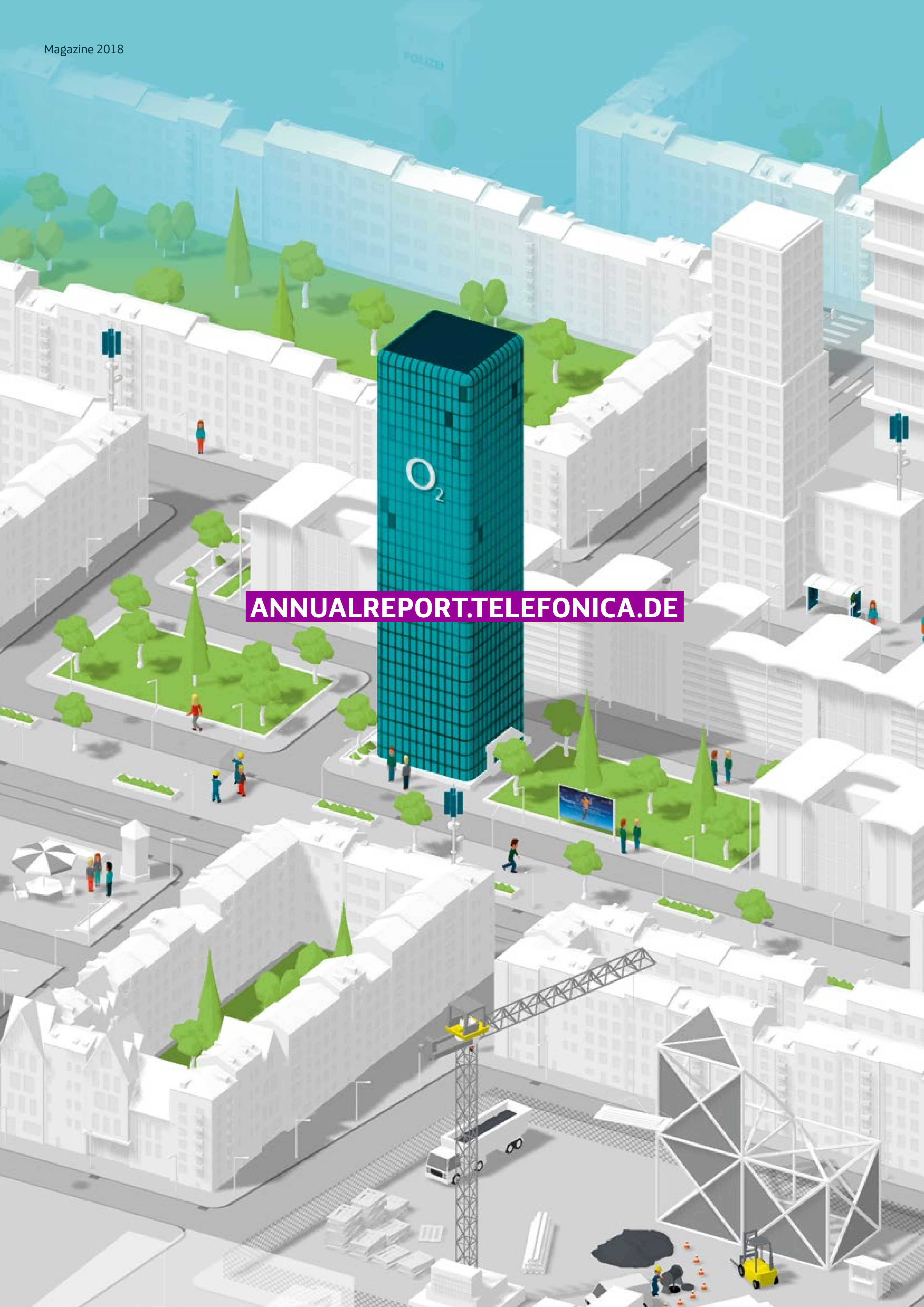
Telefónica Deutschland

DIGITAL CROSS ROADS

MAGAZINE 2018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Now more than ever, even in a period of growing digitalisation, the customer stands at the heart of our business activity. Our ongoing organisational transformation incorporates this approach and is an important step on our road to becoming a “Mobile Customer & Digital Champion”. We have the needs of not only consumers and business customers, but also industry and partners, as well as our own employees in view. At the same time, there are social issues on the possibilities and challenges of digitisation to answer. We are up to the challenge to create the optimal route into the digital future for our society and our partners. As such, we embark on this road to the future – our DIGITAL XROADS – together.

Discover our DIGITAL XROADS online!

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DIGITAL XROADS

"Mobile communication has never been as important as it is today. The heated debate over mobile communications in Germany has been particularly indicative of this. Consequently, we at Telefónica Deutschland must rise to the challenge. That is why we strive daily to become a 'Mobile Customer & Digital Champion' and our freedom campaign was a key milestone on our journey towards this goal last year. With our new unlimited plans and real mobile solutions, we are on the road to successfully realizing our vision of mobile freedom for private and business customers.

In addition to this idea of freedom, we are placing customer needs at the heart of our business activities with our digital transformation programme 'Digital4Growth'. Herein lies our ambition: to make the company a little bit simpler, faster and better every day. To achieve this, we are increasingly digitalising and simplifying our processes so that we can make our customer's everyday dealings with us even more straightforward. At the same time, we have upgraded over 6,700 LTE stations over the last few years – at a much faster rate and to a greater extent than any other provider in Germany. We will vigorously pursue expansion of the 4G network, further improve customer experience and make our network increasingly fit for the upcoming 5G network standard."

MARKUS HAAS

Chief Executive Officer (CEO)

"Mobile communication has never been as important as it is today. At Telefónica Deutschland, we take our responsibility in this area seriously."

"Our goal is to become a 'Mobile Customer & Digital Champion' by 2022. Clear goals and comprehensive measures are vital to achieving this. The same also applies financially: among other things, we have set out to earn around an additional EUR 600 million in gross profit by this date.

Right at the beginning of last year, we paved the way for the future of Telefónica Deutschland with our Capital Market Day. In addition, we initiated the first measures last year, which will deliver successive returns as early as 2019. We have also completed the integration of Telefónica and E-Plus during the year and realized more than 90 percent of our synergy targets. As in the previous three years, we continued to steadily beat OIBDA quarter after quarter in 2018 (before adjustments for one-off or regulatory effects) in comparison with previous years. In essence, the main challenge now lies in translating customers' continuous data growth into revenue and rising profits, especially with the increasing sale of high-volume plans."

MARKUS ROLLE

Chief Financial Officer (CFO)

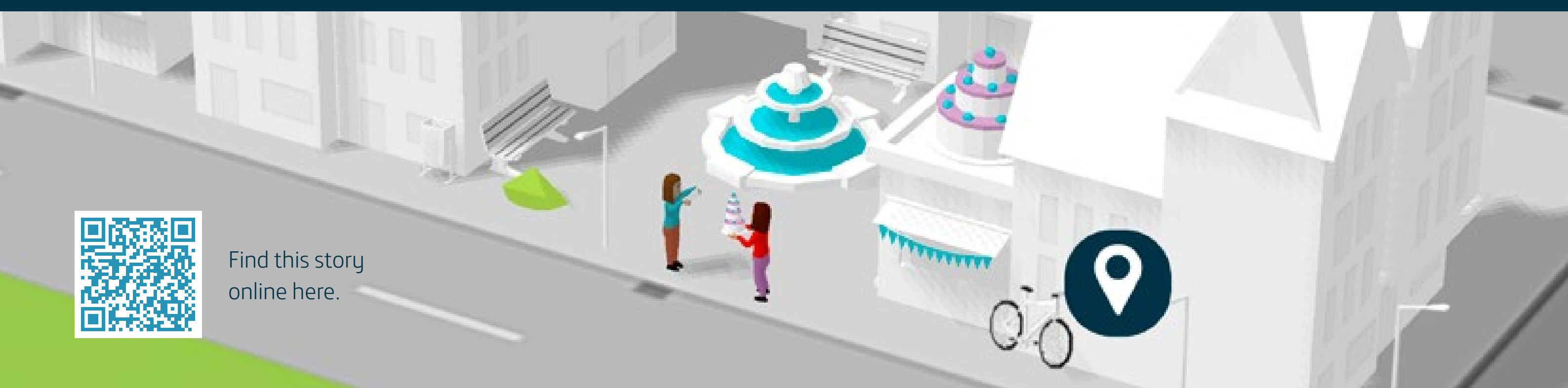
"Right from the beginning of last year, we paved the way for the future of Telefónica Deutschland with our Capital Market Day."

CONNECTION

Mobile freedom – handmade for me

In recent years, the topic of mobile communications has become an integral part of individual lifestyles and a factor of commercial success in the centre of society. This is especially demonstrated by user behaviour and ever-growing data usage. Another strong indicator is the fierce debates on frequency usage rights, competition, cost of mobile communications and the elimination of dead zones.

Increasing numbers of mobile devices besides smart phones – such as tablets, smart watches or tracking devices – are part and parcel of people's everyday life. More and more mobile music and videos are being streamed, emails read, and smart homes managed via mobile devices. People want to harness the possibilities of the digital world without restrictions and wish for simple and fast solutions. The trend towards increased data usage and more devices opens up great growth opportunities for Telefónica Deutschland: Mobile data usage in Germany is currently growing exponentially. In 2018, the volume of data transmitted over German mobile networks totalled approximately 1.39 billion gigabytes. Telefónica Deutschland recorded a data volume surge of over 50 percent. The number of LTE data users increased compared to the previous year by 9.4 percent to a total of 17.2 million users. How will this trend continue? How are user needs changing? And how does this impact Telefónica Deutschland as a provider? One thing's for certain: Freedom and autonomy are becoming increasingly important to customers and Telefónica aims to be a strong partner at their side.



Find this story online here.

"If that isn't freedom, what is?"

Nina Eglinsky, owner of Moments Bakery

If someone had told Nina a year ago where she and her mother Natascha would be today, she would never have believed it. Since becoming self-employed and documenting the journey through stories on her Instagram account, business has been growing rapidly for the small cupcake maker. The endearing mother-daughter duo share their baking creations, events outside the bakery and spontaneous dance interludes with their followers – with great results!

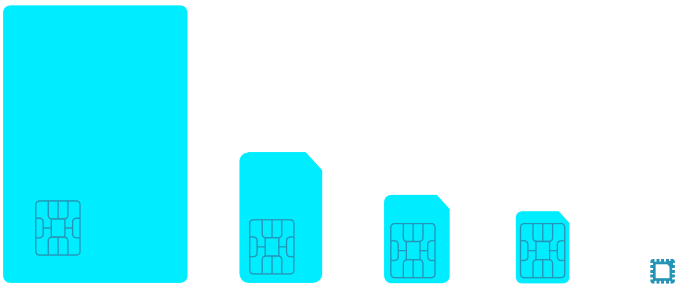
And mobile freedom is not just important to Nina professionally. Whether on her morning run or meeting up with friends; mobile devices enable her to organise her daily life and stay connected for as long as she wants.

The world of the eSIM

Telefónica Deutschland is taking advantage of the launch of eSIM to enhance customers' digital experience. Ordering and downloading eSIM profiles through the online channels of all Telefónica brands is designed to be as simple as possible for customers.

The eSIM is a digital SIM card that can be externally programmed and customised through a QR code. Various SIM profiles can be saved, activated and deactivated on the chip. As a result, an existing contract can be transferred via eSIM to a new device or a new smart phone plan can be added. With the eSIM, for example, the smart watch can take on the core functions of a smart phone – making phone calls, using the internet for streaming, or messaging – and thus keep the phone at home

SIM CARD EVOLUTION



SIM Mini SIM Micro SIM Nano SIM eSIM

AGUSTIN MACARRO

eSIM Lead Project Manager

"We have completely digitised the process of supplying SIM carts with the introduction of the eSIM. This enables us to save on logistical costs. At the same time, we are speeding up the process considerably and improving the customer experience of activating new devices."

"Because the eSIM is digital, the customer can connect their mobile devices to our network as quickly and effortlessly as using Wi-Fi at home. We offer attractive eSIM-ready smart phones and smart watches and the O_2 Connection Option on the O_2 Free plans allows up to ten eSIM profiles or SIM cards to be used as part of one contract with one data volume."

ANDREAS JOCHUMS

Senior Product Manager Post paid, private customers

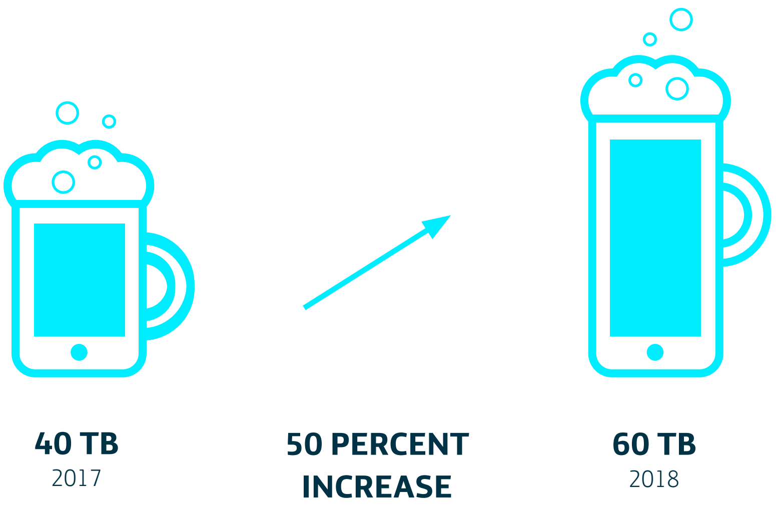
STEFAN ZIGA

Solution Architect, Network Technology

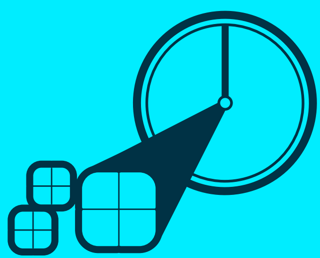
"We are working very closely with device manufacturers to ensure that our eSIM profiles can be operated on all of our customers' devices. Together we are performing extensive testing since the SIM card order process will be more closely integrated with the devices in the future."

A digital look at Oktoberfest 2018

Telefónica Deutschland customers consumed more data than ever before at Oktoberfest 2018. At the same time, they benefitted from a reliable and high-performance O_2 network.

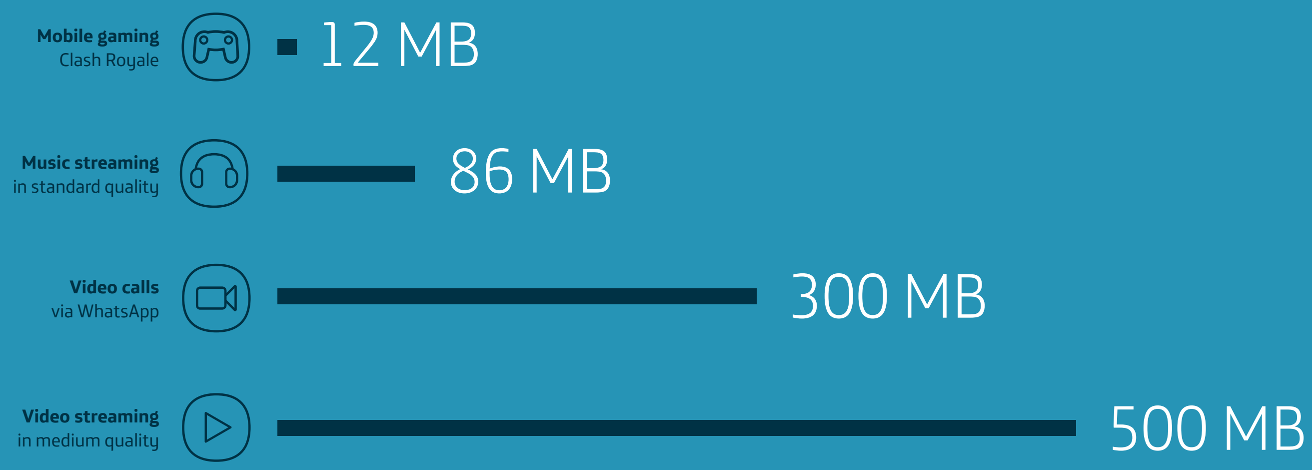


During the period of peak data usage, (6 October 2018, 6–7 p.m.), 557 GB of data was consumed. That's more than the amount used during the whole of Oktoberfest 2010.



What consumes so much data volume per hour?

What do mobile gaming, music streaming and video calls have in common? They all consume data. However, the volumes of data required for each varies greatly. The following chart shows data usage according to different applications, for example, music streaming consumes 12 times more data than mobile games do.



What do you use mobile data for?

Are you a multimedia and communication power user or are you more of a lurker? Let your usage behaviour be assessed online and find out how techno trendy you are. Simply use this QR code.

BIG DATA

The great togetherness

What increasingly looks more and more complex for outsiders can actually make many day-to-day things easier: Big Data. Massive, exponentially growing data streams open up a multitude of new opportunities. That's because the analysis of anonymised mobile communications data creates substantial value for the economy, society and ultimately for the consumer. Improved offer for local public transport? More security at major events? Less traffic congestion and emissions? All this is possible. Data analysis enables many things to become more predictable and thereby more efficient. And what is predictable guarantees more safety and reliability – for all.

