to wages and salaries (2016: EUR 562 million), EUR 78 million to social security (2016: EUR 77 million), and EUR 11 million to pensions (2016: EUR 6 million). Personnel expenses from share-based payments are presented in Note 13 Share-Based Payments; personnel expenses relating to pension plans are presented in Note 4.12 Provisions.

In addition, restructuring expenses of EUR 44 million (2016: EUR 46 million) are recognised in personnel expenses. For further information, see Note 4.12 Provisions.

5.4. Other expenses

(Euros in millions)	2017	2016
		1 January to 31 December
Other third-party services	2,168	2,331
Other operating expenses	94	77
Allowance for current assets	80	91
Advertising	291	340
Other expenses	**2,633**	**2,838**

As of 31 December 2017, other expenses included restructuring expenses of EUR 38 million (2016: EUR 43 million) (for further information see Note 4.12 Provisions).

Other third-party expenses essentially comprise commissions.

5.5. Depreciation and amortisation

(Euros in millions)	2017	2016
	1 January to 31 December	
Depreciation of property, plant and equipment	862	908
Amortisation of intangible assets	1,008	1,210
Depreciation and amortisation	**1,869**	**2,118**

5.6. Financial result

(Euros in millions)	2017	2016
	1 January to 31 December	
Interest income from financial assets	5	11
Interest expenses from financial liabilities	(37)	(44)
Accretion of provisions and other liabilities	(2)	(4)
Other exchange gains/ (losses)	0	(0)
Financial result	**(34)**	**(36)**

Interest income from financial assets primarily includes the interest income in connection with "O_2 My Handy" receivables, receivables from finance leases and interest income from late payments.

Interest expenses from financial debt primarily comprise the interest for the bonds issued in November 2013 and February 2014, the revolving credit facility signed on 22 March 2016, the financing agreement signed on 13 June 2016 with the European Investment Bank (EIB), as well as for the promissory notes and registered bonds issued in March 2015.

Interest from finance lease obligations is also included.

5.7 Income tax

Consolidated income tax group

As of 31 December 2017, the consolidated income tax group of the Telefónica Deutschland Group consisted of 17 (2016: 21) companies.

Current and deferred taxes

(Euros in millions)	2017	2016
	1 January to 31 December	
Current tax expense	(0)	(0)
Deferred tax expense	(262)	(90)
Income tax/ (expense)	**(262)**	**(90)**

The movements in deferred tax assets are as follows:

(Euros in millions)	2017	2016
As of 1 January	**427**	**505**
Deferred tax expense	(262)	(90)
Amount of deferred taxes recognised directly in equity as shown in the Consolidated Statement of Comprehensive Income	(3)	11
As of 31 December	**162**	**427**

Tax loss carry forwards and temporary differences

Tax losses carried forward for which no deferred tax assets are reported as of 31 December 2017 amounted to EUR 14,439 million for corporate income tax and EUR 14,060 million for trade tax (2016: EUR 13,781 million and EUR 13,614 million). For temporary differences of EUR 263 million in 2017 (2016: EUR 0 million) no deferred tax assets were recognised. For entities respectively the income tax group which had a negative taxable income in the previous year or in the current period, deferred tax assets of EUR 162 million (EUR 427 million the previous year) were capitalised, as the future realisation of this tax claim is to be supported by the tax income projection.

The capitalisation of tax loss carry forwards at the end of the projection period is based on more conservative estimates of future income than those which would have been anticipated for other non-accounting-related purposes.

The breakdown of deferred tax assets and deferred tax liabilities from temporary differences and tax losses carried is as follows:

	As of 31 December 2017		As of 31 December 2016	
(Euros in millions)	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Goodwill and other intangible assets	853	(685)	1,129	(797)
Tangible assets	–	(210)	6	(246)
Trade and other receivables	10	(16)	12	(36)
Other current financial assets	8	(8)	8	(13)
Financial liabilities, trade and other payables	28	(7)	19	(6)
Provisions including pension provisions	88	(18)	105	(0)
Other current financial liabilities	23	(6)	64	(4)
Tax loss carry forwards	102	–	184	–
Deferred tax assets (liabilities)	**1,112**	**(951)**	**1,527**	**(1,101)**
Netting	(951)	951	(1,101)	1,101
Deferred tax assets (liabilities)	**162**	**–**	**427**	**–**

The deferred taxes in the amount of EUR 1,112 million (last year: EUR 1,527 million) are classified in general as non-current deferred tax assets and EUR 951 million (last year: EUR 1,101 million) as non-current deferred tax liabilities.

Reconciliation of earnings before tax to income tax expense recognised

	1 January to 31 December	
(Euros in millions)	2017	2016
Loss before tax	**(118)**	**(86)**
Tax expense at prevailing statutory rate (32 %)	38	28
Non-deductible expenses	(11)	(19)
Tax free income	–	–
Change in unrecognised temporary differences and tax loss carry forwards	(289)	(98)
Other	(0)	(0)
Income tax	**(262)**	**(90)**
Current tax expense	(0)	(0)
Deferred tax expense	(262)	(90)
Income tax (expense)	**(262)**	**(90)**

6. Business Combinations

Two transactions affecting the basis of consolidation were conducted by the Telefónica Deutschland Group in financial year 2017 (for more information, please see Note 10 Group Companies of the Telefónica Deutschland Group. This change in the basis of consolidation did not have a material effect on the consolidated financial statements of the Telefónica Deutschland Group.

7. Disposal Groups

Disposal group in 2016: Sale of passive tower infrastructure to Telxius

Telxius Telecom S.A., which was a wholly owned subsidiary of Telefónica S.A. at the time of the sale, acquired all of the shares in Telxius Towers Germany GmbH (formerly Telefónica Germany Vermögensverwaltungs-gesellschaft mbH), a formerly wholly owned subsidiary of E-Plus Mobilfunk GmbH, in accordance with a share purchase and transfer agreement dated 21 April 2016.

Telxius Towers Germany GmbH was formed as part of the spin-off of cellular towers and the corresponding assets and liabilities and lease agreements. The purpose of the company is the leasing of passive tower infrastructure for the operation of mobile communications networks.

The disposal of Telxius Towers Germany GmbH had the following impact on the Group's net assets and financial position in financial year 2016:

(Euros in millions)	As of 21 April 2016
Intangible assets	(23)
Property, plant and equipment	(277)
Trade and other receivables	(0)
Prepaid expenses	(4)
Provisions	83
Trade and other payables	0
Deferred income	8
Net assets and liabilities	**(214)**
Service receivables from Telxius	1
Liabilities to Telxius	(17)
Effect on net assets excluding cash and cash equivalents	**(231)**
Fee included in cash and cash equivalents	587
Cash and cash equivalents disposed of	(0)
Net cash inflow	**587**

Subsequent to the spin-off, the Telefónica Deutschland Group has been leasing the infrastructure back from Telxius Towers Germany GmbH under the terms of a corresponding lease. Furthermore, the parties agreed that the Group will be able to charge certain service fees to Telxius Towers Germany GmbH during a transitional phase.

A net capital gain of EUR 352 million was reported in the Consolidated Income Statement in connection with this disposal. The gain on the disposal of the interest, which is reported in other operating income, is offset by consulting fees that are reported in other operating expenses.

8. Earnings per share

Basic earnings per share are calculated by dividing the profit for the year after tax attributable to the ordinary shareholders of the parent company by the weighted average number of ordinary shares outstanding during the reporting period.

Diluted earnings per share are calculated by adjusting the profit after tax attributable to the ordinary shareholders of the parent company and the weighted average number of ordinary shares outstanding in the reporting period for the effects of any dilutive effects inherent in converting potential ordinary shares.

Both basic as well as diluted earnings per share attributable to the ordinary shareholders of the parent company are calculated based on the following data in accordance with IAS 33.

	1 January to 31 December	
(Euros in millions)	**2017**	2016
Total profit (loss) attributable to equity holders of the parent for basic = diluted earnings	(381)	(176)
Weighted average number of ordinary shares issued (in million units)	2,975	2,975
Earnings per share in EUR (basic = diluted)	**(0.13)**	**(0.06)**

In addition, the share capital of Telefónica Deutschland Holding AG is conditionally increased (see Note 4.9 Equity). Shares from the conditional capital of a stock corporation are not part of the calculation of the earnings per share as they can be contingently issued.

9. Measurement Categories of Financial Assets and Financial Liabilities

In the following tables, the fair values of all financial assets and financial liabilities of the Telefónica Deutschland Group are disclosed in accordance with the measurement categories as determined by IAS 39 and in line with the requirements of IFRS 13.

As of 31 December 2017, the carrying amount of the financial assets and financial liabilities represents an appropriate approximation for the fair value (with the exception of the portion of the bonds that is not hedged – see below).

In addition, the tables show the categorisation of the financial assets and financial liabilities in accordance with the importance of the input factors that were used for their respective measurement. For this purpose, three levels or measurement hierarchies are defined:

- Level 1: Primary market value: Quoted prices (unadjusted) in active markets for identical assets and liabilities;
- Level 2: Significant other observable input parameters: Inputs observable, either directly or indirectly, which are subject to certain limitations;
- Level 3: Significant unobservable input parameters: All unobservable inputs, which might include the entity's own data as a starting point and which should be adjusted if reasonably available information indicates that other market participants would use different data.

As of 31 December 2017

Financial assets

(Euros in millions)	Hedges (not a measurement category according to IAS 39)	Available-for-sale financial assets	Held-to-maturity financial assets	Loans and receivables	Measurement hierarchy Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in the scope of IFRS 7
Non-current trade and other receivables (Note 4.4)	–	–	–	69	–	69	–	69	69	–
Other non-current financial assets (Note 4.5)	6	18	–	12	–	18	–	36	18	57
thereof: derivatives	*6*	–	–	–	–	*6*	–	*6*	*6*	–
thereof: investments in start-ups	–	*18*	–	–	–	–	–	*18*	–	–
thereof: other	–	–	–	*12*	–	*12*	–	*12*	*12*	*57*
Current trade and other receivables (Note 4.4)	–	–	–	1,263	–	1,263	–	1,263	1,263	2
Other current financial assets (Note 4.5)	4	–	–	13	–	4	–	17	17	–
thereof: derivatives	*4*	–	–	–	–	*4*	–	*4*	*4*	–
thereof: other	–	–	–	*13*	–	*13*	–	*13*	*13*	–
Cash and cash equivalents (Note 4.8)	–	–	–	587	–	587	–	587	587	–
Total	**10**	**18**	**–**	**1,944**	**–**	**1,955**	**–**	**1,973**	**1,955**	**59**

As of 31 December 2016*

Financial assets

(Euros in millions)	Hedges (not a measurement category according to IAS 39)	Available-for-sale financial assets	Held-to-maturity financial assets	Loans and receivables	Measurement hierarchy Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in the scope of IFRS 7
Non-current trade and other receivables (Note 4.4)	–	–	–	77	–	77	–	77	77	–
Other non-current financial assets (Note 4.5)	12	21	–	18	–	30	–	51	30	9
thereof: derivatives	*12*	–	–	–	–	*12*	–	*12*	*12*	–
thereof: investments in start-ups	–	*21*	–	–	–	–	–	*21*	–	–
thereof: other	–	–	–	*18*	–	*18*	–	*18*	*18*	–
Current trade and other receivables (Note 4.4)	–	–	–	1,458	–	1,458	–	1,458	1,458	1
Other current financial assets (Note 4.5)	2	–	–	23	–	25	–	25	25	–
thereof: derivatives	*2*	–	–	–	–	*2*	–	*2*	*2*	–
thereof: other	–	–	–	*23*	–	*23*	–	*23*	*23*	–
Cash and cash equivalents (Note 4.8)	–	–	–	613	–	613	–	613	613	–
Total	**14**	**21**	**–**	**2,189**	**–**	**2,203**	**–**	**2,224**	**2,203**	**11**

*The prior year's presentation was amended to improve ease of reading.

As of 31 December 2017, EUR 6 million of other non-current financial assets and EUR 4 million of current financial assets are include in a hedge. These relate to the swaps that the Group entered into in connection with the bond issuance (for further information, see Note 4.5 Other financial assets).

The fair value of other non-current financial assets is determined by discounting future cash flows at current market interest rates.

In addition, EUR 18 million of other non-current financial assets (see Note 4.5 Other financial assets) are classified as available-for-sale financial assets. These relate to investments in start-ups (for further information, see Note 4.5 Other financial assets). These assets were measured at cost, as reliable measurement on the basis of market prices was not possible. These entities generate start-up losses, and the existing business plans contain numerous unreliable assumptions. For this reason, the measurement was made in accordance with IAS 39.46c. The reduction of EUR 3 million concerns investments in start-up companies in the amount of EUR 2 million and a divestment of EUR 5 million recognised in the current year in relation to the investments in start-up companies.

All other financial assets as of 31 December 2017 were categorised as loans and receivables.

Please see the respective notes for further information.

The age structure of the financial assets that are overdue and not impaired was as follows:

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Overdue for 1–90 days	1	15
Overdue for 91-180 days	2	1
Overdue for more than 180 days	19	14
Total	**22**	**30**

With regard to financial assets that are neither overdue nor impaired, there are no indications of circumstances that could have a negative impact on their value as of the respective reporting date.

As of 31 December 2017
Financial liabilities

(Euros in millions)	Hedges (not a measurement category according to IAS 39)	Liabilities at amortised cost	Finance leases	Measurement hierarchy: Level 1 (Quoted prices)	Measurement hierarchy: Level 2 (Other directly observable market inputs)	Measurement hierarchy: Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in the scope of IFRS 7
Non-current interest-bearing debt (Note 4.10)	155	1,098	15	537	778	–	1,268	1,315	–
Non-current trade and other payables (Note 4.11)	–	17	–	–	17	–	17	17	1
Current interest-bearing debt (Note 4.10)	202	419	17	615	25	–	637	639	–
Current trade and other payables (Note 4.11)	–	2,161	–	–	2,161	–	2,161	2,161	62
Total	**357**	**3,695**	**31**	**1,152**	**2,981**	**–**	**4,084**	**4,133**	**64**

As of 31 December 2016*
Financial liabilities

(Euros in millions)	Hedges (not a measurement category according to IAS 39)	Liabilities at amortised cost	Finance leases	Measurement hierarchy: Level 1 (Quoted prices)	Measurement hierarchy: Level 2 (Other directly observable market inputs)	Measurement hierarchy: Level 3 (Inputs not based on observable market data)	Total carrying amount	Total fair value	Not in the scope of IFRS 7
Non-current interest-bearing debt (Note 4.10)	360	1,343	17	1,164	614	–	1,721	1,778	–
Non-current trade and other payables (Note 4.11)	–	15	–	–	15	–	15	15	2
Current interest-bearing debt (Note 4.10)	–	22	15	–	37	–	37	37	–
Current trade and other payables (Note 4.11)	–	2,218	–	–	2,218	–	2,218	2,218	68
Total	**360**	**3,599**	**32**	**1,164**	**2,884**	**–**	**3,991**	**4,048**	**70**

*The prior year's presentation was amended to improve ease of reading.

As of 31 December 2017, EUR 155 million of non-current interest-bearing debt and EUR 202 million of current interest-bearing debt is included in a hedge. This relates to a portion of the bonds, which are each accounted for with an interest rate swap as a fair value hedge (for further information see Note 4.10 Interest-bearing debt).

The fair value of the bonds (non-current and current interest-bearing debt) is determined based on primary market values (unadjusted quoted prices in active markets, level 1). The fair value of the other non-current interest-bearing debt is determined by discounting the future payment streams using current market interest rates.

The non-current and current trade and other payables are categorised as financial liabilities at amortised cost.

Please see the respective notes for further information.

10. Group Companies of the Telefónica Deutschland Group

In accordance with sections 285 and 313 of the German Commercial Code (HGB), the following table lists the companies making up the Telefónica Deutschland Group as of 31 December 2017.

For detailed information, please refer to the list of shareholdings published with the Annual Financial Statements of Telefónica Deutschland Holding AG in the German Federal Gazette.

Company name, registered office	Country	Consolidation	Share in % as of 31 December 2017
Parent company			
Telefónica Deutschland Holding AG, Munich	Germany	n/a	n/a
Subsidiaries			
Telefónica Germany Management GmbH, Munich[2]	Germany	Full financial year	100%
Telefónica Germany GmbH & Co. OHG, Munich[1]	Germany	Full financial year	100%
Telefónica Germany 1. Beteiligungsgesellschaft mbH, Munich[2]	Germany	Full financial year	100%
TGCS Rostock GmbH, Munich[2]	Germany	Full financial year	100%
Telefónica Germany Next GmbH, Munich[2]	Germany	Full financial year	100%
Minodes GmbH, Berlin	Germany	From May 2017	100%
Telefónica Germany Retail GmbH, Düsseldorf[2]	Germany	Full financial year	100%
co-trade GmbH, Munich	Germany	From October 2017	100%
Wayra Deutschland GmbH, Munich[2]	Germany	Full financial year	100%
O2 Telefónica Deutschland Finanzierungs GmbH, Munich	Germany	Full financial year	100%
TGCS Bremen GmbH, Munich[2]	Germany	Full financial year	100%
TGCS Hamburg GmbH, Munich[2]	Germany	Full financial year	100%
TGCS Nürnberg GmbH, Munich[2]	Germany	Full financial year	100%
E-Plus Service GmbH, Düsseldorf[2]	Germany	Full financial year	100%
TGCS Essen & Potsdam GmbH, Potsdam[2]	Germany	Full financial year	100%
TGCS Berlin GmbH, Düsseldorf[2]	Germany	Full financial year	100%
Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH, Düsseldorf[2]	Germany	Full financial year	100%
AY YILDIZ Communications GmbH, Düsseldorf[2]	Germany	Full financial year	100%
Ortel Mobile GmbH, Düsseldorf[2]	Germany	Full financial year	100%
TFS Potsdam GmbH, Potsdam[2]	Germany	Full financial year	100%
Shortcut I GmbH & Co. KG, Hamburg	Germany	Full financial year	90%
Joint Operations			
TCHIBO Mobilfunk Beteiligungs-GmbH, Hamburg	Germany	Full financial year	50%
TCHIBO Mobilfunk GmbH & Co. KG, Hamburg	Germany	Full financial year	50%
Other investments[3]			
MNP GbR, Düsseldorf[4]	Germany	Full financial year	33%
tado GmbH, Munich	Germany	Full financial year	14%
Sum Up Holdings Ltd, Grand Cayman	Cayman Islands	Full financial year	4%
Zen Guard GmbH, Berlin	Germany	Full financial year	6%
So1 GmbH, Berlin	Germany	Full financial year	16%
Stocard GmbH, Mannheim	Germany	Full financial year	17%

[1] These entities are using the exemption provisions pursuant to section 264b HGB.

[2] These entities are using the exemption provisions pursuant to section 264 (3) HGB.

[3] Other investments are not included in the consolidation.

[4] The company reported total equity of EUR 102 thousands as of 31 December 2016 . Net income amounted to EUR -33 thousand for financial year 2016.

In the first quarter of the financial year, Telefónica Germany Customer Services GmbH was renamed to TGCS Rostock GmbH, TGCS Bremen Contact Center GmbH to TGCS Bremen GmbH, TGCS Hamburg Contact Center GmbH to TGCS Hamburg GmbH, TGCS Nürnberg Contact Center GmbH to TGCS Nürnberg GmbH, E-Plus Customer Operations GmbH to TGCS Berlin GmbH, E-Plus Financial Services GmbH to TFS Potsdam GmbH, and E-Plus Customer Support GmbH to TGCS Essen & Potsdam GmbH.

In the second quarter of the financial year, Telefónica Germany Next GmbH took over Minodes GmbH.

In the third quarter of the financial year, E-Plus Services Treuhand GmbH was merged with E-Plus Mobilfunk GmbH with retroactive effect to 1 January 2017. This merger was followed by the accretion of the assets and legal relationships of E-Plus Service GmbH & Co. KG to E-Plus Mobilfunk GmbH. In a second step, E-Plus Mobilfunk GmbH was renamed to E-Plus Service GmbH. Furthermore, Go Clever GmbH and Cash & Phone GmbH were merged with Telefónica Germany GmbH & Co. OHG with retroactive effect to 1 January 2017.

In the fourth quarter of the financial year, Telefónica Germany Retail GmbH took over co-trade GmbH.

11. Joint Operations

Telefónica Germany GmbH & Co. OHG jointly controls TCHIBO Mobilfunk Beteiligungs-GmbH, Hamburg, and TCHIBO Mobilfunk GmbH & Co. KG, Hamburg, jointly with TCHIBO GmbH, Hamburg.

The business objective of TCHIBO Mobilfunk Beteiligungs-GmbH is the holding of interests in other companies. The business objective of TCHIBO Mobilfunk GmbH & Co. KG, where TCHIBO Mobilfunk Beteiligungs GmbH is its personally liable shareholder, is the marketing and sales of mobile communications services to be rendered by third parties and the marketing and sales of hardware.

As part of the joint operation in TCHIBO Mobilfunk GmbH & Co. KG, Telefónica Germany GmbH & Co. OHG reimburses the company for sales and marketing services provided by the latter, on the one hand, and otherwise supplies the company with mobile communications devices.

12. Related Parties

Related parties within the meaning of IAS 24 are defined as natural persons and companies that can be influenced by the Telefónica Deutschland Group, that can exercise a material influence over the Telefónica Deutschland Group, or that are materially influenced by another related party of the Telefónica Deutschland Group.

Transactions with related parties include transactions between the Telefónica Deutschland Group and the Telefónica, S.A. Group.

Telefónica Deutschland Holding AG is the parent company of the Telefónica Deutschland Group. It is included in the Consolidated Financial Statements of the ultimate parent company, Telefónica, S.A., Madrid, Spain (Telefónica, S.A.; its group: the Telefónica, S.A. Group). The direct parent company of the Telefónica Deutschland Group is Telefónica Germany Holdings Limited, a wholly owned subsidiary of O2 (Europe) Limited, Slough, United Kingdom (O2 (Europe) Limited), and an indirect subsidiary of Telefónica, S.A. The companies of the Telefónica, S.A. Group are related parties as Telefónica, S.A. controls the Telefónica Deutschland Group.

Note 10 provides an overview of the companies making up the Telefónica Deutschland Group. In 2016 and 2017, the following were related parties from the perspective of the Telefónica Deutschland Group:

— Telefónica, S.A. and its subsidiaries, and significant investments of Telefónica, S.A. Group (see Note 12.1 Transactions with the Telefónica, S.A. Group),

— Members of the Management Board and Supervisory Board of the Telefónica, S.A. Group and members of the Management Board and Supervisory Board of the Telefónica Deutschland Group (see Note 12.2 Transactions with the Management Board and Supervisory Board).

The extent of the transactions conducted with the Telefónica, S.A. Group and other related parties can be seen in the overviews below.

Intercompany charges are based on cost-plus or similar allocation methods.

12.1. Transactions with the Telefónica, S.A. Group

Receivables from and liabilities to the Telefónica, S.A. Group
The Telefónica Deutschland Group reports the following receivables from and liabilities to the companies belonging to the Telefónica, S.A. Group:

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Receivables from the Telefónica, S.A. Group	**650**	**643**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Cash and cash equivalents (cash pooling)	573	600
Trade and other receivables	77	43
Liabilities to the Telefónica, S.A. Group	**415**	**466**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Trade and other payables	415	466
Interest-bearing debt	0	0

Cash and cash equivalents (cash pooling)
The receivables from the Telefónica, S.A. Group as a result of cash pooling relate to the cash pooling agreement with Telfisa Global B.V.

Trade and other receivables
These receivables result from transactions in goods and services such as roaming and commissions for insurance services, as well as licence agreements between Telefónica Deutschland Group and the Telefónica, S.A. Group. As of the reporting dates of 31 December, the line item contains receivables from Telefónica, S.A. of EUR 2 million in 2017 and EUR 1 million in 2016.