Telefónica Deutschland is actively shaping these market developments and is exploiting Big Data's enormous growth prospects. Mobile communications data from everyday network use is processed anonymously and important insights are extrapolated from this data for the entire population. At the same time, however, Telefónica is committed to ensuring our customers' data sovereignty and their freedom to shape their own digital lives. Informing every decision are the company's most important guiding principles: data protection, innovation and transparency.

You can find this story online here.

"For me, being able to use movement flows to create security concepts is a real added value for the carnival."

Jacques Tilly, sculptor

The Rhineland carnival attracts over one million visitors every year to the strongholds of Düsseldorf and Cologne. The artist Jacques Tilly is, among other things, one of the many reasons why the Rose Monday parade in Düsseldorf is so well loved. Every year the famous float builder designs and builds the colourful, often politically satirical floats, which enjoy a wide reach through TV broadcasts and shares on social media. Many revellers want to experience these works of art live and in the flesh, which is why the city and its associates are working on sophisticated security and traffic concepts. In an interview with Alexander Lange, Head of Transport Analytics at Telefónica NEXT, Sven Gerling from the Düsseldorf Carnival Committee learns to what extent anonymised mobile communications data can influence and enhance these concepts.

Data protection at Telefónica Deutschland

Our pledge

We are committed to ensuring our customers' data sovereignty and their freedom to shape their own digital lives. We therefore protect all data in our products, processes and systems and ensure that Telefónica Deutschland's business activities conform to data protection regulations. Our practices are simplified and transparent and we share information with all relevant interest groups at an early stage.

Our guiding principles

Autonomy: Personal data belongs to our customers. Telefónica Deutschland handles this data responsibly and commits to enabling customers to retain data sovereignty.

Transparency: Telefónica Deutschland's communicates transparently how and why personal data is used.

Data protection: Telefónica Deutschland protects personal data in processes, products and systems using technical and organisational measures. Service providers also abide fully with legal standards. Data may only be passed on to third parties with express consent or legal permission. We only use anonymised and consolidated data when evaluating data for statistical analyses. In these cases, it is impossible to trace personal data.

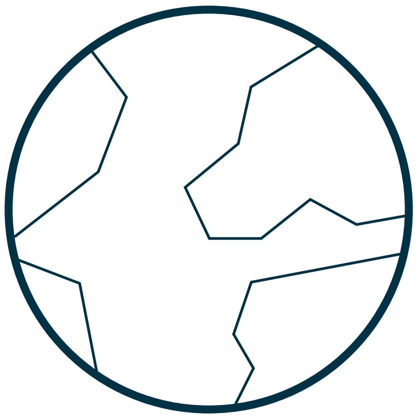
Innovation: Telefónica Deutschland shares information with regulatory authorities, legislators and other stakeholders at an early stage. In addition, the company also actively participates in the debate on data protection in the digital world. When developing new products and services, we observe and establish data protection frameworks as well as privacy-friendly designs and settings.

Why use anonymised data?

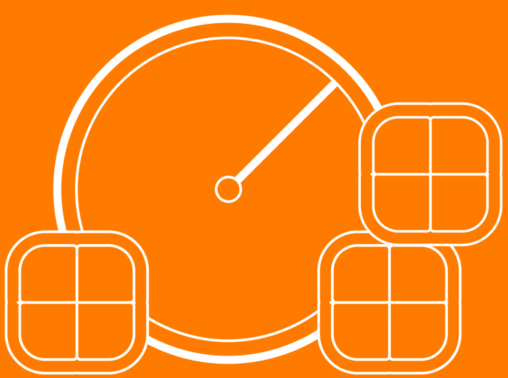
Telefónica calculates movement flows from anonymised data. Intelligently linked, this data provides important insights that are relevant for companies from various industries as well as for municipalities, public transport companies and society as a whole. Telefónica Deutschland's anonymisation procedure, which is TÜV-certified (German association for technical inspection), protects customers' privacy and prevents data from being traced back to a specific person.

Big data in numbers

That's 100 times the distance between Earth and the Moon.

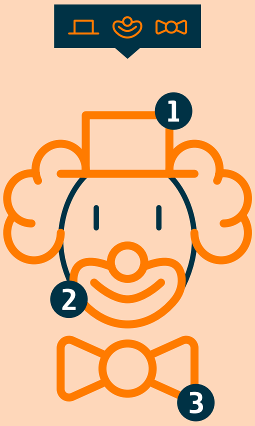


Every day we generate **2,500,000,000,000,000,000** bytes of data (2.5 quintillion).
That's equivalent to 488,000,000,000,000 DIN standard A4-sized printed pages, which would tower at 39 million kilometres if stacked together.



In 1992, 0.002 GB of data was created per second. In 2018, this figure is **50,000 GB per second**, which is a 25,000,000-fold increase.

How does the anonymisation of mobile data work?



Take a look at this reveller
He has particular characteristics on Rose Monday. Taken together, individual characteristics result in a unique data set.

Segmentation
However, there isn't just one carnival-goer out and about on Rose Monday. Data sets for all revellers are segmented into their smallest possible components and separated from any personally identifying information. Only matching components are consolidated and securely stored in various locations.

Transformation
Identifying characteristics are generalised, altered slightly with random changes or even discarded. The orange hat turns blue, for example. This makes it impossible for the information to be traced to a particular person.

Aggregation and extrapolation
If similar characteristics of a large group can be collated, then the data gathered from mobile communications can be projected onto the whole population. Valuable insights can be extrapolated from these statistics. The carnival-goers we met at the start can no longer be identified in the statistics.

[1] **DAP** Data Anonymization Platform

Carnival in the Rhineland – show case

Düsseldorf and Cologne's traffic and security concepts need to take account of hundreds of thousands of excited revellers in attendance on the crazily busy carnival days. But where are the attendees coming from? Where are they staying? And when will it all start to die down? The Rhineland show case clearly shows how and where people move around at carnival.

NETWORK AND IOT

The next generation

Fast data connections are increasingly becoming the lifelines of business, society and consumers. High-speed mobile communications are key technologies for our economy, especially for Industry 4.0, the Internet of Things, and autonomous driving. They guarantee economic growth and prosperity for an industrialised nation. The new communication standard, 5G, is already on everybody's lips in Germany, far in advance of its launch. However, the current 4G network technology can service the vast majority of digital application areas. In any case, the 5G performance features will hardly be noticeable on smart phones in current and foreseeable usage scenarios; key technology for end customers remains LTE for the time being.

The mainstream launch of 5G in Germany depends not only on the planned spectrum auction but also on the mass availability of system technology and end devices. As one of the three major mobile network operators, Telefónica Deutschland is increasingly in the focus of public interest here. The focus is on the comprehensive supply of the country and all mobile phone users with a future-proof infrastructure. That is why Telefónica is already preparing intensively for the planned market launch, which experts do not expect before 2020. The company is conducting research in this field with partners and is pushing ahead with the connection of its network locations by fibre optic with increasing intensity. As the leading provider in the private customer segment, Telefónica firmly places individual customer needs at the heart of its operation. That's because what really counts is what our customers actually need and request.

You can find this story online here.

“We are laying the foundation with our LTE expansion in the area and comprehensive 5G-pilot projects.”

Benedikt Ritter, Regional Head of Direct Sales for the South and South West at Telefónica Deutschland

Growing global trade creates increased criminality, which is reflected in the product piracy industry. Dr Carsten Frey and her company Logistics Arts are committed to tackling counterfeit medicines, foodstuffs and machinery components. Using RFID clips and chemical markers, the integrity of the carriers can be verified in order to ensure they are tamper-proof. In order to transmit the data across Germany, a LTE expansion in the area and smart IoT solutions are required.

5G – the future of mobile

“We want to continue to improve our customers’ smart phone experience even more in the future. The first step towards this is increased capacity and higher data rates. This is where 5G plays a role. However, we are initially carrying out real-world tests for industry as part of various 5G-pilot projects.”

WOLFGANG WIDDER

Senior Lead Access Engineering, Network Technology

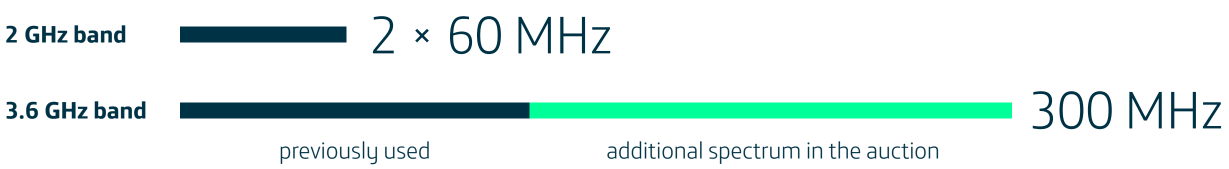
VERENA BRAUCHLE

Product Manager, private customers

“Until 5G-ready devices enter the mass market, we are offering great service for our customers with LTE. With O_2 Connect you can use up to 10 mobile devices with the same number and data capacity, for example.”

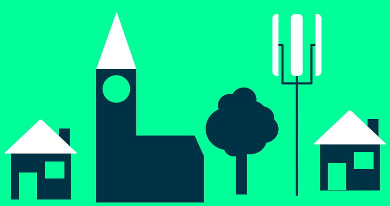
Spectrum auction in brief

The scheduled spectrum auction is awarding spectra in the 2 GHz and 3.6 GHz bands. These frequencies are expected to be used for 5G in the future. As with all frequencies over 1 GHz, they are particularly suitable for providing a high network capacity, especially in smaller areas with many inhabitants. A wide network coverage for large regions can be secured with frequencies under 1 GHz, which currently, however, is not available for new allocation.



More than double the amount previously used is therefore awarded in the 3.6 GHz band.

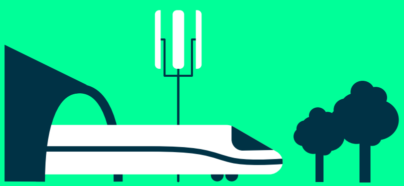
The allocation of frequencies is conditional.
These disputed conditions include the commitment to upgrade:



white spots

national motorways and main roads

You can find all the details about the conditions for supply online.



railways

ports and waterways

As of November 2018;
Source: Bundesnetzagentur
(German Federal Network Agency)

Digital dimensions

Whether you're looking at cyber security, social research or social commitment, the digital world is diverse. Telefónica Deutschland deals with a multitude of topics within its area of responsibility that go beyond mobile communications.

According to a study carried out by Telefónica Deutschland, the boundary between mobile and landline is blurring.

59%

of the population no longer differentiate between using the Internet on the go or from home.

Telefónica BASECAMP – where digitalisation is discussed

In collaboration with Tagesspiegel, Berlin's top newspaper, the "Data Debates" series of events was launched in 2017 at Telefónica BASECAMP, the main hub for the future of digital living. This is where the pioneers and rebellious thinkers of the digital world will find a stage. The monthly events debate topics such as data protection challenges in the time of increasing digitalisation and were supported by representatives from politics, business and society.

Project xMND – public transport of the future

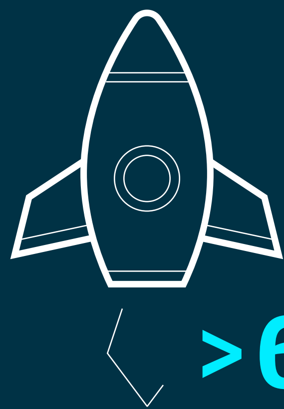
The Extended Mobile Network Data project (xMND) addresses the question of how local public transport can be made sustainable and efficient. Telefónica NEXT and other project partners are collecting data on passenger movement streams in Leipzig and the Lippe district and using the insights from this knowledge to optimise local public transport. The objective is to make local public transport more comfortable and give passengers more precise information and clearer offers.

Telefónica Volunteering Day 2018

Telefónica employees show social commitment and swap their devices for a different set of tools. Over 20,000 Telefónica employees all over the world took part in the Telefónica Group's Corporate Volunteering Day on 19 October 2018. And once again, numerous employees across Germany got involved in social organisations and institutions last year.

Smart City Munich Airport

The networking technology at Munich Airport spans over 1,575 hectares – that's equivalent to 2,200 football pitches. Electricity and gas meters are therefore spread over a huge area which makes it impossible to take readings efficiently. Thanks to Smart Meter Connect from Telefónica Deutschland, manual meter readings by employees are no longer required: The up-to-date reading is automatically submitted every 15 to 180 minutes using a smart camera system.



>6,700

Telefónica Deutschland installed additional high speed LTE stations across Germany in 2018.

Network of the future

The next step on the road to tomorrow's mobile communications network is completed. Since April 2018, Telefónica Deutschland has been cooperating with fibre optic network provider NGN FIBER NETWORK KG (NGN), who is based in Lower Franconia. The goal: to further enhance the performance of the company's own LTE network while laying the foundations for a national 5G network. More cooperative projects have been agreed with GasLINE and Unitymedia among others.

Digital Motorway Test Bed

Telefónica Deutschland is collaborating with Ericsson and many other partners from politics and industry on networked mobility of the future. That's why the "Digital Motorway Test Bed" was installed on a 30-kilometre stretch of the A9 motorway in Bavaria between Nuremberg and Greding. One of the services available on the test stretch is a full coverage, high-speed LTE mobile network to help test smart road infrastructure.

ello – the smart walker

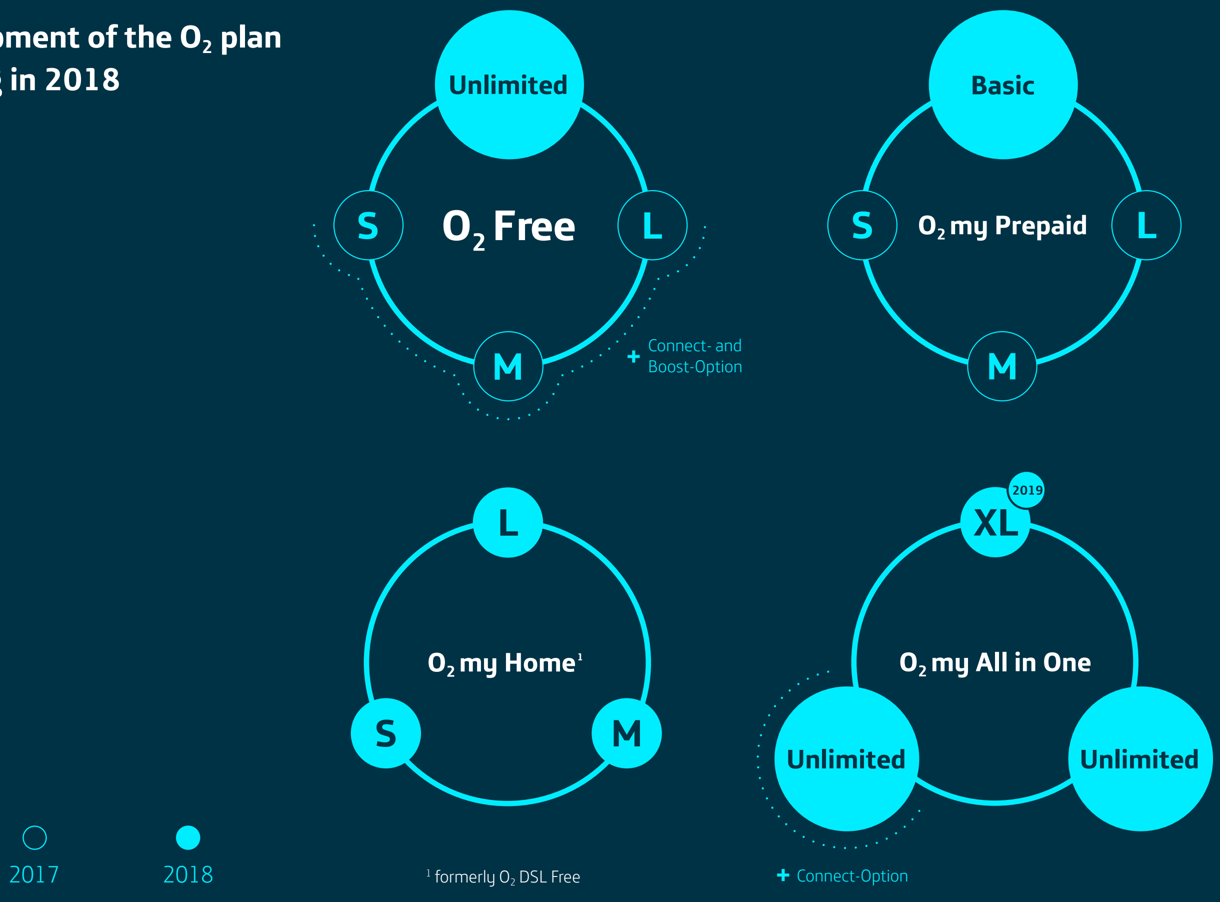
ello, the smart walker, is making life easier for hundreds of thousands of people. Thanks to smart controls and additional features such as the SOS system, lighting, tracking and automatic brakes, ello is improving mobility for people who are older or have difficulty walking. Telefónica Deutschland offers the best connectivity for the ello walker's SOS and tracking systems, thereby increasing the safety of users and their relatives.

We have more fascinating stories online. Simply use the QR code to discover them.

O_2 freedom campaign customer needs consistently at the centre of action

O_2 is the brand of freedom. No other German mobile communications brand brings to life the idea of freedom so consistently for its customers. As early as 2016, Telefónica Germany unleashed mobile communications with the new plan portfolio, O_2 Free. Even after using up the high-speed data volume, customers could continue surfing without limits or additional costs. In 2017, O_2 pioneered the introduction of extra-large data packets. And 2018 also brought many more innovations for private customers. As part of the O_2 freedom campaign, new products and applications were developed which are regarded as real milestones. These were presented to employees and the public by Wolfgang Metze and his team during the "O_2 Freedom Tour" at various locations.

Development of the O_2 plan offering in 2018



[1] formerly O_2 DSL Free

This QR code will take you to the latest news on the O_2 freedom campaign.

What launched successfully in 2018 continues in the same vein: the O_2 freedom campaign is also set to carry on making progress in 2019. Telefónica Deutschland continues to develop its freedom concept with its O_2 brand. The company is currently removing the boundaries between mobile and landline networks. Customers can now get one-stop shopping for mobile, landline and internet together on one plan – the O_2 my All in One XL. All that with high speed.

Whether at home or on the move: it makes no difference at all where you stream, game, download or upload. O_2 customers don't compromise on any half measures because they consider freedom as being able to take advantage of digitalisation whenever and wherever.

Furthermore, the strategic direction of O_2 is largely characterised by the customer promise of mobile freedom as part of the freedom campaign – no ifs, no buts. In addition to upgrading mobile and DSL products, new innovative solutions are being created to enrich O_2 customers' digital experience.

"It goes without saying that today people browse the web on the move just as much as they do at home. For them, the technology is beside the point. They place much more importance on being able to use digital services anywhere, anytime."

Wolfgang Metze
Chief Consumer Officer and member of the Management Board at Telefónica Deutschland

Smart cooperation for a successful digital transformation

Digitalisation presents new challenges for society, business and individuals. This also applies to Telefónica Deutschland and its. In order to best meet these challenges optimally and make the most of the opportunities presented by the digital age in particular, Telefónica needs to be smart, flexible and capable. An effective, continually evolving organisation is the foundation for a successful digital transformation. Telefónica therefore set the following priorities in 2018: learning, leadership, cooperation and smart ways of working. Telefónica can realise the full potential of the organisation and its individual brands – with customer needs always a central focus – by continually and autonomously developing management and staff, collaborating across teams and operating in a smart manner.

In 2018, Telefónica Deutschland launched various initiatives and offerings for new, smart ways of working. Employees from different divisions founded a community and organised BarCamps on the topic. The goal is to create a platform where interested parties and experts can debate new and agile ways of working. Networking across functions, sharing best practice cases or gaining inspiration for one's own area of work – open-ended discussions are welcome.

One of the several 2018 BarCamps was held under the title "#SmartWaysOfWorking – Agile, Lean and Co.". Over several sessions, participants discussed various topics on ways of working, digitalisation in everyday work and agile working environments. In real terms, for example, this means collectively discussing what form Workspace 2.0 could take. Or discussing what it means to cooperate smartly in employees' day-to-day interactions and why single-tasking is better than multi-tasking. Each individual participant takes the solutions that were developed collectively back into their own field of work. At this BarCamp in particular, participants discovered that even a houseboat could be a suitable co working space and that even in a highly digitalised working environment, face-to-face conversations are irreplaceable.

What exactly is a BarCamp?
BarCamps are also called un-conferences because the audience is not given any precise agenda. The participants become active themselves and contribute topics. Mutual exchange, which takes place intentionally across hierarchies and areas, ensures networking and informal learning.

NICOLE GERHARDT

Chief Human Resources Officer (CHRO)

"If we want to take advantage of the opportunities offered by digitisation from a business perspective, we must be open to new ways of thinking and working. That's the only way for us to stay agile and powerful."

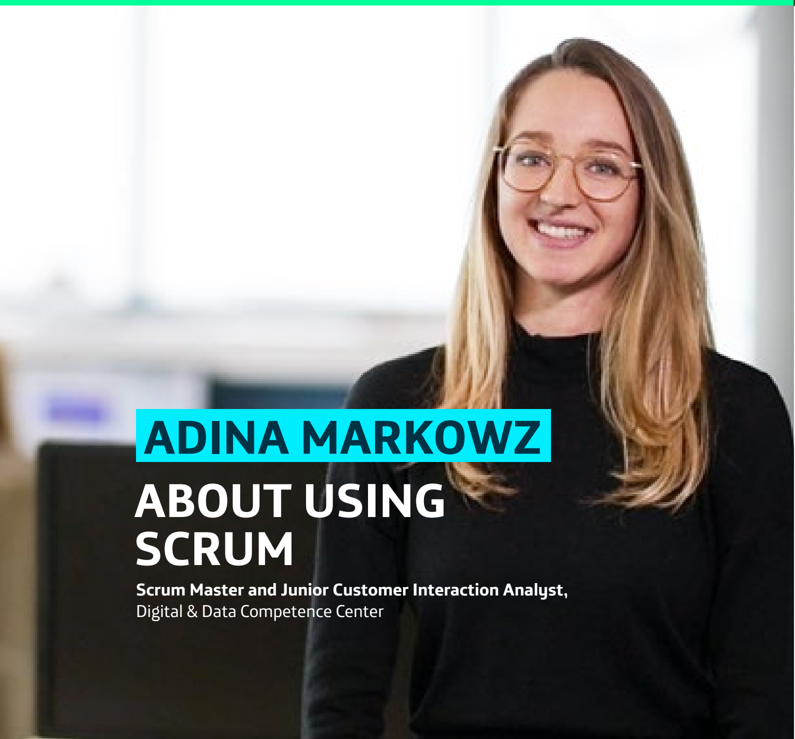
"For us, the benefit of retrospectives is that the entire team is involved in a continuous improvement process."

Within the framework of the retrospective, teams at Telefónica Germany continuously evaluate topics completed in the past. Together we take a look back and analyse: what worked? What can be improved and how?

PHILIPP KOCH

ABOUT THE RETROSPECTIVE

Scrum Master and Customer Interaction Analyst,
Digital and Data Competence Center



ADINA MARKOWZ

ABOUT USING SCRUM

Scrum Master and Junior Customer Interaction Analyst,
Digital & Data Competence Center

"I think it's important that scrum is not just understood as a method, but above all as an attitude, as a way of working."

Scrum is a form of agile project management at Telefónica Germany. It serves as a framework for the development and delivery of complex products. How? By dividing the product into phases, known as sprints. This enables a clear and adaptive development of value-adding functionalities.

Focusing on the customer

Being able to answer all customer inquiries competently, purposefully and quickly results in great service. That is exactly what Telefónica Deutschland aims to achieve. After contact with O_2, customers should feel that they are in good hands – such good hands that they tell other people about it. Technological change is altering the needs and communication behaviour of customers. Telefónica Germany has the following primary objective: the company makes the lives of their customers easier and better and gives them mobile freedom in the digital world. Telefónica offers customers the freedom to use various services increasingly independently and at any time, and to choose their preferred channel for resolving any issues.

With the My O_2 app, self-service offerings on the website, the O_2 DSL Help app, chat bots and service experts on the phone or via chat, Telefónica offers a mix of digital and personal service. The motto: The customer takes centre stage. Telefónica Deutschland is doing everything in its power to provide the best possible service and is continuing to develop the service in a targeted manner. Successfully, as numerous awards for customer service this year confirm.

Awards for Customer Service in 2018

Wirtschaftswoche award:
O_2 impresses with the best customer service for business customers – grade **"very good"** [1]

O_2 hotline in the **connect service test** received an overall grade of **"good"** [2]

My O_2 app has impressive results in the **connect test** with the grade **"very good"** [3]

CCV Quality Award
for Telefónica Deutschland in the "customer satisfaction" category [4]

CAt award "Call Centre Manager of the Year" for the Chatbot LISA project [5]

[1] Ranking "the best customer service provider for business customers" by the Deutsche Kundeninstitut (DKI – German Customer Institute) on behalf of Wirtschaftswoche).
[2] connect hotline broadband provider test: 392 points were awarded overall: once "satisfactory" (374 points), five times "good" (392, 402, 404, 415, and 422 points) and once "very good" (426 points).
[3] connect tests customer service apps provided by German network operators for service, functionality, and security).
[4] The CCV Quality Award is conferred once a year by the CCV and the trade magazine TeleTalk in three regular categories.
[5] CallCenterProfi presents the CAt Awards annually in cooperation with Management Circle during the CCW congress exhibition in Berlin).

O_2 gurus provide support online and offline

For people who need support in dealing with digital media, the O_2 gurus make an important contribution with their extensive range of services. Offline, in the numerous O_2 shops, but also by telephone, chat and video chat and online, the O_2 gurus offer assistance dealing with digital technologies. More than 30 "Helping Hands Videos" were published on the O_2 YouTube channel in 2018, which provide useful tips and tricks to customers.

O_2 gurus on YouTube.

How to reach Telefónica Deutschland's customer service department

O_2 DSL help app
With the app, customers can take action themselves if the World Wide Web isn't working as usual.

My O_2
The central contact point at O2online.de, helps customers find quick and easy responses to their questions and concerns.

O_2 community
Embedded in the service pages at O2online.de, the O_2 community supports customers in around 4,000 to 5,000 threads with questions on various topics.

Social media channels
Telefónica processes many thousands of entries on the app daily through all of its social media channels (Facebook, Twitter, etc.) across all brands.

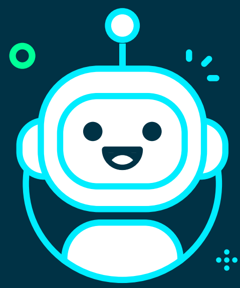
O_2 customer centre
In addition to the top stores in Berlin, Munich, and Frankfurt, customers can also find their O_2 shop in their immediate vicinity.

Chatbot LISA
LISA answer simple questions independently. This gives hotline staff more time to deal with complex queries.

O_2 hotline
If something cannot be solved online immediately, the hotline employees are happy to be there personally for customer concerns.

O_2 Helpbox
At Telefónica's central locations such as Munich and Hamburg, the O_2 video chat enables you to clarify your issues during personal discussions with a service expert in the call centre.

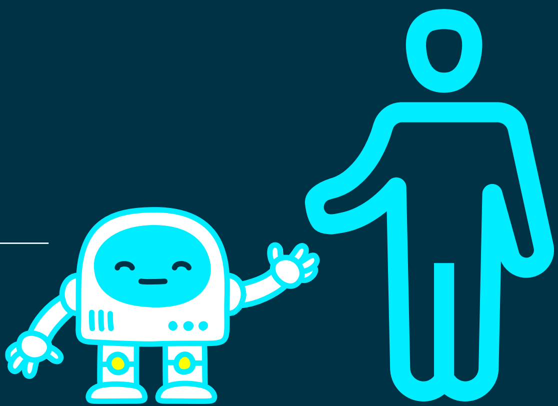
Our artificial intelligence ethics



Our ethical principles for the use of artificial intelligence focus on putting the human being in the centre. We evaluate all projects involving AI based on the following ethical principles:

"Fair and accessible to all – digitalisation is not a private party."

It is important to us that the applications of AI technology lead to fair results. We strive to ensure that there is no discriminatory effect on people – in terms of race, ethnicity, religion, disability, gender, sexual orientation or other personal circumstances. In addition, all strata of society should have access to digital opportunities. This also means that everyone should be empowered to use them in his or her context or to assess developments in digitalisation.

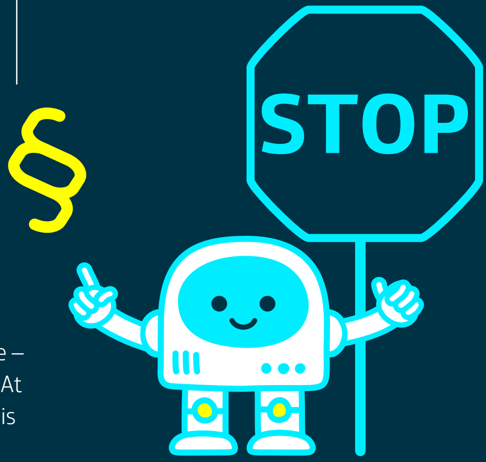


"AI should serve society: we will only overcome scepticism of the people if artificial intelligence creates tangible benefits for the individual."

AI should serve society and bring tangible benefits to people. To this end, AI systems must remain under human control and the use of value-based considerations must be guided. When using AI in products and services, we respect human rights and the goals of the United Nations for sustainable development. Wherever the human brain reaches its limits or can be freed from routine tasks, AI provides true added value. It is important that individuals themselves experience the benefits. In order to reduce scepticism about AI, it is therefore important that examples of its use are presented in a transparent and understandable manner.

"Not everything possible is morally legitimate – certain boundaries must be set for artificial intelligence."

Together, society and the economy must jointly define clear limits to the extent to which autonomous systems and AI may penetrate – across national borders. We promote this complex social dialogue. At Telefónica, we also question whether we can ethically represent this before using AI and discuss the possible long-term effects.

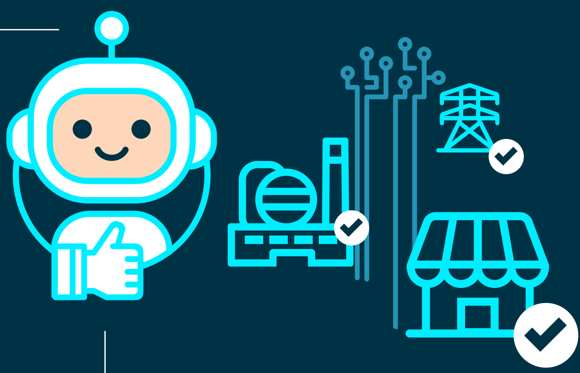


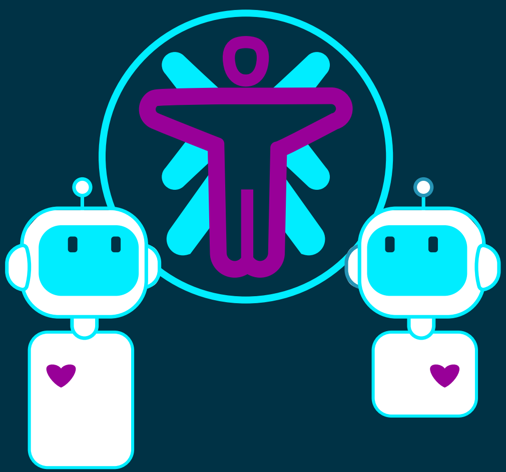
"The use of data must be transparent and the data must be protected."

In accordance with our Privacy Policy, we are convinced that everyone should decide for themselves how their data is to be used. The prerequisite for this is transparent information. But transparency means even more when it comes to AI: users should be informed whether or not they are interacting with an AI system. We make it transparent when a customer is talking to our chatbot or to a person. It is important to know whether man or machine has determined a result so that users can judge what it is based on. In the event of an AI-based decision, we strive to ensure that the logic behind a system's decision is comprehensible to the individual.

"Data resulting from cooperation with third parties must stand up to scrutiny."

AI-based products and services may also arise from cooperation with partners or third parties. In this case, we reserve the right to verify the legality and accuracy of the data and the logic behind it.





"Man must remain the supreme ethical authority."

We control machines, not vice versa. Ethical decisions should always be reserved for human beings. Our moral judgement requires implicit background knowledge that is not always explainable and programmable. In this respect, we are far ahead of machines. Therefore, in the future it should only be human beings who are able to make decisions on ethical and moral questions. And that is how we do things at Telefónica Deutschland.

Investor relations

Financial calendar and contact

2019

20 February
Q4 2018 – Preliminary results

9 May
Q1 2019 – Preliminary figures

21 May
Annual general meeting

24 July
Q2 2019 – Preliminary figures

30 October
Q3 2019 – Preliminary figures

(Subject to change)

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Letter to shareholders

Dear shareholders of Telefónica Deutschland, Dear Sir or Madam,

Mobile communications changed and shaped the lives of our customers even more in 2018 than ever before. This also applies to us as a company. We have now largely completed the integration of Telefónica Deutschland and E-Plus and are planning to achieve the targeted synergies as planned: more than 90 percent of the total savings of EUR 900 million in operating cash flow was already realized by the end of 2018. At our first Capital Markets Day in February 2018, we already set the course for the coming years. Our “Digital4Growth” transformation programme has a clear focus on the customer experience in the digital age.

However, we are aware that we have demanded a great deal of stamina from our customers again this year. The positive results of the network tests conducted by the Computer Bild, CHIP and connect trade journals clearly demonstrate the success of our enormous efforts in network consolidation. The stable churn rate of 17.3 percent in O_2 post paid private customer business also shows that we are on the right track. We are proud of the progress and success we have achieved in 2018 with our network expansion measures and our mandate for 2019 is clear: we will press ahead intensively with the expansion of our network and thus further improve our customers’ user experience. We will invest even more extensively than before in network optimisation, including comprehensive LTE expansion and improved network coverage along key transport infrastructures such as motorways and ICE lines. We are responding to the rapidly increasing data usage of our customers and making our network suitable for the future and the new 5G standard; to this end, we have concluded various partnerships for our network's fibre optic connection.

We want our customers to be able to enjoy mobile freedom in a wide variety of life situations, and we attach great importance to a good price-performance ratio and a positive customer experience. In various tests, our core brand O_2 was able to score points with data-heavy rates and convincing service for private and business customers; proof of our continuous, innovative evolutions of our product range. With “O_2 Free Boost”, “O_2 Free Connect” and “O_2 Free Unlimited”, we successfully meet the requirements of our customers.