Trade and other payables
This item primarily relates to liabilities sold by the suppliers of Telefónica Germany GmbH & Co. OHG to Telefónica Factoring España, S.A., in which Telefónica, S.A. has an interest. In addition, the item includes licence agreements, social security benefits and lease benefits for the entire Telefónica, S.A. Group.

As of the reporting dates of 31 December, the item contains other payables to Telefónica, S.A. of EUR 3 million in 2017 (2016: EUR 7 million).

Interest-bearing debt
The interest bearing debt is related to the loan agreement concluded with Telfisa Global B.V.

Revenues, other income and expenses relating to the Telefónica, S.A. Group

	Revenues, other income and interest income 1 January to 31 December		Expenses 1 January to 31 December	
(Euros in millions)	2017	2016	2017	2016
Telefónica, S.A. Group	44	400	(176)	(192)

Revenues and other income are primarily generated from goods and services such as roaming, mobile phone insurance, wholesale voice, etc. and, in the previous year, additionally from the sale of passive tower infrastructure.

Expenses include group fees totalling EUR 36 million in 2017 and EUR 55 million in 2016, together with expenses relating to the purchase of goods and services, rent, as well as other expenses in connection with transactions with the Telefónica, S.A. Group, e.g. insurance and IT services.

12.2. Transactions with Management Board and Supervisory Board

a) Management Board
In financial year 2017, the members of key management personnel included the following members of the Management Board:

— Markus Haas (CEO)

— Markus Rolle (from 1 August)

— Wolfgang Metze (from 1 August)

— Alfons Lösing (from 1 August)

— Cayetano Carbajo Martín (from 1 August)

— Guido Eidmann (from 1 August)

— Valentina Daiber (from 1 August)

— Nicole Gerhardt (from 1 August)

— Rachel Empey (until 31 July),

The remuneration system of Telefónica Deutschland Group for the members of the Management Board and the Supervisory Board is described in further detail in the Combined Management Report, Remuneration Report.

In the financial years to which the accompanying Consolidated Financial Statements relate, the members of the Management Board have not carried out any transactions with the Telefónica Deutschland Group other than as part of the normal trading and business activity of the Telefónica Deutschland Group.

In accordance with section 314 (1) no. 6a HGB, the total remuneration granted to the Management Board of Telefónica Deutschland Holding AG for the financial year ended 31 December 2017 amounted to EUR 4,147 thousand. The total remuneration in the reporting year contains no share-based payments regarding the transfer of shares without consideration.

The Telefónica Deutschland Group has not currently granted the members of its Management Board any security or loans and have not assumed any guarantees for them.

The total remuneration granted to the Management Board in accordance with section 314 (1) no. 6a HGB in 2016 amounted to EUR 4,105 thousands. The total remuneration in financial year 2016 contains no share-based payments regarding the transfer of shares without consideration.

Salaries and other benefits according to IAS 24.17 that were granted to active Management Board members are composed as follows:

		1 January to 31 December
(Euros in thousands)	**2017**	2016
Remuneration	**4,611**	**3,980**
thereof:		
Short-term employee benefits	3,884	3,558
Other long-term employee benefits	367	255
Share-based payments[1]	93	(22)
Service cost	268	189

[1] Due to forfeited share options, income from share-based payments was recognised in the previous year

Due to the conditional rights to the free transfer of shares (bonus shares) for Telefónica, S.A.'s share options for the Management Board members (for further information see the Management Report, Remuneration system for Board Members) the following changes took place:

(In units)	**2017**	2016
Share options as of 1 January	**111,242**	**266,661**
Forfeited share options	(65,990)	(133,176)
Change in composition of Management Board	37,345	–
Actual share assignment	(22,252)	(22,243)
Share options as of 31 December	**60,345**	**111,242**

The defined benefit pension obligations for the Management Board members in financial year 2017 amounted to EUR 2,248 thousand and EUR 4,185 thousand in 2016.

As of 31 December 2017 and 2016, the pension obligations for members of the former management and their surviving dependants amounted to EUR 14,448 thousand and EUR 12,443 thousands, respectively.

For further details of the pension obligations of the Telefónica Deutschland Group, please refer to Note 4.12 Provisions.

As of 31 December 2017 and 2016, the total remuneration expense for members of the former management and their surviving dependants amounted to EUR 182 thousand in 2017 and EUR 197 thousand in 2016.

b) Supervisory Board

Name	Member of the Supervisory Board	Remuneration in thousands of Euros
Eva Castillo Sanz	since 5 October 2012	80
Laura Abasolo García de Baquedano	since 12 May 2015	2
Angel Villá Boix	since 18 September 2012 to 4 October 2017	2
Patricia Cobian González	since 18 September 2012	2
Michael Hoffmann	since 5 October 2012	70
Enrique Medina Malo	since 18 September 2012	2
Sally Anne Ashford	since 18 September 2014	20
Peter Erskine	since 19 May 2016	20
Julio Linares López	since 16 October 2017	4
Christoph Braun	since July 2016	40
Thomas Pfeil	since 3 June 2013	20
Dr. Jan Erik Walter	since 3 June 2013	20
Marcus Thurand	since 3 June 2013	20
Christoph Heil	since 3 June 2013	20
Claudia Weber	since 3 June 2013	20
Joachim Rieger	since 31 October 2014	25*
Jürgen Theirfelder	since 31 October 2014	25*

*In addition to the remuneration set out in Section 20 of Telefónica Deutschland Holding AG's Articles of Association, Mr Joachim Rieger and Mr Jürgen Thiefelder receive annual remuneration for their work as Supervisory Board members of the subsidiaries TCGS Potsdam GmbH and Telefónica Germany Retail GmbH of EUR 4,500 each, which is already included in the table.

The members of the Supervisory Board received remuneration for their activities of EUR 382 thousands in 2017 and EUR 372 thousands in 2016.

Members of the Supervisory Board who are also employees of the Telefónica Deutschland Group also receive remuneration from their employment relationship, including entitlements from share-based payment agreements, subject to compliance with the requirements for participation in each individual case, and are entitled to pension schemes. This remuneration comprises the following with effect from appointment to the Supervisory Board:

(Euros in thousands)	**2017**	2016
Remuneration	**721**	**707**
thereof:		
Short-term employee benefits	693	683
Share-based payments	7	3
Service cost	21	21

As of 31 December 2017, the Telefónica Deutschland Group has not granted the members of its Supervisory Board any securities or loans, and has not assumed any guarantees on their behalf.

13. Share-based Payments

As of 31 December 2017, the Telefónica Deutschland Group had made various agreements regarding share-based payments. The financial effects of the share-based remuneration systems are, however, of minor importance for the Telefónica Deutschland Group:

— In financial year 2017, personnel expenses arising from share-based payment transactions amounted to EUR 7 million (2016: EUR 3 million).

— As of 31 December 2017, liabilities arising from share-based payment transactions amounted to EUR 0 million (2016: EUR 0 million).

14. Information Regarding Employees

The following table presents the breakdown of the Telefónica Deutschland Group's average headcount grouped with respect to their status under employment law:

Average headcount	**2017**	2016
Office staff	9,024	8,821
thereof from joint operations	12	11
Temporary staff	381	452
Total	**9,405**	**9,272**

15. Financial Instruments and Risk Management

As of the reporting date, Telefónica Deutschland Group faces a variety of risks from financial instruments. In this regard, please refer to the statements regarding risk management and financial instruments in the Combined Management Report.

16. Capital Management

The Telefónica Deutschland Group strives to guarantee the sustainability of its business and to maximise its enterprise value by permanently monitoring its capital costs, equity ratio and OIBDA.

As of 31 December 2017, the equity ratio amounted to 58.8% compared with 61.5% as of 31 December 2016. In financial year 2017, OIBDA amounted to EUR 1.785 million and EUR 2.069 million in 2016.

17. Contingent Assets and Liabilities

Indirect claims against the frequency allocation at 800 MHz, 1.8 GHz, 2.0 GHz and 2.6 GHz could result in the reassignment of the 800 MHz, 1.8 GHz, 2.0 GHz and 2.6 GHz frequencies purchased at the 2010 frequency auction. The above frequencies were (indirectly) contested, as there was pending litigation from several cable network operators, broadcasting companies and Airdata AG against the terms and conditions, on which the frequency allocation was based. This litigation was primarily aimed at the allocation conditions for 800 MHz, but also alternatively involved the rescission of the entire allocation decision (i.e. also affecting 1.8 GHz, 2.0 GHz and 2.6 GHz). The actions have now been dismissed in the court of last instance. This ends the legal disputes before the administrative courts. The possibility of additional legal proceedings due to as yet unasserted third-party claims against frequency allocations in 800 MHz in connection with the aforementioned legal action cannot be ruled out. If the appeals are successful, this could result in the reassignment of the frequencies for 800 MHz acquired at the 2010 frequency auction.

As one of the leading network operators in Germany, Telefónica Deutschland Group is exposed to the risk of claims concerning patent violations. In this context, patent owners could assert claims for licence payments and/or for the prohibition of the use of certain patent-violating technologies. This risk is mitigated by Telefónica Deutschland Group's exemption and compensation claims against its relevant suppliers. Besides compensation claims for legal costs, patent owners currently have potential licence claims that come under consideration on the basis of the provisional/court-assessed values in dispute. These claims are almost completely offset by the potentially mitigating exemption and compensation claims. The amount of the legal costs and licence claims is estimated in the low millions.

Telefónica Deutschland Group could be subject to claims or other proceedings arising in the ordinary course of business. The possible effects are of minor significance for the Group's net assets, financial position and results of operations.

18. Operating Leases, Purchase and Other Contractual Obligations

The following expected maturity dates apply for the obligations from operating leases, purchase and contractual obligations:

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Less than 1 year	554	535
1 to 5 years	1,451	1,265
Over 5 years	774	992
Obligation from operating leases	**2,779**	**2,793**

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Less than 1 year	1,351	1,129
1 to 5 years	698	47
Over 5 years	154	692
Purchase and other contractual obligations	**2,203**	**1,868**
Total	**4,982**	**4,661**

The following amounts are recognised in the Consolidated Income Statement:

	1 January to 31 December	
(Euros in millions)	2017	2016
Expenses for operating leases	642	543

The expenses for operating leases essentially include rental expenses for office buildings and shops, antenna sites, cars and network equipment (i.e. leased lines and cell sites). Some of the contracts contain renewal options. These relate primarily to lease contracts for network towers.

The Telefónica Deutschland Group provides absolute guarantees to secure rental obligations primarily for antenna sites. These guarantees are granted by external financial counterparts and are offered in the course of normal commercial activity.

The guarantees amounted to EUR 111 million as of 31 December 2017 compared with EUR 105 million in 2016.

The Telefónica Deutschland Group has entered into various sublease agreements for office buildings, cell sites and shops. The estimated payment schedule for subleases is as follows:

(Euros in millions)	As of 31 December 2017	As of 31 December 2016
Less than 1 year	13	15
1 to 5 years	17	20
Over 5 years	4	5
Income from subleases	**35**	**40**

The following amounts are recognised in the Consolidated Income Statement:

	1 January to 31 December	
(Euros in millions)	**2017**	2016
Income from subleases	22	24

19. Total Auditor's Fees

The services listed below performed by the Group's auditor, which was Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft until 2016 and PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft from 2017, were recognised in the Consolidated Income Statement.

Because the Telefónica Deutschland Group conducts all of its business in Germany, the entire amount is incurred in Germany.

	1 January to 31 December	
(Euros in millions)	**2017**	2016
Types of fee:		
Audit fees	2	2
Other audit-related services	0	0
Total fee	**2**	**2**

The auditor's fees include especially the fees for auditing the Consolidated Financial Statements of Telefónica Deutschland Holding AG and fees for auditing the annual financial statements of the subsidiaries. Other audit-related services were performed in financial year 2017 only to a minor extent.

20. Events after the Reporting Period

Telefónica Germany GmbH & Co. OHG has mandated Landesbank Baden-Württemberg (LBBW) and DZ Bank AG for the placement of a promissory note loan targeting a volume of EUR 200 million consisting of various tranches with tenors of up to 15 years. Placement has started in January 2018 and closing is scheduled to take place in the 1st quarter of 2018. The financing agreement will only be finalised after successful placement in February, payment will only be made on 28 February or in March.