From left:
Guido Eidmann (Chief Information Officer), Valentina Daiber (Chief Officer for Legal and Corporate Affairs), Markus Rolle (Chief Financial Officer), Markus Haas (Chief Executive Officer, Chairman of the Management Board Telefónica Deutschland Holding AG), Nicole Gerhardt (Chief Human Resources Officer), Wolfgang Metze (Chief Consumer Officer), Cayetano Carbajo Martín (Chief Technology Officer), Alfons Lösing (Chief Partner and Business Officer)

After giving the green light to the digital transformation of Telefónica Deutschland in February 2018, we will now focus fully on our "Digital4Growth" programme in 2019. We expect this to result in gross OIBDA growth of around EUR 600 million between 2019 and 2022. On the one hand, we want to participate in growth opportunities in our core business and, at the same time, address new business areas that arise, for example, from eSIM capability, Advanced Data Analytics (ADA) or the Internet of Things (IoT) and, on the other hand, achieve efficiency gains from the automation and digitalisation of processes. As a result, we will be "simpler, faster and better", and our customers and shareholders will benefit from this.

Our employees have once again shown great commitment and made these successes possible; they are the foundation for Telefónica Deutschland's successful market position. We would therefore like to expressly thank all our employees for their outstanding performance and their willingness and openness in the integration process as well as for the forthcoming transformation of the company. We consider ourselves to be well-positioned to become the "Mobile Customer & Digital Champion" in the future.

Finally, we would like to thank our shareholders for the confidence they have put in our work. In 2018, we again increased our free cash flow and therefore intend to propose to the next annual general meeting in May 2019 a cash dividend of EUR 0.27 per share for the 2018 financial year. Thanks to a conservative financing profile supported by a solid free cash flow performance, we also want to offer them an attractive dividend yield.

Yours sincerely,
The Management Board

Vision and strategy

Our vision

The customer is our focus. Even today, we connect more people in mobile communications than any other network operator in Germany. We have a direct customer relationship with more than 80 percent of our customers. Our customers are therefore our greatest potential for new growth.

Once the integration has been completed, we will therefore place customer benefit at the heart of our activities more consistently than ever before. To this end, we have defined a clear vision:

"We want to become the 'Mobile Customer & Digital Champion'."

This means: we want to be the preferred partner for mobile customers in the German market.

To achieve this, we are making our customers' lives easier and better and giving them mobile freedom in the digital world. We want to offer our customers a consistently positive experience with our brand, products, customer service and network. The daily user experience at Telefónica Deutschland should impress our customers in terms of ease, speed and performance.

We want to know our customers' wishes and needs even better, respond to them in real time and develop suitable products and services. To this end, we will set the benchmark in the market with our multi-brand and multi-channel sales approach. On the other hand, we are increasingly using digital interaction with our customers, because we see ourselves as pioneers of digitalisation. We attach great importance to the fact that our customers can shape their digital lives in a self-determined way.

Our strategic priorities

In order to realise our vision of the "Mobile Customer & Digital Champion", we defined three strategic priorities last year: foundation, customer experience & digitalisation and growth & profitability. They will determine our actions in the coming years.

First, we will strengthen the foundation: outstanding customer service, stable IT systems, a powerful organisation and an appropriate regulatory framework are the basis for a positive user experience and future growth.

Our second priority is to improve the customer experience in the digital age. This starts with providing a better, faster and more efficient network that meets the needs of its users in every situation. Building on this, we offer a convincing range of products and services that are tailored to the customer's day-to-day digital life. Finally, we are digitalising our company comprehensively in order to further improve the customer experience. That is why we have set up our "Digital4Growth" transformation programme. This makes us easier, faster and better for our customers.

- Easier by making interaction more intuitive for our customers and enabling a consistent experience across our channels.
- Faster by responding to customer needs and market changes in real time.
- Better, by enabling a positive customer experience across all our channels and building data-based growth areas.

SIMPLER

FASTER

BETTER

Through the successful implementation of our first two priorities, we reach the third priority: by making our customer experience stand out, we create the conditions for growth and profitability.

In the past year, we already made significant progress on these priorities, which will be set out in more detail below.

Our path to becoming a “Mobile Customer & Digital Champion” is being specified by Telefónica Group's global strategy programme: #RECONNECT. It also focuses on our customers and the connection between people and technology. The building blocks of this programme help us to achieve our growth ambitions.

#RECONNECT is Telefónica Group's formula for growth (G): $G = R^4 \times M$

The R and M parameters are defined as follows:
- RELEVANCE: We provide the best digital experience for our customers, made possible by easy-to-use, user-friendly and customised technologies.
- REVENUES – Sales: We increase the loyalty of our customers and their enthusiasm for our products and services; this opens up increasing sales potential for us.
- RETURNS: We rely on smart and efficient investments that meet the needs of our customers.
- RESPONSIBILITY – Awareness: We grow responsibly, play a bold role in shaping regulation and create value for society as a whole.

The predominant factor in all of this is MOTIVATION: it is the key to all success and thus functions in the formula as a multiplier of the four Rs. It stands for a growth mentality, a powerful, agile organisation and committed employees.

In the following, the strategic priorities outlined above on the way to becoming a “Mobile Customer & Digital Champion” will be discussed in more detail. At the same time, the individual blocks are also classified into the global #RECONNECT programme.

First strategic priority: Foundation

The basis for a positive user experience and future growth is a strong foundation of the company. This applies, in particular, to the areas of service and IT systems, organisation and framework conditions. The following section provides a comprehensive overview of the progress already made in 2018 and the ambitions in these areas.

RELEVANCE
Service

Our aim is to convince our customers with outstanding quality every time they contact us. In doing so, we consistently use the possibilities of digitalisation to achieve a high level of satisfaction with our service. It is important to us that our customers themselves decide which channels they prefer to use to get in touch with us.

In the past financial year, numerous measures were implemented to further improve the availability of hotlines and services. This includes the optimisation of processes and new training initiatives. These measures have been effective: this is demonstrated not only by internal performance indicators (such as waiting times and availability), but also by feedback from our customers. In the independent hotline test conducted by the connect trade journal, for example, O_2's customer service managed to improve by a whole grade on the previous year and thus came second in the overall ranking (grade "good"). Our service employees were particularly convincing when it came to consulting and came first among all twenty suppliers from Germany, Austria and Switzerland tested in the "quality of statements" category. Customer service was also convincing in the fixed-network business recently. The connect trade journal rated the O_2 DSL hotline as "good". Compared with the previous year, Telefónica Deutschland improved more than any other test participant.

In the coming years, we will continue to offer our customers outstanding service on a daily basis – with the right mix of personal and increasingly digital service channels. They offer customers new possibilities to resolve matters themselves in an uncomplicated, fast and completely flexible way. Our aim is to increase the e-care share of all service requests to 80 percent by 2022. We are also digitalising our internal service processes. This will enable us to solve service issues even better and faster through automation and the use of artificial intelligence, among other things.

RELEVANCE
IT systems

In addition to excellent customer service, stable and future-proof IT also forms an essential part of the foundation. To ensure this, we are creating a uniform, flexible system landscape across all market segments and sales channels. We are transforming our entire IT systems using the approach of Telefónica S.A. Group: a standardised product catalogue ensures consistency of product and price information. We are also standardising our ordering system and our Customer Relationship Management (CRM) system to further increase efficiency.

MOTIVATION
Organisation

Digitalisation is not only a challenge for technology, but above all for the organisation and its employees. We want Telefónica Deutschland to remain efficient in the face of digital change. To this end, we are developing new ways of working that fit the requirements of the digital world: we promote continuous learning in analogue and digital form. In our day-to-day work we collaborate in mixed teams across all areas in a solution-driven and trust-based manner. We also design flexible working time concepts that meet the needs of our employees today and tomorrow. The aim is to become more agile and to promote interdisciplinary cooperation and rapid decision-making. Further training should be available to our employees in real time and be easily accessible. A digital learning platform will be available to all employees for this purpose by 2020. They can find the right training that suits them in less than five clicks.

Second strategic priority: Customer experience and digitalisation

Building on a strong foundation, the second priority is the continuous improvement of our customer experience. This will be achieved by further expanding our network and comprehensively and consistently digitalising all corporate divisions.

RESPONSIBILITY
Framework conditions: Legal and Regulation

Telefónica Deutschland advocates appropriate legal, regulatory and political framework conditions and acts as a conscientious company. We are actively involved in shaping the discussion on the social and economic consequences of digitalisation. Within this framework, we are consistently committed to legal and regulatory frameworks that promote the digitalisation of Germany in the best possible way.

With regard to the auction of the 5G frequencies, we are advocating more investment-friendly procurement rules. This relates to aspects such as payment terms, roll-out obligations, auction design, provision of regional spectrum, the so-called service provider obligation and the issue of national roaming. We thereby aim to ensure for our customers and shareholders that no unnecessary barriers to investment are placed in the way of the industry. Germany needs a clear and fair framework to avoid falling behind in this important future technology.

We are also playing an active role in the ongoing antitrust review process with regard to the planned acquisition of Unitymedia by Vodafone. Because it is important for us to counteract potential restrictions of competition in the telecommunications market decisively in the interests of our customers.

RELEVANCE
Network infrastructure

We are building Germany's largest and most modern mobile communications network, which is geared to the real benefits for people in their digital day-to-day lives. We had largely completed network integration by the end of 2018. The results of the current network tests confirm the progress made: for instance, our network earned a clear "good" (2.2) in the CHIP trade journal and improved on the previous year nearly by a full ranking. We were also able to improve significantly in the connect network test.

In addition, we are pushing ahead with the expansion of LTE. We are expanding precisely where customers benefit most from better coverage and higher transmission speeds. Last year we installed more than 6,700 new LTE stations nationwide – more than any other network operator in Germany. In almost all cities, our network was expanded with additional LTE elements. At the same time, we have significantly improved performance within important transport infrastructures and in sparsely populated areas. This is also objectively confirmed by third parties: In the LTE network category, we received the ranking of "good" (1.70) overall in the CHIP test. The trade journal particularly emphasised the good network quality in metropolitan areas, as well as in large cities.

"Germany needs a clear and fair framework to avoid falling behind in this important future technology."

On our route to becoming the "Mobile Customer & Digital Champion", we are already working consistently on our network of the future today. In particular, we are ensuring that we prepare our mobile infrastructure for the future integration of 5G. Via the fibre-optic connection of our mobile communications sites and 5G pilot projects, we are creating the conditions for ultra-fast data transfer rates of the future. In this way, we are laying the foundation for future digital applications, further improving the quality of our network and making it future-proof.

We continue to rely successfully on cooperation ventures in this process: we have concluded agreements with Deutsche Telekom, NGN FIBER NETWORK, GasLINE and Unitymedia. In addition, we are cooperating with Vodafone in a pilot project for the joint use of fibre-optic-based connections. Together with these and other partners, we plan to increase our share of mobile communications sites with fibre-optic connections to 70 percent.

In addition, we are driving innovative projects with various partners. They include the establishment of the joint Early 5G Innovation Cluster test network with Nokia, the 5G Connected Mobility project with Ericsson and the testing of 5G Fixed Wireless Access (FWA) connections in collaboration with Samsung. The latter is a promising, fast and cost-effective way to provide real broadband access based on millimetre waves (26 GHz) to people across the country. FWA is therefore a sensible alternative to the expensive use of fibre optics.

RELEVANCE

Consistent digitalisation: "Digital4Growth"

We want to become simpler, faster and better for our customers. To this end, we have designed the "Digital4Growth" transformation programme.

We are becoming simpler by making interaction with our customers more intuitive and providing them with a consistent experience through our channels. To this end, we are continuing our cross-channel sales and service concept consistently (omnichannel). This means we are establishing consistent customer interfaces and interfaces for a standardised experience across all customer interactions. "Digital4Growth" uses the so-called Customer Journey Mapping method to continuously improve all customer-relevant processes. In doing so, we are consistently driven by real, precisely defined customer processes. These are analysed step by step. In this way, optimisation potentials can be identified quickly and systematically in order to noticeably improve the customer experience as quickly as possible. The goal is to increase the share of digital distribution channels to 25 percent by 2022 as part of the "Digital4Growth" programme.

With the continuous further development of the "My O_2" app, we also simplify the digital life of our customers. In this way, we offer them new opportunities to solve their own problems quickly and easily. Our customers can already manage their rates and devices easily and intuitively today. The "My O_2" app was rated "very good" by the connect trade journal in September. Through further improvements in functionality and handling, we plan to further increase their attractiveness. As a result, the use of the "My O_2" app within our customer base will increase from 20 percent (2017) to 80 percent (2022).

We are becoming faster by minimising the number of process variants and automating the remaining ones in the best possible way. This enables us to introduce new features and products much faster than in the past and to react quickly and flexibly to changing customer needs. Smart data analysis will also enable us to use our resources more flexibly and efficiently. Our aim is increasingly to satisfy the needs of our customers in real time.

We get better by enabling a positive customer experience across all our channels at every contact. We take advantage of opportunities offered by artificial intelligence (AI) and also rely on the use of smart Telefónica technologies such as AURA. This is a new digital contact channel that uses artificial intelligence to help customers quickly, easily and in real time. Since February 2018, O_2 customers can already chat with AURA via Facebook Messenger. Beyond that, we also meet customers' requirement for more digital self-service offerings.

We will continue to drive "Digital4Growth" in the coming years. By 2022 at the latest, for example, there will only be one payment process, one credit check or one activation process. The transformation program helps us to become the "Mobile Customer & Digital Champion". Through the continuous improvements within the framework of "Digital4Growth", we aim to achieve a total of around EUR 600 million in OIBDA effects (gross) by 2022.

REVENUES

Private customers

We are consistently addressing the needs of our residential customers in the digital world and will continue to focus our core brand O_2 on the customer promise of freedom. By continuously improving our O_2 Free plans, we can promote data usage and in this way increase Average Revenue per User (ARPU). In addition, we aim to increase the loyalty of our customers further and reduce the churn rate.

Our strategic focus is on data-centric mobile phone contracts, which we address with our O_2 Free plan portfolio. O_2 Free has become even more attractive with the introduction of the plan items Connect (up to 10 SIM cards for any number of end devices included in the mobile phone contract) and Boost (double the data for EUR 5 extra) in June 2018. Since August 2018 we have even been offering our customers unlimited data at a very attractive price with O_2 Free Unlimited.

In July 2018, we also introduced our completely revised O_2 my Prepaid plan portfolio. It addresses smart phone users in particular and in this respect, too, takes into account the growing interest in the use of mobile data.

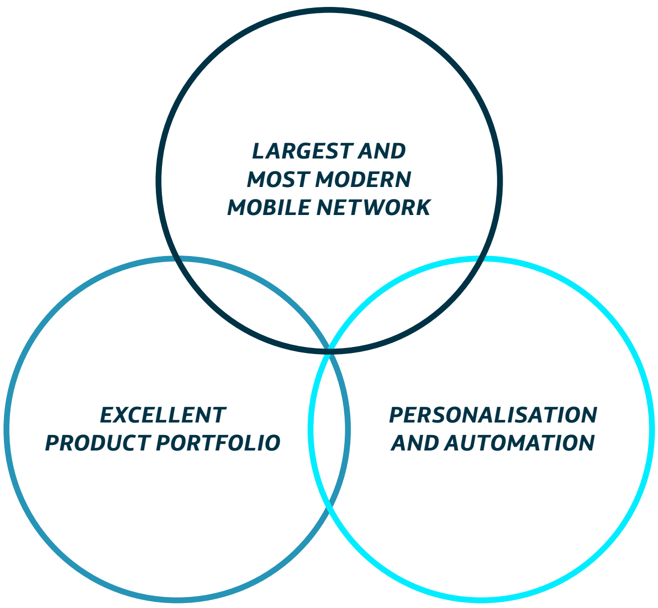
We have also consistently placed our brand promise at the centre of our range of end devices for O_2. We offer our customers maximum freedom in the choice of their preferred smart phone. This is available at O_2 not only on favourable terms, but also flexibly with or without a mobile phone contract and regardless of any contract change or contract extension.

The guiding principle of freedom also determines our O_2 my Home DSL plan portfolio, which was launched in October 2018. This enables us to offer residential customers speeds of up to 100 Mbit/s within their own four walls.

In addition, the O_2 brand has had a genuine convergent product in its portfolio since August 2018: the unlimited plan O_2 my All in One, which offers unlimited browsing both at home and on the move.

In addition to our core brand O_2, Telefónica Deutschland also offers a second brand, Blau, which is clearly differentiated from O_2, targeted at price-conscious residential customers. This means that we can offer this customer segment a mobile services portfolio that has been reduced to the essentials. In the summer of 2018 the new Blau plan portfolio was introduced, underlining this customer promise and offering an even more attractive price/performance ratio. Excellent customer service (it was rated “Good” by the magazine connect) also contributes to the popularity of the Blau brand. Blau also received the “High Customer Loyalty” accolade from Focus Money.

WE OFFER AN OUTSTANDING CUSTOMER EXPERIENCE.



REVENUES
Partner customers

In addition to the O_2 and Blau brands, our partner business is a key pillar of our strategy. With a focused multi-brand strategy, we are successfully reaching all market segments aside from our own brands. Examples include the ALDI TALK, AY YILDIZ, Ortel Mobile and Tchibo Mobil products, which are implemented through partnerships or equity interests.