No additional events subject to disclosure requirements occurred after the 2017 end of the financial year.

21. Declaration of Compliance with the German Corporate Governance Code

The Management Board and the Supervisory Board last submitted a declaration of compliance in accordance with section 161 of the German Stock Corporation Act (AktG) on 12 /13 /14 /16 October 2017. The complete wording of the declaration of compliance is available on Telefónica Deutschland's website at **www.telefonica.de/declaration-of-compliance-2017**.

Munich, 12 February 2018

Telefónica Deutschland Holding AG

The Management Board

Markus Haas

Markus Rolle

Valentina Daiber

Guido Eidmann

Nicole Gerhardt

Alfons Lösing

Cayetano Carbajo Martín

Wolfgang Metze

Further Information

Further information
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Telefónica Deutschland Holding AG Declaration of the Statutory Representatives

To the best of our knowledge, and in accordance with the applicable reporting principles, the Consolidated Financial Statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Combined Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the material opportunities and risks associated with the expected development of the Group.

Munich, 12 February 2018

Telefónica Deutschland Holding AG

The Management Board

Markus Haas

Markus Rolle

Valentina Daiber

Guido Eidmann

Nicole Gerhardt

Alfons Lösing

Cayetano Carbajo Martín

Wolfgang Metze

Independent Auditor's Report

To Telefónica Deutschland Holding AG, Munich

Report on the Audit of the Consolidated Financial Statements and of the Group Management Report

Audit Opinions

We have audited the consolidated financial statements of Telefónica Deutschland Holding AG, Munich, and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of 31 December 2017, the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the financial year from 1 January to 31 December 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of Telefónica Deutschland Holding AG, which is combined with the Company's management report, for the financial year from 1 January to 31 December 2017. We have not audited the content of those parts of the group management report listed in the "Other Information" section of our auditor's report in accordance with the German legal requirements.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § [Article] 315e Abs. [paragraph] 1 HGB [Handelsgesetzbuch: German Commercial Code] and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as at 31 December 2017, and of its financial performance for the financial year from 1 January to 31 December 2017, and
- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the group management report does not cover the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

Pursuant to § 322 Abs. 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the Audit Opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the consolidated financial statements and on the group management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements
Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

❶ Recoverability of other intangible assets
❷ Recoverability of deferred tax assets on loss carryforwards
❸ Appropriateness of revenue recognition
❹ Financial instruments

Our presentation of these key audit matters has been structured in each case as follows:

① Matter and issue
② Audit approach and findings
③ Reference to further information

Hereinafter we present the key audit matters:

❶ **Recoverability of other intangible assets**

① In the Company's consolidated financial statements other intangible assets amounting to EUR 5.5 billion (38.6% of total assets) are reported. This item includes network licenses (primarily for UMTS (3G) and LTE (4G)) amounting to EUR 2.7 billion, the Company's customer base amounting to EUR 1.9 billion, and two paired blocks of unused network licenses in the 700 MHz range amounting to EUR 0.3 billion, among other items. These assets mainly reflect investments made in previous financial years and the acquisition of the E-Plus Group in financial year 2014, and – apart from the unused network licenses for which amortization had not yet begun as of the balance sheet date – are recognized at cost less amortization and write-downs. All intangible assets in use within this balance sheet item are amortized over their expected useful economic lives. An impairment test was carried out for the unused network licenses in the 700 MHz range in order to determine any possible need for write-downs. The Company also performs an impairment test for both intangible assets in use and those not yet in use when there are indications of potential impairment. Impairment tests are carried out in each case at Group level, since there are no independent cash inflows below the level of the Group as a whole, and for that reason the whole Group is treated as a cash-generating unit.

The outcome of the analyses carried out by the Company and of the impairment test is dependent in particular on the estimates made by the executive directors with respect to the future cash inflows from the cash-generating unit. Future developments in technology, the Company's state of technological progress, the amount of current and planned investment in the network, competitors' general performance and the development of the customer base all play a significant role in making those estimates. Against this background, the assessments and estimates made by the executive directors in this respect are subject to considerable uncertainty, with the result that this matter was of particular importance for our audit.

② For the purposes of our audit, we firstly assessed the procedures for identifying and evaluating issues and developments which could result in an impairment of the intangible assets, including the controls established. In a further step, among other things we evaluated the assumptions and inputs used by the executive directors for the purpose of the analyses and the impairment test, such as the current state of technological development, the performance of competitors and the telecommunications market generally, and the development of the customer figures provide to us, in order to determine whether they form an appropriate basis for the executive directors' assessment of the possible impairment of individual other intangible assets. We based our assessment, among other things, on a comparison with general and sector-specific market expectations as well as the executive directors' detailed explanations regarding the primary assumptions and inputs. Furthermore, supplemental to the impairment test performed by the Company, we carried out sensitivity analyses and established that the assets concerned are adequately covered. In our view, the assumptions and inputs used by the executive directors were properly derived overall.

③ The Company's disclosures relating to the other intangible assets are contained in section "4.2 Other intangible assets" in the notes to the consolidated financial statements.

❷ Recoverability of deferred tax assets on loss carryforwards

① In the consolidated financial statements of the Company deferred tax assets after netting of EUR 162 million (of which EUR 102 million represents loss carryforwards) are reported. This item was recognized to the extent that the executive directors consider it probable that taxable profit will be available in the foreseeable future which will enable the deductible temporary differences and unused tax losses to be utilized. For this purpose, if insufficient deferred tax liabilities are available, future taxable profits are projected on the basis of the adopted business plan. The negative earnings for the earlier years were mainly the result of non-recurring restructuring expenses and costs in connection with the acquisition of the E-Plus Group in financial year 2014. In light of the synergies expected to result from the acquisition and the fact that the amortization of the UMTS licenses will come to an end for the most part by December 2020, the executive directors expect that there will be sufficient positive taxable income from financial year 2021, on the basis of which deferred tax assets on loss carryforwards can be recognized. From our point of view, the accounting treatment of deferred taxes was of particular importance in the context of our audit, as the Company's strategic and tax planning depends to a large extent on estimates and assumptions made by the executive directors and is therefore subject to uncertainties.

② As part of our audit, in collaboration with internal specialists from Tax Accounting, we reviewed the internal processes and controls implemented for recording tax matters and the methodological procedures, among other things. We further assessed the recoverability of the deferred tax assets relating to loss carryforwards and deductible temporary differences on the basis of the Company's internal forecasts of the future taxable earnings situation of Telefónica Deutschland Holding AG and its significant tax group companies for income tax purposes, and we evaluated the appropriateness of the underlying estimates and assumptions. For this purpose, we also focused on the effects on earnings resulting from the anticipated synergy effects of the acquisition of the E-Plus Group that were reflected in the forecasts. Based on our audit procedures, we were able to satisfy ourselves that the estimates and assumptions made by the executive directors were justified and adequately documented.

③ The Company's disclosures relating to deferred taxes are contained in section "5.7 Income tax" in the notes to the consolidated financial statements.

❸ Appropriateness of revenue recognition

① In the Company's consolidated financial statements revenues of EUR 7.3 billion are reported in the consolidated income statement. The revenues comprise revenues from the provision of services (mobile service revenues and fixed line / DSL business), revenues from the sale of handsets and other revenues. In view of its complexity, the number of systems necessary for the accurate recording and allocation of revenues, the constantly changing pricing and tariff models, and the use of multiple element arrangements, this significant item in terms of its amount is subject to particular risk. Against this background, the correct application of the accounting standards is considered to be complex and is based in some respects (e.g. monthly deferrals of revenues) on estimates and assumptions made by the executive directors, with the result that this matter was of particular importance for our audit.

In addition, from financial year 2018 onward the application of the new standard on revenue recognition, "International Financial Reporting Standard 15 – Revenue from Contracts with Customers" (IFRS 15), will have a significant impact. Its effects have already been presented in the notes to the consolidated financial statements for financial year 2017. The Company will exercise the option to use a practical expedient on initial application and recognize the cumulative effect of the transition directly in equity as of 1 January 2018 in accordance with the transitional provisions. The cumulative adjustment to equity (before deferred taxes) in the Company's opening balance sheet as of 1 January 2018 presumably amounts to between EUR 400 million and EUR 420 million. The largest portion of this effect amounting to between EUR 415 million and EUR 430 million (before deferred taxes) results from the initial recognition of the costs of obtaining contracts and is reflected in a corresponding increase in retained earnings. In view of the expected material impact and the complexity of the Group-wide implementation of the new standard, the presentation of the expected impact was of particular importance for our audit.

② In the knowledge that the high degree of complexity and the need to make estimates and assumptions give rise to an increased risk of accounting misstatements, as part of our audit we initially assessed the systems used by the Company and the processes and controls established for the purpose of recording revenue. This also included an evaluation of the IT systems environment from the transfer of data from the mediation systems via the measurement and billing systems up to entry in the general ledger. Our audit also covered the changes made to the systems and the controls implemented for this purpose. Furthermore, we examined customer invoices and the related payments received on a sample basis and obtained balance confirmations for business customers. In addition, we evaluated the effects of the multiple element arrangements on the financial statements and the mapping of business relationships with traders and business partners. We applied consistent audit procedures for the audit of the operating subsidiaries to ensure that we responded appropriately to the inherent audit risk in the audit field. We were able to satisfy ourselves that the systems, processes, and controls in place are appropriate and that the estimates and assumptions made by the executive directors are sufficiently documented and substantiated to ensure that revenue is properly reported and recorded.

With regard to the initial application of IFRS 15 from financial year 2018 onward, we evaluated the Company's assessment of the impact of the new standard. For this purpose, among other things we evaluated the estimates for the Company's business models made for accounting purposes and assessed the design of the processes set up to map the transactions in accordance with the new standard as well as the IT tools developed to support the implementation of the required logic. In addition, we assessed the appropriateness of the methods used to determine the expected impact of the initial application of IFRS 15.

We were able to satisfy ourselves that the systems and processes set up by the executive directors and the estimates and assumptions made are sufficiently documented and substantiated to ensure that the expected impact of initial application is properly presented.

③ The Company's disclosures on the specific considerations relating to revenue recognition in the consolidated financial statements of Telefónica Deutschland Holding AG are contained in the explanatory notes on the accounting policies in sections "3. Accounting policies" and "5.1. Revenues" in the notes to the consolidated financial statements. The expected effects of the initial application of IFRS 15 are presented in section "3. Accounting policies" in the notes to the consolidated financial statements.

❹ Financial instruments

① Telefónica Germany GmbH & Co. OHG, a subsidiary of Telefónica Deutschland Holding AG, enters into a large number of different primary and derivative financial instruments for the purpose of ensuring liquidity and in order to hedge interest rate risks arising from the Group's financing activities. These primarily consist of bonds amounting to EUR 1.1 billion, promissory notes and registered bonds amounting to EUR 304 million and loans amounting to EUR 450 million reported under the balance sheet item "Interest-bearing debt". The "Other financial assets" balance sheet item includes the fair values amounting to EUR 10 million of interest rate swaps held for hedging purposes and entered into for a portion of the nominal amounts of the bonds, representing a total amount of EUR 350 million. These interest rate swaps form part of a fair value hedge whose effectiveness is measured prospectively using a critical terms match and sensitivity analysis, and retrospectively using the dollar offset method. Telefónica Germany GmbH & Co. OHG has also entered into factoring agreements with a number of banks, which involve transactions for the sale of receivables at irregular intervals. Receivables are derecognized when transferred. In our view, these matters were of particular importance for our audit due to the high complexity of the contracts and the number of transactions as well as the extensive accounting and reporting requirements.

② As a part of our audit and in collaboration with our internal specialists from Corporate Treasury Solutions, among other things we assessed the contractual and financial parameters of the financial instruments and retraced the accounting treatment, including the effects on profit or loss. We also assessed the Company's internal control system with regard to (derivative) financial instruments, including the internal activities to monitor compliance with the hedging policy. In addition, for the purpose of auditing the fair value measurement of the interest rate swaps, we also assessed the methods of calculation employed using market data. Furthermore, we obtained bank confirmations in order to assess the completeness of the interest rate swaps and to audit their fair values. With regard to the expected cash flows and the assessment of the effectiveness of the interest rate swaps for the purpose of determining whether hedge accounting is applicable, we essentially conducted a retrospective assessment of past hedging levels and the calculation of effectiveness using the dollar offset method. For the factoring transactions, we evaluated the contracts for sales currently in progress.

On the basis of our audit procedures, we were able to satisfy ourselves that the controls in place are appropriate and that the estimates and assumptions made by the executive directors are sufficiently documented and substantiated to ensure that financial instruments are properly accounted for.

③ The Company's disclosures on the accounting treatment of financial instruments are contained in section "4.10. Interest-bearing debt" and section "9. Measurement categories of financial assets and financial liabilities" in the notes to the consolidated financial statements.

Other Information

The executive directors are responsible for the other information. The other information comprises the following non-audited parts of the group management report:

- the statement on corporate governance pursuant to § 289f HGB and § 315d HGB included in section "Management Declarations" of the group management report
- the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB

The other information comprises further the remaining parts of the annual report –excluding cross-references to external information – with the exception of the audited consolidated financial statements, the audited group management report and our auditor's report.

Our audit opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

Responsibilities of the Executive Directors and the Supervisory Board for the Consolidated Financial Statements and the Group Management Report
The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report
Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional scepticism throughout the audit. We also:

— Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.
- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.
- Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 9 May 2017. We were engaged by the supervisory board on 20 July 2017. We have been the group auditor of the Telefónica Deutschland Holding AG, Munich, without interruption since the financial year 2017.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Stefano Mulas.

Munich, 19 February 2018

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Klaus Bernhard
Wirtschaftsprüfer
(German Public Auditor)

Stefano Mulas
Wirtschaftsprüfer
(German Public Auditor)

Supervisory Board Report for the 2017 financial year

Eva Castillo Sanz,
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG

Dear Shareholders,

In the interests of good corporate governance, the Supervisory Board collaborated well with the Management Board on the basis of trustful cooperation, advised it and fulfilled its controlling responsibilities in the reporting period with regard to all significant topics. The Supervisory Board of Telefónica Deutschland Holding AG consistently and responsibly performed its duties as set out by law, the Articles of Association and the by-laws.

Composition of the Supervisory Board

During the 2017 financial year, the Supervisory Board consisted of 16 members, initially being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Ángel Vilá Boix, Laura Abasolo García de Baquedano, Patricia Cobián González, Sally Anne Ashford, Peter Erskine, Michael Hoffmann and Enrique Medina Malo as well as the employee representatives Christoph Braun (Vice Chairperson of the Supervisory Board), Marcus Thurand, Thomas Pfeil, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Christoph Heil and Claudia Weber.

All shareholder representatives were re-elected by the Annual General Meeting on 9 May 2017 for another period in office.

With effect of 4 October 2017, Ángel Vilá Boix resigned as member of the Supervisory Board. As requested pursuant to sect. 104 para 2 and 3 No. 2 German Stock Corporation Act (AktG) by Management Board, Julio Estéban Linares López was appointed as new member of the Supervisory Board by order of the Local Court of Munich of 16 October 2017.

In the Supervisory Board of Telefónica Deutschland Holding AG, the independent member Michael Hoffmann performs the function of financial expert with the knowledge as requested by section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

In the beginning of the financial year 2017, Management Board consisted of two members:

As CEO, Markus Haas was also responsible for the operative business of the whole Telefónica Deutschland Group and performed the function as Labour Director (Arbeitsdirektor). Rachel Empey was responsible for finance and strategy as CFO and additionally for the areas Transformation & Integration, Business Intelligence, Innovation and Telefónica Next.

In its meeting on 20 July 2017, Supervisory Board approved Rachel Empey´s request of an early termination of her service agreement. As mutually agreed, Rachel Empey left the Management Board at the end of 31 July 2017. Supervisory Board appointed Markus Rolle as new CFO of Telefónica Deutschland Holding AG with resolution on 20 July 2017, effective as of 1 August 2017. Furthermore, Supervisory Board decided by resolution as of 20 July 2017 to extend the Management Board of Telefónica Deutschland Holding AG to eight members and thus appointed the following additional members of the Management Board of Telefónica Deutschland Holding AG, effective as of 1 August 2017:

— Wolfgang Metze as new Chief Consumer Officer

— Alfons Lösing as new Chief Partner and Business Officer

— Valentina Daiber as new Chief Officer Legal & Corporate Affairs

— Guido Eidmann as new Chief Information Officer

— Nicole Gerhardt as new Chief Human Resources Officer as well as Labour Director (Arbeitsdirektor), (Markus Haas resigned as Labour Director by the end of 31 July 2017)

— Cayetano Carbajo Martín as new Chief Technology Director.

Cooperation between the Management Board and Supervisory Board

The Management Board provides the Supervisory Board with a monthly report, which covers in particular relevant financial key performance indicators (KPIs).

The Chairperson of the Supervisory Board and the Management Board are also in constant contact outside Supervisory Board meetings. Here they discuss in particular the current position and future development of the company as well as the progress of current material projects, in the reporting period among others especially transformation and integration measures and development into a digital telecommunications company. The Chairperson of the Supervisory Board informs the other members of the Supervisory Board of important issues discussed in that context.

In the reporting period, the Management Board involved the Supervisory Board in due time in all material decisions. For this purpose, it submitted reports and documents to the Supervisory Board and provided additional information when required. When necessary, the Supervisory Board was also able to refer to the expertise of external consultants. Supervisory Board voted – where necessary – on resolution motions and reports of Management Board after thorough assessment and discussion.

Meetings of the Supervisory Board

In 2016, five regular meetings of the Supervisory Board took place, namely on 16 February 2017 (meeting on the financial statements for the 2016 financial year; “Bilanzsitzung”), 24 April, 20 July, 23 October and 18 December 2017.

In addition, there were further resolutions of the Supervisory Board outside of meetings.

In 2018, there were two meetings, on 2 February 2018 and on 19 February 2018 (meeting on the financial statements for the financial year 2017, “Bilanzsitzung”).

Fundamental issues dealt with by the Supervisory Board

The first meeting of the Supervisory Board in the 2017 financial year took place on 16 February 2017 and was also the meeting regarding the financial statements for the 2016 financial year (“Bilanzsitzung”). In addition to the items associated therewith, such as the approval of the financial statements (Group and of the corporation) and the combined management report for the 2016 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), in particular the final agenda and resolution motions for the Annual General Meeting on 9 May 2017 were discussed. Moreover, the results of the employee survey as well as the operational and legal integration of E-Plus Mobilfunk GmbH into Telefónica Germany GmbH & Co. OHG were discussed.

The agenda of the Supervisory Board meeting on 24 April 2017 comprised operational topics and M&A transactions in addition to the financial data for Q1 and the outlook. Furthermore, Corporate Governance and Compliance topics as well as Audit and Risk Management were dealt with.

Among other things, the meeting on 20 July 2017 addressed the half-yearly financial data, the long term business plan of Telefónica Next with focus on Advanced Data Analytics and Internet of Things, the merger of Cash&Phone into Telefónica Germany GmbH & Co. OHG, Compliance topics as well as the efficiency of the Supervisory Board. Moreover, the meeting dealt with Management Board matters such as the early resignation of Rachel Empey with effect of 31 July 2017 and the appointment of the new Management Board members with effect of 1 August 2017.

The topics discussed at the meeting on 23 October 2017 included financial issues (especially the Q3 results and the business plan), the results of the Supervisory Board efficiency survey as well as the diversity concepts for Supervisory Board and Management Board. It was also agreed together with Management Board that the Annual General Meeting for the 2017 financial year would be held on 17 May 2018.

At the meeting on 18 December, mainly the budget for the financial year 2018 was approved.

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, operational issues including the synergy reports and the market positioning were dealt with.

In June 2017, the Supervisory Board also held a strategy workshop together with the Management Board.

All Supervisory Board members in office for the entire 2017 financial year participated in more than half of the meetings in the reporting period.

Outside of the meetings the Supervisory Board passed resolutions to the extent required, especially by e-mail. For instance, inter alia the resolution on the Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG) in October 2017 was passed this way – following appropriate preparation at presence meetings.

Committees of the Supervisory Board

The Supervisory Board has installed four committees: a Nomination Committee, a Mediation Committee, an Audit Committee and a Remuneration Committee.

The Audit Committee is responsible in particular for advice on and the passing of resolutions in accounting matters. It deals with issues relating to accounting, internal control systems and auditing, risk management, compliance and the financial, asset and earnings situation. It also assesses the necessary independence of the external auditor and is responsible for coordination with the external auditor. The Audit Committee consists of four members:

— Michael Hoffmann (Chairperson)

— Laura Abasolo García de Baquedano

— Thomas Pfeil and

— Christoph Heil.

In 2017, the Audit Committee met five times. In addition to the regular topics financial results, auditing, risk management and compliance, it dealt in particular with the change of auditor for the financial year 2017.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:

— Eva Castillo Sanz (Chairperson)

— Christoph Braun

— Julio Estéban Linares López (from 13 December 2017) and

— Marcus Thurand.

There was no need for the Mediation Committee to convene in the reported year.

The Remuneration Committee is responsible for preparing topics and details relating to Management Board remuneration. In particular, its preparatory work supports the decision making process of the full Supervisory Board.

The Remuneration Committee has the following members:

— Sally Anne Ashford (Chairperson)

— Eva Castillo Sanz

— Dr. Jan-Erik Walter and

— Claudia Weber.

The Remuneration Committee met six times in the reporting period.

The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting.

The Nomination Committee has the following members:

— Patricia Cobián González (Chairperson)

— Eva Castillo Sanz

— Enrique Medina Malo.

In the reported year, the Nomination Committee prepared- by email resolution - the election proposal for the Annual General Meeting on 9 May 2017 for the regular election of the eight shareholder representatives.

Corporate Governance

Good corporate governance is essential for corporate success and is therefore in the interest of the company's shareholders. Further details on the corporate governance of Telefónica Deutschland Holding AG can be found in the Management Declaration pursuant to section 315d in connection with 289f German Commercial Code in the Annual Report and on the company's website at **www.telefonica.de/management-declaration-2017** and in the Corporate Governance Report on the company's website at **www.telefonica.de/corporate-governance-report-2017**.

On 20/21 July 2017 the Compliance Declaration approved on 13/14 and 17 October 2016 and published, updated on 11/12 December 2016 was updated and published again.

On 12/13/14 and 16 October 2017 the Management Board and the Supervisory Board approved a new Declaration of Compliance pursuant to section 161 German Stock Corporation Act (AktG). The Declaration of Compliance was published on the company's website at **www.telefonica.de/declaration-of-compliance-2017**. Earlier versions of the Declaration of Compliance can be also found at the website.

Six of the 16 members of the Supervisory Board hold positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies. Both the Supervisory Board members and the Management Board members disclose potential conflicts of interest promptly to the Supervisory Board.

In the reporting period, no conflicts of interest within the meaning of the German Corporate Governance Code arose.

The Supervisory Board fulfils the gender diversity quota of at least 30 % (during the financial year 2017: 31.25 % female members).

In the beginning of the financial year 2017, 50 % of the members of the Management Board were female. Since 1 August 2017, the quota is 25% (two members of the eight member Management Board are female), so the established gender diversity quota of at least 20 % for the members of the Management Board was exceeded. The quota of 25% determined on 18 December 2017 has also been met.

Review of the Financial Statements 2017

Pricewaterhouse Coopers GmbH Wirtschaftsprüfungsgesellschaft, audited the annual financial statements and the consolidated financial statements as well as the combined management report as of 31 December 2017 of Telefónica Deutschland Holding AG and the Group and provided each with an unqualified audit opinion. The annual financial statement of Telefónica Deutschland Holding AG and the combined management report for Telefónica Deutschland Holding AG and the Telefónica Deutschland Group were prepared in accordance with German commercial law. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as they are applied in the European Union (EU) and the additional requirements which have to be applied in accordance with section 315e German Commercial Code (HGB). The auditor carried out the audit in accordance with section 317 HGB considering German principles of proper auditing set by the Institute of Public Auditors in Germany (IDW) as well as for the consolidated financial statements.