Other cooperation partners from the telecommunications industry are mobilcom/debitel, Drillisch (1&1), Versatel, Breko and various cable providers. We offer these partners a broad portfolio of options. The basis is a scalable business model with different depths of added value. This enables us to offer tailor-made solutions for different customer groups and serve their needs even better. In this case, too, independent tests confirm that our strategy meets the needs of the market. In 2018, for example, ALDI TALK was named “Mobile Brand of the Year” for the fifth time in a row, in a representative customer survey conducted by the market research company YouGov in cooperation with the business and financial newspaper Handelsblatt.

Going forward, too, we intend to continue growing together with our wholesale business to complement our core brand O_2. So we will continue to be flexible and responsive to our partners' needs and support them in improving the customer experience.

REVENUES
Business customers

Telefónica offers lean mobile and landline products tailored to business customers. Our focus remains on addressing small and medium-sized companies through our core brand, O_2, with an innovative product portfolio. Here, too, the customer experience based on lean, user-oriented mobile and landline products is at the forefront.

Since October 2018, for example, business customers have had the option of an all-in package with the new O_2 Free Business Unlimited. It includes the most important elements for everyday mobile business at home and abroad in one plan. In addition to unlimited LTE high-speed data, which can be used on up to five devices, the plan also includes Europe-wide telephone and SMS services, as well as additional roaming services in other countries of the world.

In addition to O_2 Free Business, Telefónica has also, since November 2018, been offering business customers convergence benefits for the first time, when they order products from several of our B2B product ranges together. In doing so, we consistently respond to our customers' wishes. With O_2 Business Fusion, we offer companies an integrated product for mobile, Internet and landline communications. O_2 Unite provides a pooling plan model for corporate customers that is unique in the German market.

We also offer business customers a range of services relating to the Internet of Things (IoT), machine-to-machine communication (M2M) and managed connectivity. In this way, Telefónica Deutschland supports companies on their path to a networked future through simple and demand-driven products. We intend to expand this division in the future, as described in the following section.

REVENUES
New business: Internet of Things and intelligent data analysis

Through the growth markets of the Internet of Things (IoT) and advanced data analytics (ADA), we are opening up new areas of expansion that are close to our core business. They not only open up new revenue opportunities, but also contribute to improving the overall customer experience.

Our customers are connecting an increasing number of end devices to their networks. We want to become the leading provider of mass-market Internet of Things solutions for residential customers. In this context, we are establishing a comprehensive eco-system. It is designed to enable customers to utilise easy-to-use IoT end devices and solutions. In this way, we are seizing the opportunities resulting from the exponential growth of devices and things connected to the Internet via mobile phone technology. By 2022, we plan to increase the number of network devices per customer to an average of four.

In addition to a future leading role in the end customer market, we also offer business customers and partners innovative IoT solutions. Through the IoT Smart Center platform, the Global SIM and IoT Connect, Telefónica Deutschland can offer flexible, secure and cost-efficient networking solutions. The IoT Partner Programme (IPP) also helps firms to develop and network new and futuristic technologies.

We will continue to develop new business models in these areas in the coming years, making use of both agile methods and the strengths of the Telefónica Deutschland Group. By 2022, we expect revenue to increase by around EUR 200 to 300 million cumulatively as a result of IoT.

In addition to the Internet of Things, intelligent data analysis plays a key role for us. On the one hand, data analyses and artificial intelligence methods help us to respond better to changing market demands. For example, we acquire new customers in a more targeted way by customising campaigns and our offers even better on the basis of data analyses. Artificial intelligence also helps us to optimise our mobile network.

With the help of data analysis, we also support other companies in gaining new insights from Big Data, e.g. for traffic planning and the retail trade. Using our anonymisation process developed in-house, we guarantee the security of our customers' data. In Transport Analytics, for example, we use anonymised data from Germany's largest mobile customer base to draw conclusions about air quality from the flows of people under way. We also support cities in traffic planning.
In Retail Solutions, we combine the performance potential of data analysis and IoT to give retailers insight into customer behaviour and enable them to interact more effectively with their customers.

“We want to become the leading provider of mass-market Internet of Things solutions for residential customers. In this context, we are establishing a comprehensive eco-system.”

Third strategic priority: Growth and Profitability

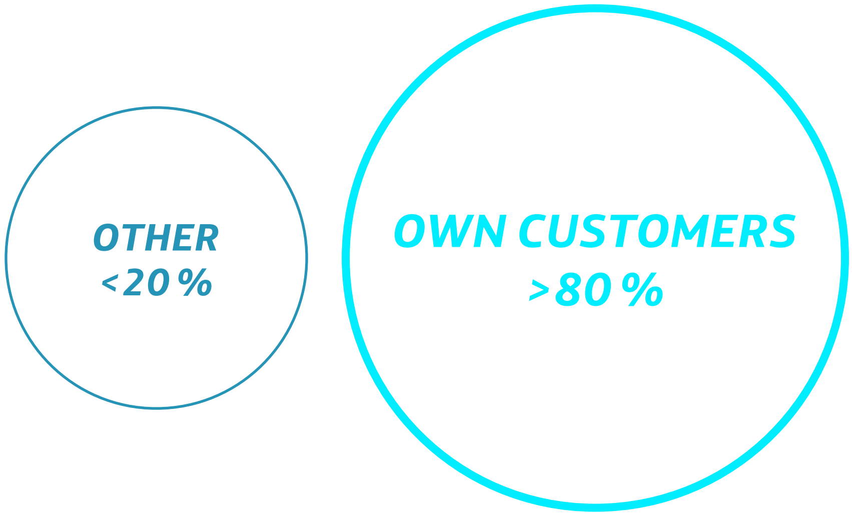
Our strategy is creating an excellent basis for further business success. By placing the customer consistently at the centre of our actions, we differentiate ourselves and enable new growth.

By focusing on optimising fundamental factors in success such as network and customer service and the customer promise "Mobile Freedom", we create an outstanding customer experience. We are continuing our data monetisation strategy to increase Average Revenue per User (ARPU) and further reduce churn. Our transformation programme, "Digital4Growth", will not only enable us to act faster and more efficiently, but also to tap new revenue potential, so that we will experience overall growth in line with the German market.

We are making intelligent investments in our network and in the transformation and digitalisation of the company. Over the medium term, we will keep the level of our investments stable. In particular, the transformation to a digital company enables us to continuously increase efficiency, with the result that we can steadily reduce our operating costs.

Overall, we are aiming for a continuous, positive development of our profitability. At the same time, we are reaffirming our commitments to our shareholders: we firmly believe that we are in a position to continue generating a solid free cash flow. In addition, we continue to support an above-average shareholder return with a high dividend distribution in relation to free cash flow.

OUR CUSTOMERS ARE OUR GREATEST GROWTH POTENTIAL



Highlights of financial year 2018

G 01

MOBILE ACCESSES (POSTPAID/PREPAID)
IN MILLIONS

G 02

REVENUE
IN MILLIONS OF EUR

G 03

OIBDA BEFORE EXCLUDING EXCEPTIONAL AND SPECIAL EFFECTS
IN MILLIONS OF EUR

G 04

OIBDA MARGIN EXCLUDING EXCEPTIONAL AND SPECIAL EFFECTS
IN PERCENT

In the 2018 financial year, the German mobile market environment remained dynamic across all segments, yet rational, with a clear focus on profitable growth through increased data usage by customers and the monetarisation of plans with a large data volume. To support and promote this, we expanded our portfolio to include the new O_2 Free plans with Boost option to double the data volume and the unique O_2 Connect function for up to 10 devices, as well as adding various Unlimited plans for residential and business customers.

By the end of the 2018 financial year, we had largely completed network integration; the network test results confirm the positive impact. For example, the Telefónica Deutschland network achieved a clear improvement in its score on the CHIP test and the connect network test, among others. In parallel with the finalisation of network integration, we pushed ahead with the expansion of LTE nationwide and made our network more dense with additional LTE elements in almost all cities in Germany. In addition to the LTE expansion along major transport infrastructure, we also connected additional communities to our network in sparsely populated areas. In 2018, this meant that our network gained a total of more than 6,700 LTE sites. To ensure cooperation with the other network operators, we signed the National Mobile Services Pact as well as the Mobile Services Pacts in Bavaria and Hesse in the 2018 financial year. We also entered into agreements with Deutsche Telekom, NGN FIBER NETWORK, GasLINE and Unitymedia to connect our mobile communications sites to their fibre optic infrastructure.
In preparation for the introduction of the 5G mobile standard, we plan to connect around 70 percent of our sites with fibre optic by 2022 and are driving forward innovative projects with a range of partners. These include the “5G Connected Mobility Project” with Ericsson, development of the joint test network “Early 5G Innovation Cluster” with Nokia and the testing of “Fixed Wireless Access (FWA)” connections in cooperation with Samsung. All in all, our extensive network projects will create a fully integrated, modern and more powerful network for our customers, as well as an ideal basis for future network technologies such as 5G.

This puts us on the right track to become Germany's "Mobile Customer & Digital Champion". Our transformation programme "Digital4Growth", which was presented at our first Capital Markets Day in February 2018, consistently focuses on customer needs and the user experience in the digital age. By doing so, we are creating the basis for further profitable growth.

As of the end of December 2018, the number of customer lines operated by the Telefónica Deutschland Group amounted to 47.1 million, a decrease of 1.1 percent compared with the same period in the previous year. Mobile accesses fell to 42.8 million, down 0.8 percent year-on-year. This was mainly due to the decline of the customer base in the mobile prepaid segment, which is attributable to changes in the regulatory environment (identity check and European Roaming Regulation). Mobile post paid business continued to post a positive trend, with around 1,002,000 new accesses (net).

Revenues in the 2018 financial year amounted to EUR 7,320 million, an increase of 0.3 percent year-on-year (-0.1 percent compared with the previous year at EUR 7,290 million in accordance with IAS 18). Adjusted for negative regulatory losses of EUR 44 million for the year as a whole (mainly in connection with the European Roaming Regulation), revenues in the 2018 financial year amounted to EUR 7,364 million, an increase of 0.9 percent (to EUR 7,334 million, an increase of 0.5 percent according to IAS 18) year-on-year.

OIBDA before exceptional and regulatory items rose by +5.3 percent to EUR 1,938 million in the 2018 financial year (+3.4 percent to EUR 1,903 million year-on-year according to IAS 18). Exceptional items amounted to EUR 87 million and were mainly related to network consolidation. The impact of usage elasticity in the context of European roaming legislation was the main reason for the negative regulatory losses of EUR 54 million. The additional savings from OIBDA-related integration activities totalled around EUR 100 million for the 2018 financial year. The good progress in network consolidation enabled us to bring forward savings of ~EUR 20 million from 2019 to 2018 over the year as a whole. On this basis, the OIBDA margin before exceptional items and regulatory effects[1] rose by 1.1 percentage points year-on-year to 26.3 percent.

Capital expenditure (CapEx)[2] rose by EUR 16 million year-on-year to EUR 966 million due to the massive network consolidation and simultaneous LTE expansion, with additional CapEx synergies of around EUR 50 million being realised.

Consolidated net financial debt[3] fell to EUR 1,129 million as of the end of December 2018 as a result of the typical trend in free cash flow during the year. The debt ratio was 0.6x, i.e. it remained within our target debt ratio of a maximum of 1.0x.

Please refer to p. 03 of the Group Management Report for a more detailed presentation of the financial outlook for 2019.

[1] Exceptional items in the period from January to December 2018 included restructuring expenses of EUR 84 million and acquisition-related consultancy fees of EUR 2 million; the regulatory effects for the period from January to December 2018 amounted to EUR 54 million
[2] Including additions from capitalised finance leases and excluding capitalised borrowing costs for investments in spectrum licences
[3] Net financial debt includes current and non-current interest-bearing financial assets and interest-bearing liabilities as well as cash and cash equivalents, although no payments for mobile radio frequencies

Our share

As the Investor Relations department, we act as an interface between the company Telefónica Deutschland, the capital market and other stakeholders. We inform interested parties promptly, regularly and comprehensibly about the operational and strategic development of the company, for which we provide relevant information clearly and without delay. These activities and the regular, active dialogue are intended to give investors the opportunity to inform themselves about the development of the company and to make investment decisions on the basis of a well-founded assessment.

Economic situation and capital market environment

In 2018, the German economy recorded another upswing and, according to initial calculations by the Federal Statistical Office, achieved GDP growth of 1.5 percent (price-adjusted) year-on-year in an environment marked by global crises. The impetus for this growth comes in particular from the domestic market. Consumer spending by households and government expenditure increased, as did investment in equipment, buildings and other assets. Exports continued to rise, with imports also reporting an increase. The number of unemployed people went down significantly compared with the previous year.

The global stock markets were strongly influenced by global economic and political developments in 2018 and were unable to continue the positive trend of previous years. In addition to the negotiations on the UK's exit from the European Union which carried on until the end of the year, concerns about trade tariffs between the US and other nations have repeatedly unsettled the stock markets.

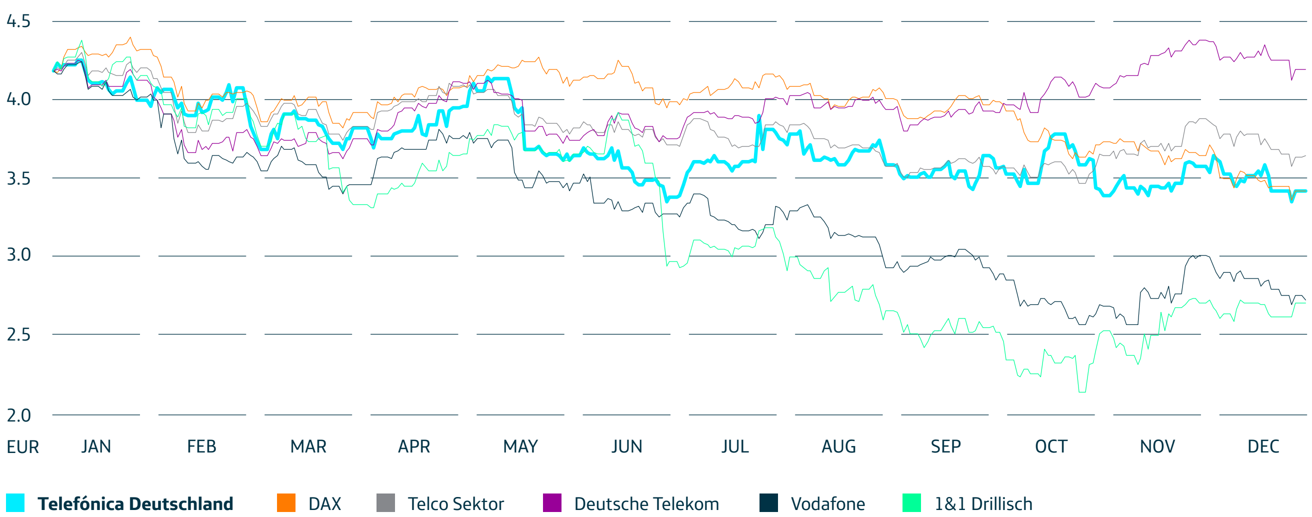
The German benchmark index DAX and its European counterpart, the Stoxx600, performed almost in parallel in 2018. Following a positive start to the year, the highs for the year had already been reached by the end of January. After a recovery that lasted from February to May, the indices were able to keep their performance stable until autumn. Prices then fell sharply in the third quarter of the year, reaching lows at the end of November. Even the last month of the year did not lead to any significant recovery on the stock markets. As a result, the DAX closed 2018 with a loss of 18.3 percent, while the Stoxx600 ended the year slightly better, although with a loss of 15.5 percent.

The European telecommunications sector was also unable to escape the global negative trend affecting stock markets. The index peaked at the beginning of the year before reaching its low at the end of October with a slight recovery, i.e. somewhat earlier than the European markets. From this point on, the price performance of the European telecommunications index became detached from the performance of the European markets and there was a slight recovery, with the result that the index closed the year at -13.0 percent.

At the beginning of 2018, Telefónica Deutschland's share price performed largely in line with the German and European benchmark indices. Following the high for the year of EUR 4.252 in January, the dividend payment in May was followed by a decoupling from market trends. The Telefónica Deutschland share recorded significant losses and reached its low for the year at EUR 3.346 on 28 June 2018. A recovery then got under way and, while the share was able to largely offset the losses compared with the DAX and the European telecommunications index, it remained volatile. This was the case particularly in view of the ongoing discussions surrounding the upcoming awarding of 5G spectrum licences. Telefónica Deutschland shares ended the year with a loss of 18.3 percent and a closing price of EUR 3.418.

G 05

SHARE PRICE PERFORMANCE 2018
1 JANUARY TO 31 DECEMBER, REBASED



Shareholder remuneration at Telefónica Deutschland

We are maintaining our attractive shareholder remuneration policy with a high payment ratio for the dividend in relation to free cash flow. A conservative financial policy and financial flexibility remain at the core of our financing strategy. In the course of the 2019 financial year, we will adjust our self-defined debt target in two respects: firstly, we will reflect the technical changes resulting from the introduction of IFRS 16, which we expect to have a significant impact on our margin, balance sheet and debt ratio. Secondly, we are considering introducing a higher target debt ratio in order to tap into our full financial strength for the upcoming 5G investments, while maintaining our BBB investment-grade rating from Fitch.