The financial statement documentation of Telefónica Deutschland Holding AG and the Group, the separate non-financial declaration for Telefónica Deutschland for the financial year 2017 as well as the Management Board's proposal for the distribution of profit and the respective auditor's reports were submitted to the Supervisory Board in due time prior to the meeting on 19 February 2018 ("Bilanzsitzung"). The Audit Committee and the full Supervisory Board thoroughly examined the Annual Financial Statement (Jahresabschluss), the Group financial statements, the combined Management Report for Telefónica Deutschland Holding AG and the Group, the separate non-financial declaration, the Management Board proposal for the distribution of profit and the respective auditor´s reports and discussed the documents in detail together with the auditor on 19 February 2018.

The Supervisory Board approved the auditor's findings in the audit reports and had no objections after its own assessment.

At its meeting on 19 February 2018, the Supervisory Board approved the annual financial statements of Telefónica Deutschland Holding AG and the consolidated financial statements together with the combined management report for the 2017 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Relations to affiliated companies

The report on relations to affiliated companies (dependency report) as prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act was also audited by the auditor. With respect thereto, the auditor issued the following unqualified opinion (uneingeschränkter Bestätigungsvermerk):

"Based on our audit and assessment, which were carried out in accordance with professional standards, we confirm that

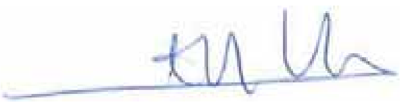
1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,

The dependency report as prepared by the management board and audited by the auditor as well as the audit report on the dependency report were submitted to the Supervisory Board in due time. Having examined the dependency report and the corresponding audit report and discussed it with the auditor, the Supervisory Board had no objections against the dependency report and the Management Board's declaration on the relations to affiliated companies contained therein after the result of its own assessment and agrees with the auditor's findings.

The Supervisory Board thanks the former Management Board member Rachel Empey and the former Supervisory Board member Ángel Vilá Boix for the excellent and cooperative collaboration. The Supervisory Board also thanks Markus Haas, Markus Rolle, Wolfgang Metze, Alfons Lösing, Valentina Daiber, Nicole Gerhardt, Guido Eidmann, Cayetano Carbajo Martín and all employees of Telefónica Deutschland Group for their dedication and excellent work in the past year. With their commitment, which in the reporting period was influenced in particular by transformation, they have contributed considerably to the success of the company."

Munich, 19 February 2018

On behalf of the Supervisory Board



Eva Castillo Sanz
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG

Corporate Governance Report

The German Corporate Governance Code establishes a standard for transparent control and management of companies. In accordance with 3.10 of the German Corporate Governance Code, the Management Board and the Supervisory Board of Telefónica Deutschland inform about Corporate Governance as follows. This Corporate Governance Report is also published together with the Management Declaration in accordance with section 315d in connection with 289f German Commercial Code (HGB) on our website at **www.telefonica.de/corporate-governance-report-2017.**

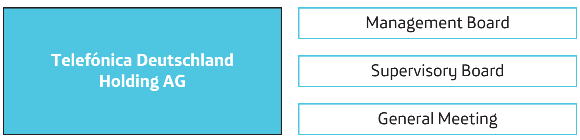
Declaration of compliance

The Management Board and Supervisory Board of Telefónica Deutschland feel committed to the principles of transparent corporate governance and regularly consider the principles of the German Corporate Governance Code. On 12/13 /14 and 17 October 2017 they last stated a declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG). The full text of the compliance declaration and its update may also be viewed on the company's website at **www.telefonica.de/declaration-of-compliance-2017**.

The company's governing bodies

As a German stock corporation, Telefónica Deutschland has three governing bodies: the general shareholders' meeting, the Supervisory Board and the Management Board. Their duties and powers are essentially determined by the German Stock Corporation Act, the Articles of Association and the by-laws of both the Management Board and the Supervisory Board.

1 / A / Management and governing bodies



German corporate law provides for a clear separation of personnel between management and controlling bodies.

The managing body is the Management Board. It manages the company in its own responsibility in the best interest of the company with the objective of sustainable value creation. The Management Board is monitored and advised by the Supervisory Board. Management Board and Supervisory Board work together closely in the interest of the welfare of the company. All transactions and decisions that are of fundamental or material importance to the company are carried out in close coordination between the Management Board and the Supervisory Board.

The Management Board informs the Supervisory Board regularly, promptly and comprehensively on all material questions regarding the company, especially on planning, business development, strategy, risk situation and risk management as well as on compliance. Furthermore, the Management Board provides the Supervisory Board with information in case deviations of plans or objectives may occur in course of conducting of business and of the reasons thereof.

Details regarding the composition and the operating principles of the Management Board, the Supervisory Board and the Supervisory Board's committees can be found in the management declaration in accordance with section 315 d in connection with 289f of the German Commercial Code (HGB) (Erklärung zur Unternehmensführung) on the Telefónica Deutschland Holding AG website under **www.telefonica.de/management-declaration-2017.**

Taking into account the German Corporate Governance Code (GCGC), Supervisory Board amended its Competence Profile on 18 December 2017 in order to ensure an even more qualified supervision of Management Board´s actions.

The Supervisory Board is to be composed in such a way that its members as a group possess the knowledge, ability and expert experience required to properly advise and supervise the Management Board. Each member of the Supervisory Board should be prepared and in a position to invest sufficient time and input and have the necessary personal qualities, in particular integrity, motivation and personality to fulfil their office. All members of the Supervisory Board shall consider responsible and ethical behaviour of a reputable business person.

In addition, each member of the Supervisory Board should have specialist knowledge in at least one of the areas relevant for advising and supervising the Management Board. The different professional backgrounds, specialist knowledge as well as the experience and lives of the members should complement each other, so that the Supervisory Board can draw upon as wide a range as possible of experience and varieties of specialist knowledge, e.g. Finance, M&A, Strategy,Marketing & Sales, Legal and Regulatory, HR, Network & Technology.

The Supervisory Board has specified concrete objectives regarding its composition (5.4.1, 2nd paragraph of the German Corporate Governance Code) considering inter alia the specifics of the company, its shareholders' structure and the company's international activities, diversity and taking into account that half of the members of the Supervisory Board are elected by the employees pursuant to German Co-Determination law. In this context, the Supervisory Board has set the following objectives regarding its composition:

— The Supervisory Board is to have at least two independent members (within the meaning of no. 5.3.2 sentence 2 and 5.4.2 German Corporate Governance Code) and should not include any persons who hold an office (e.g. at a significant competitor) which may create a material and not only temporary conflict of interest.

— At least 30 % of the members of the Supervisory Board should be female, at least 30 % male.

— At least one third of the Supervisory Board members to be elected by the General Meeting should have international working experience, knowledge of the English language as well as an understanding of global economic contexts ("internationality").

— The standard term of office of supervisory members should end with the Annual General Meeting following the supervisory board reaching 75 years of age unless an individual member´s experience is of special value to the company and the Supervisory Board has approved such exception.

— A standard limit of 15 years, i.e. three full terms of office, shall apply to members of the Supervisory Board. In the company´s best interest and upon approval by Supervisory Board, deviation from the general maximum period is possible, especially in order to fulfil other composition criteria.

In addition to the legal requirements, the Supervisory Board - taking the recommendations of the German Corporate Governance Code 2017 into account with regard to the independence - determines the following criteria for independence.

Independent members are members who:

— are not directly or indirectly employed by Telefónica Deutschland or its major shareholder or any of companies affiliated with them and / or

— do not currently hold a board function (whether executive or non-executive) at Telefónica Deutschland´s major shareholder or any of the companies affiliated with them and/ or

— do not have a material shareholding. A material shareholding in this sense means 3 % of the shares of the company and / or

— are not closely related (in the meaning of art. 3 para. 1 No. 26 of the Market Abuse Regulation) to an executive or non-executive board member of Telefónica Deutschland or its major shareholder or any of the companies affiliated and / or

— have no material relationship (e.g. commercial agreement like sales, customer/supplier, consultancy or other agreements) with Telefónica Deutschland or its major shareholder or any of the companies affiliated or its governing bodies which could constitute a (not just temporary) conflict with the best interest of the Company and / or

— are not members of governing bodies of, or exercises advisory functions at, significant competitors of the company.

In the Supervisory Board´s opinion, the number of at least two independent members of the shareholder representatives is appropriate. One of the independent members shall act as the financial expert pursuant to sec. 100 para. 5 of the German Corporation Act. The independent members of the Supervisory Board of Telefónica Deutschland Holding AG in the financial year 2017 were Michael Hoffmann and Sally Anne Ashford. Michael Hoffmann also was the independent financial expert within the Supervisory Board.

Supervisory Board is convinced that these concrete targets also reflect the shareholder structure appropriately.

Supervisory Board considers these concrete targets and the competence profile as currently met.

The abovementioned competence profile and the composition criteria form the requirements of the diversity concept to be met by the Supervisory Board, see also **www.telefonica.de/management-declaration-2017**.

Relationship to shareholders and the General Meeting

The shareholders are generally informed four times a year about the financial and earnings situation and business development.

The company provides for further information on its website **www.telefonica.de/investor-relations,** especially the financial calendar. Furthermore, analyst conferences, roadshows and meetings take place.

The shareholders exercise their rights according to the law and the Articles of Association before and during the General Meeting, especially by exercising their voting rights (amongst others on profit distribution, discharge and the election of the auditor).

Risk Management

For the management and supervisory board of Telefónica Deutschland Group, internal control and risk management are fundamental tools for the governance. The risk management department reports regularly to the management board and the audit committee on current risks, action plans and developments. Our risk management process is designed to timely identify, evaluate and mitigate company risks through constant communication with the relevant stakeholders. The risk management system is continuously improved and reviewed by the external auditor.

You may find further details in the Section “Report on Risks and Opportunities” within the Annual Financial Statement.

Compliance

Telefónica Deutschland Group is committed to comply with all laws, regulations, processes, rules and enactments applicable to its business activity. The company has a compliance department that is concerned with the implementation and optimization of the compliance organization within the whole company, the coordination of compliance activities and advises employees on their questions. The approach pursued is preventive, raising awareness and informing employees in order to preclude potential violations of rules. Employees and third parties have the possibility to report suspected breaches of law e.g. via an external whistleblower system, the Ombudsman, in a protected manner.

The compliance programme focuses on behaviours protecting fair competition, avoiding corruption and conflicts of interests as well as on ethically appropriate behaviour. These topics are covered by mandatory online trainings, as are the areas of data protection, anti-discrimination and information security. Each employee is required to complete certain mandatory training sessions in regular intervals based on his or her job responsibilities. Clear guidelines and policies were established for the most important compliance matters.

The existing Compliance Management System is continuously developed further to adjust it to the changing legal and economic conditions. The Management Board and the Supervisory Board (especially the Audit Committee in charge of monitoring internal control systems and Compliance) is informed regularly on compliance activities.

In this overall context, the company has also a Capital Market Law department in the area of the General Counsel which ensures that the insider rules are complied with (including trainings and maintaining insider lists wherein any persons who act for the company and have authorised access to insider information are registered).

Management and Supervisory Board deal with the topic compliance on a regular basis.

Transparency and communication

Telefónica Deutschland shareholders can receive information on the company´s website. This includes press releases, corporate news and ad-hoc news. The company’s Articles of Association are also published on the website.

Relevant shareholdings of Management and Supervisory Board

The members of the Management Board hold shares of Telefónica Deutschland Holding AG. No member hold options on shares of Telefónica Deutschland Holding AG.

As per 31 December 2017, the Management Board held approximately 0.0014 % of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed – if applicable – as managers´ transactions.

As per 31 December 2016, the Supervisory Board held approximately 0.0007 % of the shares of Telefónica Deutschland Holding AG. These shareholdings were obtained through the stock market and are listed – if applicable – as managers´ transactions.

Managers´ Transactions

According to sec. 19 Market Abuse Regulation persons discharging managerial responsibilities, as well as persons closely related to them are obliged to disclose transactions in shares or debt instruments of Telefónica Deutschland or other derivatives or financial instruments linked thereto if the value of these transactions reaches or exceeds EUR 5,000 per annum.