On 30 October 2018, Telefónica Deutschland management announced its intention to propose to the next Annual General Meeting (expected to be held on 21 May 2019) a cash dividend of EUR 0.27 per share for the 2018 financial year. This corresponds to an increase of approx. 4 percent compared with the previous year.

Activities of the Investor Relations department of Telefonica Deutschland

The core of our investor relations work is prompt, open and transparent reporting, an active and regular dialogue with our shareholders, analysts, investors and other stakeholders, and expansion of our network of national and international contacts. We continued this intensive dialogue in the 2018 financial year and presented our strategy and business model at numerous conferences and road shows, as well as at our first Capital Markets Day in February. Last year, the Management Board and the Investor Relations team participated in 246 investor meetings (2017: 259). In total, the team was on the road for 9 weeks (2017: 9 weeks) in Europe and North America.

A total of 31 analysts monitor the performance of the Telefónica Deutschland share (as of 31/12/2018); with price targets between EUR 2.30 and EUR 5.90 per share. As of the end of 2018, the target price averaged EUR 3.94 for all analyst estimates, i.e. more than EUR +15 percent above the closing price of EUR 3.42 on the stock market.

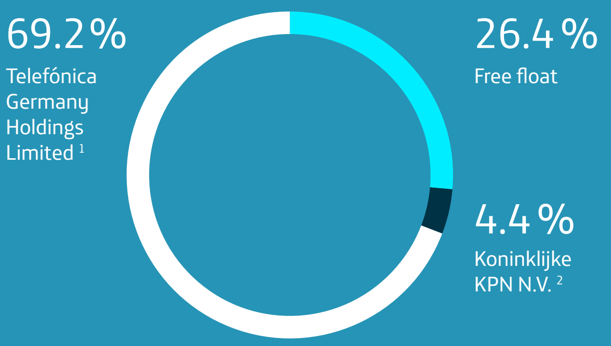
Rating	Number
Buy/Add/Outperform/Overweight	12
Hold/Neutral/Equal weight	8
Sell/Underweight/Underperform	11

We hold telephone conferences to coincide with the publication of our annual report and quarterly results. Here, investors and analysts have the opportunity to pose their questions directly to the Management Board. These conferences will subsequently be available as webcasts on the Investor Relations website for one year.

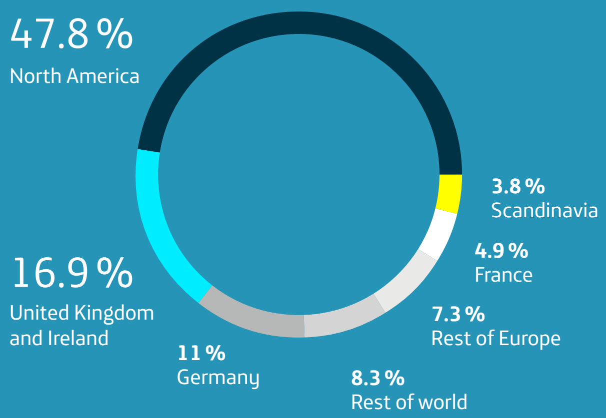
Further information on the company and the Telefónica Deutschland share can be found via the contact details provided on the next page.

G 06 / G 07

SHAREHOLDER STRUCTURE OF TELEFÓNICA DEUTSCHLAND



GEOGRAPHICAL DISTRIBUTION OF FREE FLOAT[3]



[1] Telefónica Germany Holdings Limited is an indirect wholly owned subsidiary of Telefonica, S.A.; status: according to share register on 31/12/2018
[2] Status: 31/12/2018 according to KPN press release on 30/01/2019
[3] Source: NASDAQ, October 2017.

T 01

TELEFÓNICA DEUTSCHLAND BONDS

Issue date	Currency	Volume	Tenor	Coupon	Instrument rating	Listing
10 February 2014	EUR	500,000,000	7 years	2.38 %	BBB	Regulated market of the Luxembourg Stock Exchange
05 July 2018	EUR	600,000,000	7 years	1.75 %	BBB	Regulated market of the Luxembourg Stock Exchange

Long-term issuer rating of Fitch: BBB, outlook: positive

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Page 27: Telefónica Deutschland?

Telefónica

Deutschland

DIGITAL CROSS ROADS

ANNUAL REPORT 2018

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COMBINED MANAGEMENT REPORT

for the Financial Year 2018

Combined Management Report
P. 03–66

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

1 January to 31 December

(in EUR million)	2018	2017	% Change
Revenues	**7,320**	**7,296**	**0.3**
Revenues (excl. regulatory effects 2018)	**7,364**	**7,296**	**0.9**
Mobile service revenues	5,267	5,287	(0.4)
Mobile service revenues (excl. regulatory effects 2018)	5,310	5,287	0.4
Operating income before depreciation and amortisation (OIBDA), adjusted for exceptional effects[1] (excl. regulatory effects 2018)	**1,938**	**1,840**	**5.3**
OIBDA adjusted for exceptional effects (excl. regulatory effects 2018)	*26.3%*	*25.2%*	*1.1%-p.*
Operating income before depreciation and amortisation (OIBDA), adjusted for exceptional effects[1]	**1,884**	**1,840**	**2.4**
OIBDA margin, adjusted for exceptional effects	*25.7%*	*25.2%*	*0.5%-p.*
Operating income before depreciation and amortisation (OIBDA)	**1,797**	**1,785**	**0.7**
OIBDA margin	*24.6%*	*24.5%*	*0.1%-p.*
Operating income	**(190)**	**(84)**	**125.2**
Profit/(loss) for the period	**(230)**	**(381)**	**(39.5)**
Basic earnings per share (in EUR)[2]	**(0.08)**	**(0.13)**	**(39.5)**
Total CapEx[3]	**(966)**	**(950)**	**1.7**
thereof CapEx[4]	(958)	(932)	2.8
thereof additions from capitalised finance leases	(8)	(18)	(55.5)
Investment ratio (CapEx/Sales ratio)[5]	**13.2**	**13.0**	**1.4**
Operating cash flow (OIBDA-CapEx)[6]	**839**	**853**	**(1.7)**
Free cash flow pre dividends and payments for spectrum[7]	**733**	**680**	**7.8**
Total accesses as of 31 December (in thousands)	**47,089**	**47,604**	**(1.1)**
Mobile accesses (in thousands)	42,819	43,155	(0.8)
thereof M2M accesses (in thousands)	1,188	1,027	15.7
Mobile accesses (in thousands) according to calculation customary to the market[8]	*45,256*	*45,918*	*(1.4)*
Net adds in mobile prepaid business (in thousands)	(1,338)	(1,903)	(29.7)
Net adds in mobile postpaid business (in thousands)	1,002	737	35.9
Postpaid share (%)	**52.0%**	**49.3%**	**2.7%-p.**
Total ARPU (in EUR)	**10.0**	**9.7**	**3.1**
Postpaid churn excl. M2M (%)	**1.6%**	**1.6%**	**0.0%-p.**
Non-SMS data over total data revenues (%)	**85.4%**	**80.8%**	**4.6%-p.**

As of 31 December

	2018	2017	% Change
Net financial debt[9]	**1,129**	**1,064**	**6.1**
Debt ratio[10]	0.6x	0.6x	8.5
Number of employees	**8,868**	**9,281**	**(4.4)**

(1) Exceptional effects as of 31 December 2018 include restructuring expenses of EUR 84 million as well as consultancy costs related to M&A transactions amounting to EUR 2 million. As of 31 December 2017, exceptional effects included 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.

(2) 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 2018 and 2017.

(3) Excluding the additions from business combinations and capitalised borrowing costs for investments in spectrum.

(4) Total CapEx excluding additions from capitalised finance leases.

(5) The calculation is based on total CapEx.

(6) The calculation is based on CapEx.

(7) 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.

(8) Starting in the 2017 financial year, Telefónica Deutschland Group introduced an additional method of counting the number of mobile accesses. This method takes market practices into account, among other things, when determining the time frame for inactive customers.

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

(10) The debt ratio is defined as net financial debt divided by the OIBDA for the last 12 months adjusted for exceptional effects.

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 47.1 million customer accesses as of 31 December 2018, Telefónica Deutschland Group is one of the three leading integrated network operators in Germany. We offer mobile and fixed services for private and business customers as well as innovative digital products and services in the area of IoT (Internet of Things) Advanced Data Analytics. In addition, our numerous wholesale partners purchase extensive mobile communications services from us.

In the mobile sector, we serve the increasing demand for mobile services as a consequence of the digitalisation of ever more areas of life. We are the only telecommunications provider with mobile communications network of its own that concentrates exclusively on Germany – Europe's most attractive mobile communications market. With a total of 42.8 million mobile accesses as of 31 December 2018, we are a leading provider in this market. We have a direct customer relationship with more than 80% of our mobile customers. In addition, we have already acquired 4.3 million fixed-line customers for our telephony and high-speed internet products. 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
A key success factor of our marketing and sales approach is our 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.

We rely on complementing sales channels in order to serve the various customer needs to the best of our ability. Our sales landscape includes both direct sales channels including 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.

G 01

OUR BRANDS[1]

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

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. In addition, by means of joint activities and strategic partnerships, we offer further mobile services brands. These include, for example, TCHIBO mobile or ALDI TALK, in cooperation with MEDIONmobile. 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.

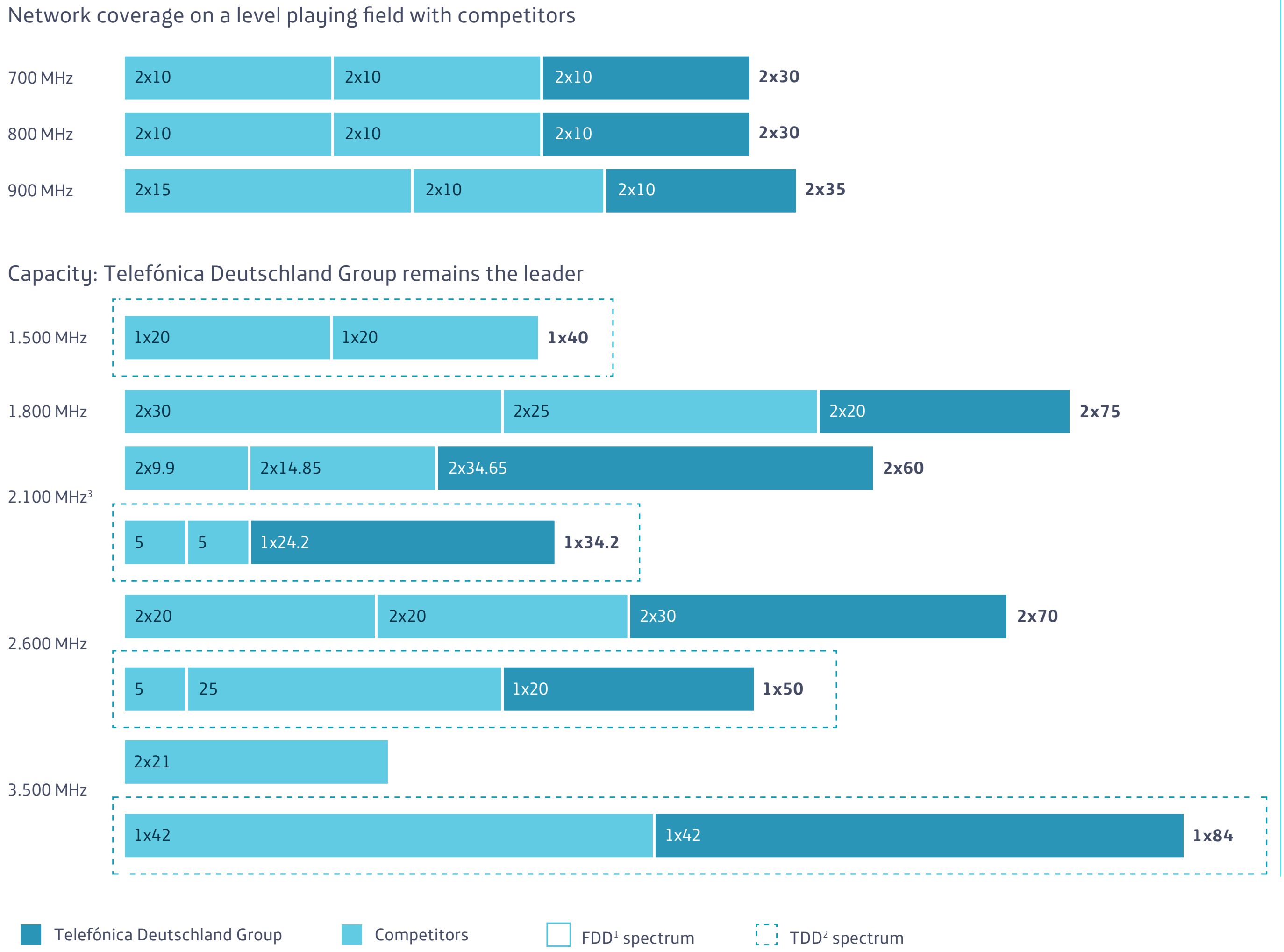
Mobile service is the main revenue stream
In 2018, at EUR 5,267 million, mobile services were the most important revenue stream for the Telefónica Deutschland Group (72% of total volume). In this area, we offer private and business customers mobile voice and data services both on a contractual basis (postpaid) and in the prepaid segment.

The basis for this is our state-of-the-art mobile communications network. By the end of 2018, we had largely completed the merger of the O_2 and E-Plus networks, which will allow our customers to benefit from the strength of the new joint network. The combined UMTS/LTE coverage for mobile internet is approximately 95%. The Telefónica Deutschland Group has also consistently continued the expansion of its LTE network. As of the end of December 2018, the Company achieved a Germany-wide LTE coverage rate of 88%. We thus provide a high-quality network experience particularly in urban and suburban areas.

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



[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)

Hardware business: State-of-the-art products and financing offers
We use many channels to distribute a wide variety of terminal devices to our customers. Via our O_2 My Handy programme, customers can, for example, buy any device in O_2's offering – regardless of their mobile phone contract, whether mobile phone, tablet or smart watch – immediately or pay in 24 monthly instalments. For the customer, this approach offers more flexibility and more transparency with regard to the costs of the mobile phone or mobile phone 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 mobile contract. We also supply our wholesale 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 7 percentage points compared to 31 December 2017 to around 44%[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.

Innovative products and digital services open up additional business potential
In order to make our smartphone offerings even more attractive to our customers, we offer additional products such as insurance benefits and virus protection. Additional digital services, such as video and music streaming, a gaming flat rate for mobile devices, an online fitness studio or our award-winning O_2 Banking, provide our customers with additional added value.

We are also driving forward the digital growth areas of Advanced Data Analytics (ADA) and IoT. For example, we offer companies and public institutions new insights in areas such as transport, retail and advertising, which we create in the field of advanced data analytics. We also offer private and business customers IoT solutions to open up the connected world of the Internet of Things.

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. It grants us long-term access to future-proof next-generation fixed-line infrastructure, and currently provides a total of more than 32 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 fiber-optic. With these advantages, Telefónica Deutschland Group is in an excellent position to provide full service fixed-line offerings to both residential and business customers.

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.

Private customers: Offering mobile freedom in the digital world
The O_2 brand is a market leader in the consumer postpaid 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 tariff portfolio. O_2 Free has become even more attractive with the introduction in June 2018 of the tariff components Connect (up to 10 SIM cards for any mobile device included in the mobile phone contract) and Boost (double data volume for an extra charge of EUR 5). Since August 2018, we have been offering our customers unlimited data volume at a competitive price with O_2 Free Unlimited.

The large data packages in the O_2 Free tariffs offer customers an impressive price/performance ratio. 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. We are also seeing rising interest in smartphones and the use of mobile data in the prepaid area. In July 2018, we therefore introduced our completely revised O_2 my Prepaid tariff portfolio, which addresses smartphone users in particular.

[2] Based on mobile accesses excluding M2M accesses.

Our new O_2 my Home tariff portfolio launched in October 2018 is another firm step towards positioning O_2 as a brand offering freedom in the DSL area. This enables us to offer residential customers speeds of up to 100 Mbit/s within their own homes. Since August 2018, we have also been offering O_2 my All in One, a tariff that combines unlimited mobile communications with a fully-fledged fixed-network connection including a telephony and internet flat rate at a competitive price/performance ratio.

The Blau brand is the second O_2 brand clearly defined for price-conscious private customers, offering this customer segment a mobile communications portfolio reduced to the essentials and transparent communication. In the summer of 2018, the new Blue tariff portfolio was introduced, which lives up to this customer promise and offers mobile freedom at an attractive price/performance ratio.

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 from the reseller and service provider include MEDIONmobile (ALDI TALK), 1&1 Drillisch, mobilcom/debitel and cable providers. We also address ethnic target groups with brands such as AY YILDIZ or Ortel Mobile. As part of the merger with E-Plus, 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. Drillisch also has an option to increase the network capacity to a total capacity of up to 30%.

Business customers: Focus on small and medium-sized enterprises (SMEs)
We serve SMEs and Small Offices/Home Offices (SoHo) via our core brand O_2, for example with the innovative product portfolio O_2 Free Business and the product O_2 Business Fusion. O_2 Business Fusion is a comprehensive offering consisting of mobile communications, internet and fixed-line telephony, in which the customer receives everything needed for communication at work or on the move in a combined product, and at an impressive price/performance ratio. With O_2 Unite, we also offer a pooling rate model for corporate customers that is unique in the German market.

Within the business customer market area we also offer machine-to-machine-communication (M2M) and managed connectivity services. We intend to further expand this business area in the future. The focus of our product Telefónica IoT Connect, for example, is not only on the pure transmission of data, but also on intelligent networking and the control of connectivity, enabling a broad spectrum of new services that can be flexibly adapted to the requirements and needs of customers.

New business: Internet of Things and Advanced 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 the field of 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.

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 take a leading role in the area of Consumer IoT.

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. Supervisory Board 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 the invitation to the Annual Shareholders' Meeting.

In the eight-person Management Board, all operational and strategic decisions for successfully managing the Company in the individual business divisions are taken in weekly meetings. This comprises 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. 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. 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.

This systematic approach serves as the basis for identifying both growth opportunities and risks and as the source of our corporate strategy and investment decisions. The corporate strategy is then translated into concrete strategies for the different organisational units. At this level, the opportunities relevant to the respective organisational unit are prioritised in the operational implementation of the strategy.

Our vision is to become the Mobile Customer and Digital Champion in Germany by 2022. To achieve this, our first strategic priority is to strengthen the fundamental foundations of our business: an excellent customer service, stable IT systems, a powerful organisation and an appropriate regulatory framework. The second priority is to improve the customer experience in the digital age. This starts with providing a better, faster and more powerful network and a compelling range of products and services tailored to the customer's everyday digital life. To this end, we have also launched our "Digital4Growth" transformation program, with which we aim to achieve EUR ~600 million in gross OIBDA effects by 2022. "Digital4Growth" is designed to generate further growth and make the company faster, simpler and better.

Our third priority is to develop growth potential in our core business and new business areas, combined with the positive development of our profitability. The company will press ahead with data monetisation and expects to increase sales to market levels in the medium term. Telefónica Germany Group intends to use the digital transformation to further improve margins and at the same time keep its investments (CapEx) stable in the medium term. Based on a conservative financing profile and supported by a solid free cash flow, the company will continue to offer its shareholders attractive returns.

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DIGITAL4GROWTH: GOALS BY 2022

O_2 App penetration **>80%** (vs. 20% 2017)	**Tariff reduction** **-40%**	**Total IT expenditure / customer** **-15%**	**PO customer migration** **-2% percentage points**
Lead time product **Within hours**	**Manual interventions in the back office** **-80%**	**Share of digital distribution channels** **>25%** (vs. 15% in 2017)	**GA market share in SME segment** **~ 30%**
Devices connected to the network / customer **#4** (vs. #1.5 in 2017)	**eCare share of service incidents** **~ 80%** (vs. 65% in 2017)	**Reduction of shops** **>10%**	**Sales increase through IoT** **~200-300 EUR million cumulated**

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 starting in financial year 2018:

G 04

PERFORMANCE INDICATORS

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 cash flow	Net leverage ratio	Nets adds in mobile communications business	Customer satisfaction	Employee satisfaction

Revenues
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. In order to improve comparability with previous years, we have adjusted this figure to reflect the regulatory effects of the year under review.

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' in the digital markets of the future, 'Advanced Data Analytics' and 'cloud computing'.

Operating result adjusted for exceptional effects
The OIBDA corresponds to the operating income before amortisation of intangible assets and depreciation on 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. 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 ratio (CapEx/Sales ratio)
For the Telefonica Deutschland Group, the investment ratio (CapEx/Sales ratio) essentially serves to secure our future business activities and reflects the percentage share of investments in revenue. Capital expenditure (CapEx) consists of the additions to property, plant and equipment and other 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. Investments in mobile frequency licences and mergers are not included in CapEx. Following the introduction of IFRS 16, additions from capitalised right-of-use assets continue not to be part of the investments underlying the calculation.

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

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.

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 provides information about the change in working capital. Working capital management is thus an essential element of the managing of free cash flow in the relevant reporting period.

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

Net leverage ratio

The net leverage ratio 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).

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. In view of the impact of the implementation of IFRS 16 as of 1 January 2019, and to ensure appropriate financial flexibility with respect to the forthcoming spectrum auction and 5G investment, we will review and probably increase the targeted level during the 2019 financial year. As part of the adjustment, we intend to maintain our investment grade BBB rating from Fitch.

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 positive number of net adds leads to a growing customer base. A distinction is made between contractual customers (postpaid) and customers without a contractual commitment (prepaid). The number of net adds is influenced by various factors: More new customers can be won with a highly attractive product portfolio and a high level of customer satisfaction among existing customers leads to a lower churn rate. One of the goals of this performance indicator is to allow the evaluation of customer acquisition and retention measures.

Customer satisfaction

Customer satisfaction is among the most important priorities of our business. Accordingly, we continually strive for a better positioning of our brands in order to attract private, partner and business customers for our products. Our objective is to serve the most satisfied customers on the German telecommunications market with the most popular brands. This means that we always strive to create customer-oriented offers and provide outstanding services across all our customer interfaces. We are confident that high customer satisfaction values reduce termination rates and increase recommendation rates. 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.

Employee satisfaction

The success of Telefónica Deutschland Group is largely based on the commitment and professional qualifications of the company's employees. Only with them can the digital transformation of the company and thus sustainable economic success be achieved. Our employees have made our company what it is today. In order to evaluate the commitment of our employees and the general working climate, we conduct an annual online, anonymous and voluntary survey among all employees of the Telefónica Deutschland Group on employee satisfaction. The results we obtain are communicated and intensively discussed in workshops at all management levels. The aim of this is to allow the organisation and the individual areas to develop and improve continuously.

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 continues to grow. However, the economy is being dampened by a difficult foreign trade environment and temporary exceptional effects in the automotive industry. According to initial calculations by the Federal Statistical Office, the price-adjusted gross domestic product (GDP) in 2018 will be 1.5% higher than in the previous year. This means that the German economy has grown for the ninth consecutive year. German economic growth has lost some of its momentum, but in 2018 was still above the average of +1.2% for the last ten years. The growth drivers in 2018 were consumption and investment: Both private consumer spending (+1.0%) and government spending (+1.1%) were higher than in the previous year. The labour market continues to develop positively and in 2018 the number of people in employment reached a new high. On average, in 2018 44.8 million employed persons contributed to the economy in Germany.

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:

Today's consumers are mobile. They want to be online anytime, anywhere. The smart phone has developed from a pure communications device into a universal mobile companion and the control centre of mobile life. According to a survey by the industry association Bitkom, 57 million German citizens aged 14 or older used a smartphone in 2018. The smartphone is also paving the way for new technologies such as augmented and virtual reality, as well as voice control. Voice control is conquering living rooms in the form of stationary digital voice assistants such as Amazon Echo and Google Home. According to the industry association Bitkom, every eighth German citizen over the age of 18 uses an intelligent loudspeaker with a digital voice assistant.

The trend towards connectable products is continuing. This is supported by the introduction of eSIM as the key to the Internet of Things. More and more manufacturers are bringing eSIM-enabled smartphones and wearables onto the market. At the same time, the per capita number of connected mobile devices is increasing. The boundaries between consumer electronics, information and communication services and even traditional household appliances, such as refrigerators or coffee machines, are increasingly disappearing as a result of control via smartphones or digital voice assistants.

The television market is also 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 the most widespread form of television. On the other hand, video streaming has become an integral part of media consumption: Watching video clips, series and films on demand is already part of everyday media life for many people in Germany. This is reflected in rising user numbers and growing willingness to pay of the customers.

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 116.4 million customers (SIM cards) at the end of September 2018, the German mobile telecommunications market is the largest in the EU. The notional mobile penetration rate was 141%, i.e. each German citizen had an average of 1.4 mobile SIM cards. The customer growth from January to September 2018 was attributable primarily to the more valuable postpaid sector. Overall, postpaid customers accounted for 55.9% of total connections as of the end of September 2018. This share was 53.9% at the end of September 2017.

The mobile market continued to develop dynamically in 2018, but rationally, with a clear focus of providers on profitable growth, increased data usage by customers and the monetisation of tariffs with large data volumes.

The steadily growing demand for more data-intensive internet services has led to a further increase in mobile data usage. According to analyst estimates, average data consumption per mobile customer rose from 1.2 GB in 2017 to 1.9 GB in 2018. This corresponds to an increase of around 60 percent.

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

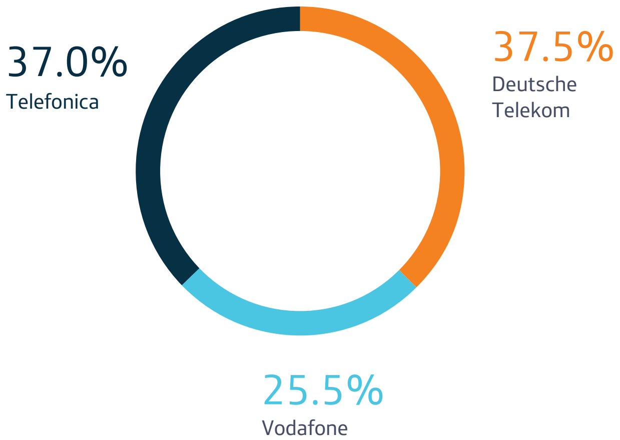
The German mobile telecommunications market is an established market

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). At the end of September 2018, the Telefónica Deutschland Group held a market share of 37.0% with 43.0 million mobile customers (according to calculation customary to the market[3]: 45.4 million).

[3] Starting in the 2017 financial year, Telefónica Deutschland Group introduced an additional method of counting the number of mobile accesses. This method takes market practices into account, among other things, when determining the time frame for inactive customers.

G 05

MARKET SHARE IN THE MOBILE TELECOMMUNICATIONS MARKET
BASED ON CUSTOMERS (IN %)
AT THE END OF SEPTEMBER 2018



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 around 3% year-on-year; the customer base is therefore estimated to have grown to 34.3 million by the end of 2018. 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 2018, more than 33% of fixed line customers used connections of at least 50 Mbit/s; at the end of 2017 this was still at 28%. 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 8% in 2018 to an average of 90 GB per connection.

Source: Analysys Mason, Bundesnetzagentur, 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 is continuing the process to provide new frequencies in the 2 GHz and 3.6 GHz ranges

As a result of its frequency requirements assessment begun at the end of 2017 and following public consultation on corresponding drafts at the beginning of 2018, the BNetzA published Presidential Chamber Decisions I and II on 14 May 2018. According to these decisions, the frequencies in the 2 GHz and 3.4 to 3.7 GHz ranges identified for nationwide provision will be allocated by auction and, at 2 GHz, the frequencies expiring at the end of 2020 and the end of 2025 will be allocated jointly. At the spectrum ranging from 3.7 to 3.8 GHz is excluded from the auction and is to be allocated in an application procedure. The Telefónica Deutschland Group filed an action against the decisions in due time and instituted summary proceedings to establish the suspensive effect of the action. In the summary proceedings, the Administrative Court of Cologne rejected the application for provisional legal protection as unfounded in its decision of 21 December 2018; in the parallel proceedings, a first instance decision is expected during 2019.

Following an oral hearing on 13 July 2018 and the public consultation procedure on corresponding drafts in which Telefónica Deutschland Group participated which began at the end of September 2018, the BNetzA published the final Presidential Chamber Decisions III and IV on the frequency usage regulations and the auction rules on 26 November 2018. The decisions provide for far-reaching coverage obligations for households and transport routes including railways, federal motorways, federal highways and state roads as well as seaports and waterways. In some cases, the supply by other mobile network operators is to be credited. A transmission rate of 100 Mbit/s is prescribed for households, federal motorways, federal highways and railways with heavy passenger traffic, and 50 Mbit/s for other traffic routes. A maximum latency of 10ms is specified for federal motorways and federal highways. In addition, the regulations call for the building of 500 base stations for rural areas and 1,000 base stations for 5G applications. Different coverage obligations apply to new entrants. In addition, frequency allocation holders are obliged to negotiate with suitable service providers regarding the shared use of radio capacities, with suitable interested parties regarding the local or regional provision of spectrum at 3.6 GHz and with other nationwide allocation holders regarding roaming and infrastructure sharing. Applications for admission to the auction could be submitted in writing until 25 January 2019. The auction is scheduled to begin in the first quarter of 2019. In December 2018, Telefónica Deutschland Group filed an action against Presidential Chamber Decisions III and IV in due time.

Parallel to the award procedure, the BNetzA is preparing an application procedure for frequency allocations in the 3.7 to 3.8 GHz range and has consulted a draft on which Telefónica Deutschland Group submitted its comments by 28 September 2018. Local allocations are planned for some of the frequencies, primarily with a view to applications for industry 4.0. In addition, reciprocal rights of co-use between nationwide and local allocations as well as the demand-oriented supply of 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 the frequency range above 24 GHz, the BNetzA is also initially preparing an application procedure for 26 GHz. To this end, in 2018 the BNetzA developed initial considerations which are to serve as a basis for the development of allocation regulations and on which the Telefónica Deutschland Group submitted its comments by 19 October 2018.

The application procedures are to be further developed in 2019 and finalised in good time before the start of the auction.

Local roaming

The government coalition is considering initiating a legislative process to introduce an enabling basis for local roaming in the near future, or the corresponding regulations in the current 5th TKG Amendment Act. These powers of authorisation are intended to allow BNetzA to order significant gaps in local roaming in locally delimitable areas to be filled. These orders would be directed at mobile network operators, which would compete with each other. The legislative process is not expected to be completed before March 2019. The Telefónica Deutschland Group considers this legislative proposal to be an unnecessary and disproportionate intervention in the competitive mobile telephony market.

Overall mobile communications concept 2019

In a resolution dated 26 November 2018, the BNetzA Advisory Council determined that it would like to develop an overall concept for the expansion of mobile communications networks in Germany by mid-2019 together with the BNetzA, the German federal government, the Bundestag and the federal states. The aim of this concept is to develop a path for the further development of mobile radio networks in rural areas. From the perspective of the Telefónica Deutschland Group, it cannot be expedient to develop such a concept without the participation of the market. The Telefónica Deutschland Group will therefore play an active role in the political process.

Telecommunications market

EU revises legal framework for telecommunications (telecoms review)

The European Parliament adopted the EU Code of Conduct for Electronic Communications on 16 November 2018 and the European Council gave its approval on 4 December 2018. The EU Code provides for a fundamental revision of the rules for the telecommunications 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, investment-friendly access regulation and the future institutional framework. The Code sets the right course, but also contains ambiguities, especially with regard to the future structure of access regulation. The final EU regulations entered into force on 20 December 2018 and still have to be transposed into national law. In Germany, the legislator plans to draft a corresponding amendment to the Telecommunications Act in 2019.

Discontinuation of data retention by BNetzA

In 2017, 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 temporarily discontinued the retention in 2017. The legally binding clarification of the legality of the storage obligation also continued in 2018.

Access and compensation regulation

Roaming-like-at-home

In 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 was in line with the specifications of BNetzA, the warning was not agreed to. The VZBV therefore filed an action. A court decision is expected in the first half of 2019.

EU regulates price caps for intra-EU calls and SMS as of May 2019

By way of an amendment to the Roaming Regulation that came into force in December 2018, charges for calls and SMS from Germany to other EU countries will be capped with effect from 15 May 2019. A maximum charge of 19 EUR cents per minute may then be levied for calls and 6 EUR cents per SMS (net in each case) for SMS messages. This change has a direct effect in all EU member states and does not require a national legal transposition act.

MTR and FTR

The mobile termination fees (MTR) approved by the BNetzA in its decision of 6 March 2017 were further reduced as planned from 1 December 2018 from 1.07 EUR cents per minute to 0.95 EUR cents per minute. This fee is effective until 30 November 2019. Approval procedures for the MTRs valid from 1 December 2019 will be carried out in 2019.

The fixed termination rates (FTR) of 0.1 EUR cents per minute expired at the end of December 2018. The Telefónica Deutschland Group has submitted a new fee application to BNetzA for the subsequent period. A provisional retroactive decision is expected at the beginning of 2019. It is expected that charges will continue to be set symmetrically for all regulated fixed network operators in the future. The FTRs of Telekom Deutschland GmbH serve as a reference benchmark for all the other fixed line operators.

BNetzA Consultation and market investigation on fibre-optic infrastructures continues

The investigations initiated by the BNetzA in 2017 on “Issues of price regulation for FttH/B-based wholesale products with a view to the roll-out of high-performance fibre-optic infrastructures” as well as on the need for regulation and the existence of significant market power on markets 3a (= market for wholesale access provided locally at a fixed location) and 3b (= market for wholesale mass market products provided centrally at a fixed location) continued in 2018. The core issues of these investigations were the questions of the regulatory support for an accelerated roll-out of fibre-optic networks based on charges and the allocation of FttH/B-based wholesale products to the nationwide access market, which also includes copper-based and cable connections. Initial decisions are expected to be made in the second quarter of 2019 at the earliest.

Introduction of a regulated wholesale product “Super Vectoring” by Telekom

In August 2018, Telekom Deutschland GmbH expanded its product offering as part of the regulated wholesale service “Bitstream Access” through “Super Vectoring” connections. This significantly increases the possible bandwidth of VDSL connections compared to today (from max. 100 Mbit/s to up to 250 Mbit/s). Super Vectoring is not available nationwide, but Telekom is continuously upgrading its network infrastructure. The prices offered by Telekom for super vectoring were reviewed by the BNetzA and considered competitive. An improvement in Telefónica Deutschland Group’s competitive position in the fixed line market is expected due to Super Vectoring as competitiveness versus cable network operators and FTTB/H providers can be improved.