Respective declarations can be found on the Telefónica Deutschland website at **www.telefonica.de/managers-transactions**

Accounting and auditing

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft with seat in Frankfurt am Main, branch Munich, has been appointed auditor and group auditor for the financial year 2017 by resolution of the annual General Meeting on 9 May 2017.

Management Declaration

in accordance with sections 315d in connection with 289f of the German Commercial Code (HGB)

1. Declaration of compliance in accordance with section 161 of the German Stock Corporation Act (AktG)

Pursuant to section 161 of the German Stock Corporation Act (AktG), the management board and the supervisory board of a listed stock corporation are required to declare annually that the company has complied and is complying with the recommendations of the "Government Commission for the German Corporate Governance Code", as published in the official part of the Federal Gazette by the Federal Ministry of Justice, or, alternatively, are to declare which recommendations the company has not followed or does not follow and why not. The declaration shall be published permanently on the company's website.

On 12/13/ 14 and 16 October 2017, the Management Board and Supervisory Board of Telefónica Deutschland Holding AG ("Company") issued a declaration of compliance pursuant to section 161 paragraph 1 German Stock Corporation Act (AktG). The present declaration of compliance refers to German Corporate Governance Code ("GCGC") as amended on 7 February 2017, published in the Federal Gazette on 24 April 2017.

Management Board and Supervisory Board of the Company declare pursuant to sec. 161 para. 1 of the German Stock Corporation Act that since the issuance of the last compliance declaration the Company has complied, and will in the future comply, with the recommendations of the GCGC with the following exceptions:

1. While determining the total compensation, the Supervisory Board shall, according to 4.2.2, 2nd paragraph, sentence 3 GCGC, consider the relationship between the compensation of the Management Board and that of the senior management and the staff over-all, particularly in terms of its development over time whereupon the Supervisory Board shall determine how senior managers and the relevant staff are to be differentiated. With regard to the board member service agreements which have been signed in July 2014 and have become effective in October 2014 following closing of the acquisition of E-Plus, the Supervisory Board has deviated from this recommendation. Since the Company did not have, prior to closing of the acquisition of E-Plus, sufficient information regarding the remuneration structure at E-Plus, it could not consider the relationship between the compensation of the Management Board and that of the senior management and the relevant staff because this also would have required information on the remuneration structure at E-Plus. With regard to the board member service agreements that became effective on 1 January 2017 and on 1 August 2017 respectively, the above mentioned recommendation of the GCGC has been followed so that this recommendation will be fully complied with in the future.

2. The recommendation in 4.2.3, 2nd paragraph, sentence 4 GCGC that both positive and negative developments shall be taken into account with respect to the structure of the variable remuneration components has not been and will not be followed. The Management Board and the Supervisory Board are of the opinion that the remuneration of the Management Board is nevertheless oriented towards a sustainable company development. The remuneration consists of fixed as well as of short- and long-term variable components. The relevant parameters for the determination of the variable remuneration are overall oriented towards sustainable development and structured in a way that they, as a whole, do not provide incentives for business decisions which are opposed to the interests of the Company.

3. In 4.2.3, 2nd paragraph, sentence 7 the GCGC recommends that the variable remuneration components shall relate to rigorous and relevant comparison parameters. A partial deviation from such recommendation has been and will be made. The amount of the annual bonus depends to some extent also on parameters regarding Telefónica, S.A. In addition, a part of the long-term remuneration components is dependent on parameters regarding Telefónica, S.A. or may be dependent on such parameters. Furthermore, one former management board member received a share award under a restricted share plan which comprised shares of Telefónica, S.A. The Management Board and the Supervisory Board are of the opinion that no misdirected incentives are created thereby.

4. The GCGC recommends in 4.2.3, 2nd paragraph, sentence 6 that the amount of compensation shall be capped, both overall and for variable compensation components. This recommendation has been and will be partially deviated from as neither for the stock option programme nor for the so-called Deferred Bonus nor for the so-called Bonus III caps have been determined. By doing so, the Supervisory Board shall be granted the necessary room for manoeuvre to ensure the balance between short-term and long-term variable remuneration elements at any time. Furthermore, some of the board member service agreements do not provide for the exact amount of the Company's pension expenses. The Company has assumed the corresponding pension commitments from the respective Management Board member's former employer and continues them unchanged.

5. The recommendation in 4.2.3, 2nd paragraph, sentence 8 GCGC that forbids a retroactive change of performance objectives or comparison parameters has not been and will not be followed. The service contracts partially allow a retroactive change of the criteria for the variable remuneration. From the Management Board's and the Supervisory Board's view, this is necessary because the Company is active in an extremely volatile and innovative market environment, and a change of corporate strategy in the interest of a sustainable company development must also be possible within the calculation period for the variable remuneration components. Such changes of corporate strategy necessary with a view to reasonable company interests shall not be hindered or delayed as a result of monetary interests of the members of the Management Board. Thus, in particular the Supervisory Board is of the opinion that flexibility is required as to performance objectives and comparison parameters.

6. The GCGC recommends in 4.2.3, 3rd paragraph that, for pension schemes, the Supervisory Board shall establish the level of provision aimed for in each case also considering the length of time for which the individual has been a Management Board member and take into account the resulting annual and long-term expense for the Company. This recommendation has been and will be partially deviated from. There are defined contribution commitments in place for some Management Board members of the Company which do not aim at a specific pension level. Therefore, with regard to this form of the pension commitments, the Supervisory Board does not refer to an aimed level of provision, since these pension commitments have been assumed from the Management Board member's former employer.

7. The recommendation in 4.2.5, sentence 4 GCGC that the compensation report shall also include information on the nature of fringe benefits provided by the Company has been up to now only been followed partially, as the fringe benefits provided by the Company were only disclosed to the extent they were provided to all Management Board members. Where fringe benefits were only provided to individual Management Board members, these were not shown. Furthermore, the recommendation in 4.2.5 sentence 5 and 6 GCGC regarding the presentation of the remuneration of the Management Board, especially in accordance with the model schedules, has not been followed up to now. The general meeting on 5 October 2012 had resolved pursuant to sec. 286 para. 5 German Commercial Code, to dispense with disclosure of the compensation of individual Management Board members for the period of 5 years, i.e. until and including for the financial year 2016. For that period, it was thus not foreseen to comply with the presentation as recommended in 4.2.5 sentence 5 and 6 GCGC. Furthermore, Management Board and Supervisory Board took the view that the individualization involved in the disclosure of individual fringe benefits would have contradicted the resolution of the general meeting. As there was no reiteration of the "opt-out" resolution taken in this year´s general meeting, the remuneration of the Management Board will in the future be presented in accordance with 4.2.5 sentence 5 and 6 GCGC with the qualification that the information scheduled in the model tables for the previous year 2016 will be omitted due to the "opt-out" resolution being still in force for that period.

8. Pursuant to 5.4.1, 2nd paragraph GCGC the Supervisory Board shall specify concrete objectives regarding its composition, considering inter alia within the framework of the specific situation of the Company an age limit and a regular limit of length of membership appropriately. Supervisory Board has resolved on concrete objectives regarding its composition, however so far without either specifying a concrete objective regarding an age limit for Supervisory Board members or a general limit of length of membership to the Supervisory Board. In the view of the Supervisory Board, the ability to control and supervise the Management Board is not necessarily restricted by reaching a certain age and the possibility to build on long-time expertise of individual members in the Supervisory Board may serve the Company´s interest to a greater extent. In order to meet the requirements of the GCGC regarding the specification of concrete criteria for its composition in future, Supervisory Board determined a standard age limit for members of the Supervisory Board as well as a standard limit of membership to the Supervisory Board to be applied in principle, following intense discussions in early October and taking into account the specific corporate situation of the Company, thus ensuring future compliance with this recommendation.

9. Notwithstanding the recommendation in 5.4.6, 1st paragraph, sentence 2 GCGC that the chair and membership in committees is also to be taken into account in the compensation of the Supervisory Board members, only the chair of the audit committee receives an additional compensation. The Company takes the view that this reasonably takes into account the current composition of the Supervisory Board.

This Compliance Declaration and previous declarations of compliance are available on the company's website for 2017 at **www.telefonica.de/declaration-of-compliance-2017**.

2. Relevant disclosures of management practices

Telefónica Deutschland Holding AG and its administrative bodies are committed to efficient, sustainable and transparent corporate management as well as to values that form the basis of common business principles described in the company's code of ethics called "Our business principles". This code includes various fundamental principles and guidelines aimed to direct both management and employees in their daily work. It provides valuable help, particularly with respect to business situations in which legal and/or ethical conflicts of interest arise so that decisions can be taken with integrity and professionalism, both in the design and implementation of work processes and in the manner in which the company interacts with customers, shareholders, employees, suppliers and other stakeholders.

The company's business principles are available on the company's web site at **www.telefonica.de/geschaeftsgrundsaetze.**

Compliance with the business principles is of eminent significance since the company's reputation is built on and affected by decisions and actions taken by its administrative bodies and employees. It is therefore carefully monitored by means of close cooperation between the functions Compliance, Human Resources, Internal Audit, Corporate Responsibility and Legal.

The company's compliance programme includes the main areas of anti-corruption with clear guidelines and procedures, competition law and the avoidance of ethically inappropriate behaviour. Employees and third parties have the possibility to report potential breaches of law - especially indications of corruption) in a protected manner e.g., within an external whistle-blower system **(www.telefonica.de/ombudsmann).**

In the financial year 2017, the company's Data Protection Officer monitors compliance with data protection legislation. This is a top priority for the company. The functions compliance, data protection, company security and internal audit form – as does the legal department – part of the department General Counsel which reports directly to the Management Board.

Further details regarding the compliance organization of the company are explained in the Corporate Governance Report which forms part of the Annual Report and is also available on the web site of the company at **www.telefonica.de/corporate-governance-report-2017**.

3. Composition and working procedures of the Management Board, Supervisory Board and the Supervisory Board's Committees

In the beginning of the financial year 2017, there were two members of the Management Board of Telefónica Deutschland Holding AG (Markus Haas, CEO (Vorstandsvorsitzender) and Rachel Empey; CFO (Finanzvorstand)). Since 1 August 2017, the Management Board consists of eight members, Markus Haas, CEO, Markus Rolle, CFO, Wolfgang Metze (Chief Consumer Officer), Alfons Lösing (Chief Partner and Business Officer), Cayetano Carbajo Martín (Chief Technology Officer), Valentina Daiber (Chief Officer Legal and Corporate Affairs) and Nicole Gerhardt (Chief Human Resources Officer and Labour Director "Arbeitsdirektor").

The Supervisory Board determined in 2015 in accordance with section 111 paragraph 5 German Stock Corporation Act (AktG) a gender diversity quota of at least 20 % for the Management Board. This quota was effective until December 2017 and was exceeded throughout, in December 2017 Supervisory Board resolved on a quota of 25%, to be met by 30 June 2022:

Until 30 July 2017, 50% of the members of the Management Board were female (one member of the two member Management Board was female). Since 1 August 2017, the share of female members is 25% (with Nicole Gerhardt and Valentina Daiber two members of the eight member Management Board are female).

Considering the abovementioned minimum gender quota and taking into account the age limit in the Management Board service agreements, the company aims at competencies, skills and experience complementing each other in the best interest of the company for the administration.

In accordance with its business principles, the company has committed explicitly to diversity and equal opportunities in the company. Supervisory Board and Management Board are convinced that diversity sustainably serves the company´s best interest. The Diversity Concept for the Management Board consists of the following diversity criteria detailed pursuant to sect. 289f para 2 No. 6 Commercial Code (HGB).

Members of Management Board shall especially provide longstanding leadership from different areas relevant to the company. At least one member shall have international work or educational experience and the Management Board as a body shall have longstanding experience in telecommunications, finance, sales and staff management.

The target for a minimum quota for male and female members in the board is 25%.

Such targets shall be considered by Supervisory Board for appointment and succession planning of members of Management Board.

The targets have been met since the beginning of the financial year 2017 and are currently being met as may be verified via the Curricula vitae of the members of the Management Board published on the company´s website under **www.telefonica.de/management-board**. The 30 % minimum gender quota for the male and female share of the leadership level Reporting Level 1 (Berichtsebene 1) determined by Management Board is also part of the sustainable diversity strategy.

In accordance with section 76 para. 4 of the German Stock Corporation Act (AktG), the Management Board had set goals for the female quota of the two levels below the Management Board in 2015 voluntarily. The minimum gender diversity quota which had to be fulfilled until 30 June 2017 was determined at 16 %. On 30 June 2017, the quota fell short of the target, the share of female members was 8% for the first management level and 13% for the second management level. The diversity strategy and measures introduced in 2013 already did not show the desired effect, thus the quota could not be met. Nevertheless, the Management Board still pursues the target to promote diversity in the Telefónica Deutschland group and thus has determined a new quota of 30 % for female and male share in management, to be met by 30 June 2022. This target shall be achieved by the company´s new diversity strategy introduced on 1 January 2018. Due to organisational changes after the restructuring of the Management Board the relevant management level has now been defined as Reporting Level 1 (Berichtsebene 1).On 31 December 2017 the share of female members of this group was 13 %.

The Management Board in its own responsibility manages the company's business with the objective of creating sustainable value in the company's interest, taking into consideration the interests of its shareholders, employees and other stakeholders of the company. The work of the Management Board is governed in particular by the by-laws of the Management Board enacted with Supervisory Board approval and by the company's Articles of Association. The Management Board develops the strategic direction of the company, coordinating this regularly with the Supervisory Board, and also ensures its implementation.

Each Management Board member is responsible for managing the area of business allocated to it, but without prejudice to their joint responsibility for managing the company as a whole. All matters of fundamental or material importance for the company and/or its affiliates, in particular matters regarding organization, company policy, investment and financial planning as well as all investments significantly exceeding the annual budget approved by the Supervisory Board have to be decided by the entire Management Board. Furthermore, every Management Board member can submit matters to the full board for decision. Transactions and measures of particular significance are also subject to the prior approval by the Supervisory Board.

Management Board meetings are held regularly, generally once per week. Meetings may also be held by phone or video conference. Resolutions of the Management Board may also be passed outside of meetings, in particular in writing, by fax, phone or e-mail.

The Management Board reports regularly to the Supervisory Board on the company's course of business, inter alia by providing the Supervisory Board with written reports each month covering key performance indicators for the company's business. Moreover, the Management Board must report to the Supervisory Board any transactions of possible material significance to the company's profitability or liquidity. Finally, the Management Board must report to the Supervisory Board any important events or affairs subject to section 90 para. 1 sentence 3 of the German Stock Corporation Act (AktG). The Management Board performs these measures as required by law.

The Supervisory Board consists of sixteen members, eight shareholder and eight employee representatives. Ángel Vilá Boix left the Supervisory Board of Telefonica Deutschland Holding AG with effect of 4 October 2017. Julio Linares López was appointed as his successor by the relevant court with resolution dated 16 October 2017.

The current members of the Supervisory Board are: Chairperson Eva Castillo Sanz, Deputy Chairperson Christoph Braun and the Supervisory Board Members Julio Linares López, Laura Abasolo García de Baquedano, Peter Erskine, Patricia Cobián González, Michael Hoffmann, Sally Anne Ashford, Enrique Medina Malo, Marcus Thurand, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Thomas Pfeil, Christoph Heil, and Claudia Weber.

The Supervisory Board consists of five female and eleven male members (i.e. 31.25% female and 68.75 % of male members). Therewith the requirements of section 96 para. 2 German Stock Corporation Act (AktG) as also determined by the Supervisory Board (30 % minimum gender diversity quota) are fulfilled.

Supervisory Board is convinced that diversity is an important factor to enable its monitoring and steering responsibilities in the best interest of the company.

In accordance with the company´s business principles Supervisory Board has committed explicitly to diversity and equal opportunities in the company. Supervisory Board is convinced that diversity sustainably serves the company´s best interest. The criteria of the Diversity Concept for the Supervisory Board required by sect. 289f para 2 No. 6 Commercial Code (HGB) consist of the competence profile and the composition criteria of the Supervisory Board. Supervisory Board is of the opinion that these criteria ensure the diversity serving the best interest of the company. Details of the competence profile and the composition criteria are described in the Corporate Governance Report, published on the company´s intranet site under **www.telefonica.de/corporate-governance-report-2017**.

The Nomination Committee and the Supervisory Board as a whole consider competence profile and composition criteria from an early stage when recommending candidates to the General Meeting and thus implement the diversity concept of the Supervisory Board.

The requirements defined by the Diversity Concept have been met since the beginning of the financial year 2017 and are still being met as evidenced by the Curricula Vitae of the Supervisory Board members detailing professional and personal backgrounds including current mandates, published under **www.telefonica.de/supervisory-board**.

The Supervisory Board advises and monitors the Management Board in the management of the company on an ongoing basis and must be consulted in all matters outside the ordinary course of business which are of particular importance to the company. The Supervisory Board appoints and dismisses the members of the Management Board and determines the remuneration of the Management Board. The Supervisory Board Chairperson coordinates the activities of the Supervisory Board and cooperation with the Management Board. The principles governing the work of the Supervisory Board and its cooperation with the Management Board are essentially described in the by-laws for the Supervisory Board and in the company's Articles of Association.

The Supervisory Board holds at least two meetings in a calendar half-year. Meetings of the Supervisory Board may also be held by telephone or video conference, and resolutions of the Supervisory Board may also be passed outside of meetings, in particular in writing, by fax, phone or e-mail.

The Supervisory Board reviews the efficiency of its activities at least once a year, thus also in 2017.

Composition and work of the committees of the Supervisory Board

In order for the Supervisory Board to carry out its tasks in an optimal manner, there are currently four committees of the Supervisory Board. The Supervisory Board can implement further committees if necessary. The Supervisory Board receives regular reports on the work of the committees.

The Audit Committee is responsible for preparing the decision of the Supervisory Board regarding the approval of the financial statements, discussing the quarterly and half-year reports with the Management Board, monitoring the accounting processes and internal control systems (including compliance, risk management and internal audit systems) and the auditor's review of the financial statements. It furthermore is responsible for the coordination with the auditor. Currently, the audit committee consists of the following members:

- Michael Hoffmann (Chairperson)
- Laura Abasolo García de Baquedano
- Thomas Pfeil and
- Christoph Heil.

The Nomination Committee is responsible for proposing suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González was elected chairperson of the nomination committee. Further members are Eva Castillo Sanz and Enrique Medina Malo.

The Mediation Committee with the responsibilities as defined in section 31 Co-Determination Act (MitbestG) consists of the following members:

- Eva Castillo Sanz (Chairperson)
- Christoph Braun

- Julio Linares López (since 13 December 2017) and
- Marcus Thurand.

Ángel Vilá Boix belonged to the Mediation Committee until 4 October 2017.

The members of the Remuneration Committee are:

- Sally Ashford (Chairperson)
- Eva Castillo Sanz
- Claudia Weber
- Dr. Jan-Erik Walter

More details on the composition and work of the Committees of the Supervisory Board are provided in the Supervisory Board Report.

9 February 2018

Management Board Supervisory Board

Glossary

The glossary also contains abbreviations as used in the Group Management Report.

Advanced Data Analytics (ADA)	Data analytics for optimising day-to-day business as well as for the development of new products and services
AktG	Aktiengesetz (German Stock Corporation Act)
ARPU	Average Revenue per User
BEREC	Body of European Regulators for Electronic Communication
Bitkom	German Federal Association for Information Technology, Telecommunications and New Media
BMWi	German Federal Ministry for Economic Affairs and Energy
BNetzA	Bundesnetzagentur
bp	Basis points
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
Brexit	British Exit –act of leaving by the United Kingdom from the European Union
CapEx	Capital expenditures: additions to property, plant and equipment and intangible assets excluding investments in licences for mobile phone frequency usage rights
Carrier	Telecommunication network operator authorized by the federal network agency
CF	Cashflow
cloud services	A dynamic infrastructure, software and platform services, which are available online
DRS	German Accounting Standard
DSL	Digital Subscriber Line: technology to transmit data in the local loop to private end-customers
EIB	European Investment Bank
EU	European Union
Euribor	Euro Interbank Offered Rate
ExComm	Executive Committee
FCF	Free Cashflow
FTE	Full-time equivalent
FTR	Fixed network Termination Rates
FttB	Fiber To The Building or Fiber To The Basement. In telecommunications FttB means that the fiber-optic cable is terminated in the user's house (basement).
FttH	Fiber to the Home. In telecommunications FttH means that the fiber-optic cable is terminated right in the user's home or apartment.
FTTX	This includes the options for fiber-optic roll-out: FttB and FttH.
GCGC	German Corporate Governance Code
GHz	Gigahertz
GSM	Global System for Mobile Communications
GSMA	Global System for Mobile Communications Association
GWh	Gigawatt hours
HGB	Handelsgesetzbuch (German Commercial Code)

IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
ICS	Internal control system
IMEI	International Mobile Equipment Identity
IoT	Internet of Things
ISIN	International Securities Identification Number
IT	Information Technology
Joint Venture	Two or more companies founding a new enterprise for cooperation
KPI	Key Performance Indicator
KPN	Koninklijke KPN N.V., The Hague, Netherlands
Leaver Program	Severance payment program for the planned downsizing in the context of the merger of E-Plus
LTE	Long Term Evolution: further development of the UMTS/HSPA mobile communications standard
LTM	Last 12 months
M2M	Machine-to-Machine communication, automatic exchange of information between machines
MBA	Mobile Bitstream Access
Mbit	Megabit
MHz	Megahertz
MSR	Mobile service revenue
MTR	Mobile termination rates
MVNO	Mobile Virtual Network Operator
Net Adds	New customers for the period less those customers leaving are designated as net additional customers
O2 (Europe) Limited	O2 (Europe) Limited, Slough, United Kingdom
O_2 Free	The “O_2 Free” data plan allows customers to remain online with speeds of up to 1 Mbit/s even after they have used all of their high-speed data
O_2 My Handy	Monthly payment model for mobile phones and other devices
OIBDA	Operating Income before Depreciation and Amortization
Opex	Operating expenses
OTT	Over The Top
OTT services	Over-the-top- services (e.g. WhatsApp, Facebook)
PIP	Performance and Investment Plan
Prepaid/Postpaid	In contrast to postpaid contracts, prepaid communication services are services for which credit has been purchased in advance with no fixed-term contractual obligations
pureLRIC	Pure Long Run Incremental Costs – Benchmark to regulate costs associated with interconnection fees
RCF	Revolving Credit Facility
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
Smartphone	Mobile handset that can be used as a wireless phone, a web browser, and an e-mail reader simultaneously
smart TV	A television set with integrated computer functions

smart watch	A mobile device which consists of a electronic watch with additional computer functions, attached to a bracelet
SME	Small- and Medium-sized Enterprises
SMS	Short Message Service
SoHos	Small offices/Home offices
Tablet	A wireless, portable personal computer with a touch screen interface
Telefónica Deutschland	Telefónica Deutschland Holding AG, Munich
Telefónica, S.A.	Telefónica S.A., Madrid/Spain
Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telefónica NEXT	Telefónica Germany Next GmbH, Munich
Telxius S.A.	Telxius Telecom S.A., the infrastructure entity of Telefónica
TKG	Telekommunikationsgesetz (Telecommunications Act)
TSM-R	Telecom single market regulation
ULL	Unbundled Local Loop: bridges the distance between the local exchange and the termination point on the customer's premises or in their home, so it is also known as the "last mile"
UMTS	Universal Mobile Telecommunications Service: international mobile communications standard of the third generation which unites mobile multimedia and telematics service under the frequency spectrum of 2GHz.
VATM	Association of Telecommunications and Value-Added Service Providers
VDSL	Very High Data Rate Digital Subscriber Line (see DSL)
Vectoring	Vectoring is a noise-cancelling technology that removes the electro-magnetic interference between lines, enabling higher bit rates
VZBV	Federation of German Consumer Organisations
Wearables	Wearable computers or wearables are miniature electronic devices that are worn under, with, or on top of clothing
Wholesale	Selling services to third parties who sell them to their own end customers either directly or after further processing

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