Overview of the Financial Year 2018

In 2018, the German mobile communications market environment remained dynamic yet rational across segments, with a clear focus on profitable growth on the back of increased customer data usage and the monetisation of tariffs with large data volumes. In order to support and promote this, we have relaunched the O_2 Free portfolio and the Blue portfolio for more price-sensitive customers. In addition, we have expanded our portfolio by various Unlimited tariffs for retail and business customers. We continue to focus on offering mobile freedom to our customers. The new O_2 Free tariffs – with the Double-Data Boost option and the unique O_2 Connect option for up to 10 devices – support our ARPU-up strategy and help us counteract legacy base effects, OTT effects and the ongoing negative regulatory effects on mobile service revenue.

By the end of financial year 2018, we had largely completed network integration and the network test results confirm the positive impact. Telefónica Deutschland Group network, for example, achieved a clear improvement in the Chip test and the Connect network test. Parallel to finalising the network integration, we pushed ahead with the nationwide expansion of LTE and added additional LTE elements in almost all cities in Germany. In addition to expanding LTE along important transport infrastructure, we also connected further communities in sparsely populated areas to our network. Overall, we thus added more than 6,700 LTE stations to our network in 2018.

The successful finalisation of network integration and the resulting significant improvement in our network quality is an important milestone on our way to becoming the “Mobile Customer and Digital Champion”. Building on these achievements, we will continue to expand and optimise our mobile network while further improving customer experience. In addition to expanding LTE, which also includes improving network coverage along important transport routes such as motorways and ICE lines.

As of the end of December 2018, Telefónica Deutschland Group’s customer accesses amounted to 47.1 million, a decrease of 1.1% compared to the same period of the previous year. The number of mobile accesses was 42.8 million[4] at the end of the year, a decrease of 0.8% compared to the previous year. This was in particular due to the decline in the customer base in the mobile prepaid segment as a result of changes in the regulatory environment (legitimation check and European roaming regulation) and the pre- and postpaid market trend.

The mobile postpaid business continued to show a positive trend with 1,002 thousand net additions in the 2018 financial year. The contribution of the partner business remained solid in a rational market environment and contributed 60% to gross additions in the 2018 financial year. Telefónica Deutschland Group maintained its primary focus on customer retention and the development of its existing customer base. By the end of December 2018, the prepaid customer base decreased by 1,338 thousand net disconnections and amounted to 20.5 million connections, a minus of 6.1% compared to 31 December 2017. The churn rate in the postpaid segment was stable at 1.6% in the 2018 financial year. The churn rate in the O_2 postpaid consumer business remained low and improved by 0.1 percentage points year-on-year to 1.4% in the 2018 financial year.

Revenue was EUR 7,320 million, an increase of 0.3% year-on-year (EUR 7,290 million, a decrease of 0.1% year-on-year based on IAS 18). Adjusted for negative regulatory effects totalling EUR 44 million, revenue in financial year 2018 amounted to EUR 7,364 million, an increase of 0.9% year-on-year (EUR 7,334 million, an increase of 0.5% year-on-year based on IAS 18). The positive effects from the marketing of the O_2 Free Portfolio were partially offset by the ongoing headwind of OTT trends and shifts within the customer base.

OIBDA was EUR 1,797 million, compared to EUR 1,785 million in the previous year, an increase of 0.7%. As per IAS 18 reporting, OIBDA was EUR 1,762 million, a decrease of 1.3%. Adjusted for exceptional effects[5] and excluding regulatory effects in 2018, OIBDA amounted to EUR 1,938 million in 2018, an increase of 5.3% (EUR 1,903 million, an increase of 3.4% based on IAS 18) compared to EUR 1,840 million in 2017. The exceptional effects amounted to EUR 87 million and were mainly related to network consolidation. Usage elasticity effects in connection with the European roaming legislation were the main driver of the negative regulatory effects in the amount of EUR 54 million. Additional savings from OIBDA-relevant integration activities totalled to approximately EUR 100 million in 2018. The good progress of network consolidation enabled us to bring forward savings of EUR ~20 million from 2019 to the reporting year. As a result, the OIBDA margin adjusted for exceptional effects[2] and excluding regulatory effects rose by 1.1 percentage points year-on-year to 26.3% (by 0.7 percentage points year-on-year to 25.9% as per IAS 18 reporting) in financial year 2018.

As expected, capital expenditure (Total CapEx) in the financial year 2018 rose by EUR 16 million year-on-year to EUR 966 million due to the massive network consolidation efforts and the simultaneous LTE expansion, with additional synergies of around EUR 50 million being realised.

[4] From the 2017 financial year, Telefónica Deutschland Group introduced a supplementary methodology for counting mobile accesses. This method takes market practices into account, among other things, when determining the time frame for inactive customers. According to the new counting method, we had more than 45.3 million mobile accesses as of the end of December 2018.

[5] Exceptional effects in the financial year 2018 included restructuring expenses of EUR 84 million and consultancy costs related to M&A-transactions amounting to EUR 2 million; the regulatory effects amounted to EUR 54 million in the year under review.

T 01

OVERVIEW OF FINANCIAL YEAR 2018

	Reference value 2017 (in EUR million)	Original Outlook 2018[6] (year-on-year in %)	Updated Outlook 2018[6,7] (year-on-year in %)	2018 financial year (year-on-year in %)	Evaluation
Revenue	7,296	Broadly stable (excluding negative regulatory effects of EUR 30-50 million)	Broadly stable (excluding negative regulatory effects of EUR 30-50 million)	+0.5% Based on IAS 18	As expected
Operating income before depreciation and amortisation (OIBDA), adjusted for exceptional effects	1,840	Broadly stable to slightly positive (excluding negative regulatory effects of EUR 40-60 million)	Slightly positive (excluding negative regulatory effects of EUR 40-60 million)	+3.4% Based on IAS 18	As expected
Investment ratio	13%	Approx. 12-13%	Approx. 12-13%	13.2%	As expected
Dividends	0.26 EUR/share As approved by the Annual General Meeting on 17 May 2018	Annual dividend growth for 3 consecutive years (2016-2018)	Annual dividend growth for 3 consecutive years (2016-2018)	Dividend proposal of EUR 0.27 per share to the Annual General Meeting in May 2019	As expected

[6] 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.
[7] With the publication of the quarterly report as of 30 September 2018, the range for OIBDA adjusted for exceptional effects was specified.

Business development is further detailed in the following sections.

Results of Operations

T 02

CONSOLIDATED INCOME STATEMENT

1 January to 31 December

(in EUR million)	2018	2017	Change	% change
Revenues	**7,320**	**7,296**	**24**	**0.3**
Other income	177	159	17	11.0
Operating expenses	(5,700)	(5,670)	(29)	0.5
Supplies	(2,459)	(2,396)	(64)	2.7
Personnel expenses	(610)	(642)	32	(5.0)
Impairment losses in accordance with IFRS 9[1]	(79)	(73)	(5)	7.3
Other expenses	(2,552)	(2,560)	8	(0.3)
Operating income before depreciation and amortisation (OIBDA)	**1,797**	**1,785**	**12**	**0.7**
OIBDA margin	**24.6%**	**24.5%**	**–**	**0.1%-p.**
Depreciation and amortisation	(1,987)	(1,869)	(118)	6.3
Operating income	**(190)**	**(84)**	**(106)**	**>100**
Financial result	(42)	(34)	(9)	26.0
Profit/(loss) before tax	**(233)**	**(118)**	**(114)**	**97.0**
Income tax	3	(262)	265	(>100)
Profit/(loss) for the period	**(230)**	**(381)**	**150**	**(39.5)**

[1] The rules of IAS 39 were applicable to the comparison period.

T 03

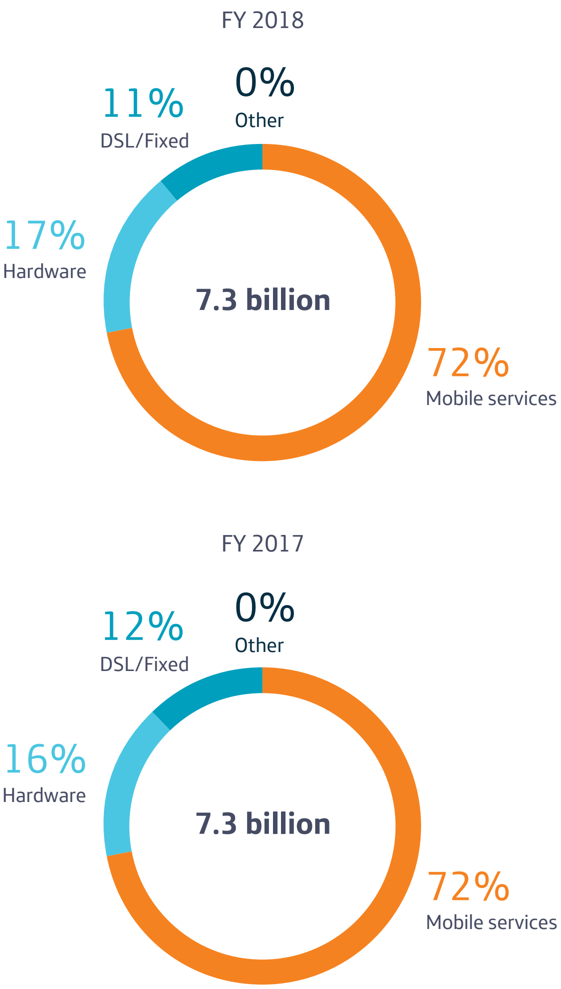
REVENUE BREAKDOWN

1 January to 31 December

(in EUR million)	2018	2017	Change	% change
Mobile business	**6,539**	**6,415**	**125**	**1.9**
Mobile service revenues	5,267	5,287	(20)	(0.4)
Handset revenues	1,272	1,128	144	12.8
Fixed line/DSL business revenues	**767**	**862**	**(95)**	**(11.0)**
Other revenues	**13**	**19**	**(6)**	**(30.1)**
Revenues	**7,320**	**7,296**	**24**	**0.3**

G 06

REVENUES
(IN % AND EUR BILLION)



Increase in revenue

Revenues increased in the course of the financial year 2018 due to strong revenue growth in the handset business. As a result, the decrease in Fixed line/DSL business revenues due to a lower DSL customer base and the decommissioning of the ULL infrastructure of the wholesale business, as well as lower mobile service revenues due to regulatory effects related to the European Roaming Legislation (>ANNUAL REPORT 2018, REGULATORY INFLUENCES) were offset. Excluding the regulatory effects of EUR 44 million, revenues were 0.9% higher than prior year level.

Mobile service revenues slightly declining

The revenue decline in an ongoing challenging and competitive German market environment reflected regulatory effects, sustained OTT trends, and the ongoing legacy base rotation. Excluding the regulatory effects mainly from the EU roaming legislation, mobile service revenues were higher than prior year level. Telefónica Deutschland Group still operates in a dynamic competitive environment in which the above-mentioned revenue effects continued to have opposite effects to the benefits from the successful marketing of the O_2 Free portfolio to new and existing customers. The good development of our partner brands contributed to the continuous postpaid customer base growth. Thereby the greater availability of 4G products in this market segment was a key factor. Consequently, our mobile postpaid customer base increased by 1,002 thousand net adds to 22.3 million in financial year 2018 (2017: increase of 737 thousand), which led to an increase of the postpaid share of total mobile customers by 2.7 percentage points to 52.0% year-on-year. Despite a low price level in our partner business and the impact of regulatory effects, the average revenue per user (ARPU) could be increased to EUR 10.0 in comparison to the previous year (2017: EUR 9.7). 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. The percentage share of non-SMS data revenues in data revenues rose by 4.6 percentage points year-on-year to 85.4%.

Increase in handset revenues
Handset revenues are generally subject to general fluctuation, as they depend on the launch of new mobile devices. Due to improved demand for mobile devices in financial year 2018, the handset sales– including to mobile service partners – increased year-on-year.

Decline in fixed-line/ DSL business revenues
In the course of the decommissioning of the ULL infrastructure, the wholesale customer migration was also finalised in the financial year 2018. The associated revenue decline contributed to a reduction in fixed-line revenue. On the contrary fixed retail revenue once more benefited from rising demand for VDSL as well as from a largely stable customer base compared to previous year, resulting in a slowdown of the revenue decrease.

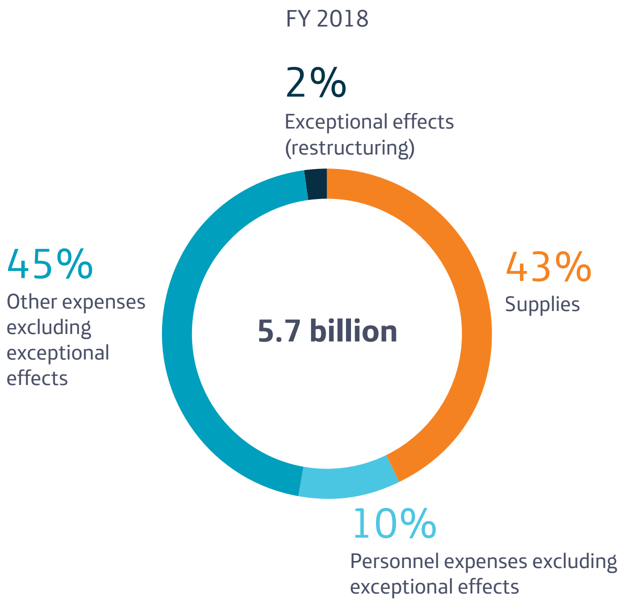
Increase in operating expenses
Higher hardware cost of sales relating to the higher demand for handsets outweighed savings from integration-related measures and a market strategy focusing on value over volume, thus operating expenses increased year-on-year. Operating expenses in financial year 2018 include restructuring costs of EUR 84 million, mainly related to network consolidation.

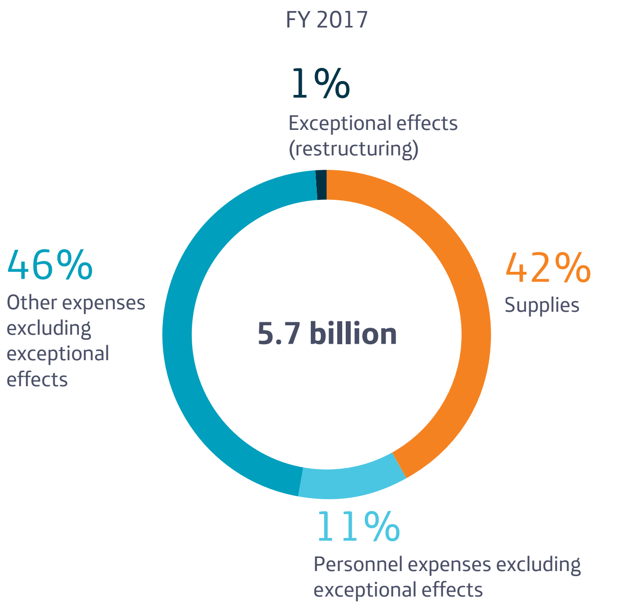
Increase in supplies
Cost for supplies in the financial year 2018 were higher than in the previous year period. Hardware cost of sales increased year-on-year in accordance to the strong demand for handsets, while connectivity-related cost of sales declined as higher wholesale costs for outbound roaming were balanced by lower voice termination costs.

Lower personnel expenses
Personnel expenses were mainly affected by the finalisation of the employee restructuring programme in the reporting period. Restructuring expenses amounted to EUR 19 million in the financial year 2018 compared to EUR 44 million in the financial year 2017.

G 07

OPERATING EXPENSES
(IN % AND EUR BILLION)





Slight decrease in other expenses

The savings from integration initiatives were partially compensated by higher commercial investments into positioning and marketing of the O_2 Free portfolio in a dynamic but rational market environment. The other expenses included restructuring costs of EUR 66 million in the financial year 2018 (2017: EUR 38 million).

OIBDA growth reflecting successful synergy capture as well as market invest and regulatory effects

Both, OIBDA as well as OIBDA excluding exceptional effects increased year-on-year. Contributed by additional cost and revenue related synergy effects of approximately EUR 100 million. The exceptional effects amounted to EUR 87 million and were mainly related to the network consolidation. Negative regulatory effects amounted to EUR 54 million mainly on the back of higher wholesale costs in connection with European roaming legislation.

Increase in depreciation and amortisation

The increase is the result of the ongoing consolidation of the mobile communications network and the associated shortening of the useful lives of individual assets.

Operating income down

This development is due in particular to the year-on-year increase of EUR 118 million in depreciation and amortisation.

Decline in the financial result

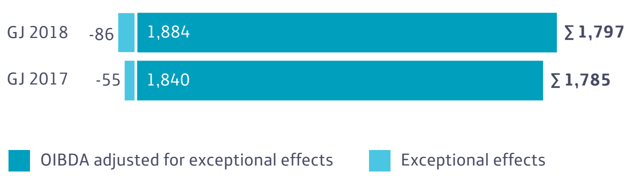
Due to the increase in financial expenses, which are mainly attributable to the refinancing of the maturing bond and the raising of another registered bond and the promissory note loan, the financial result deteriorated year-on-year.

Income tax

The Telefónica Deutschland Group did not record any positive taxable income in 2018 and will hence not pay any current income taxes, as in previous period. The tax income of EUR 3 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 262 million.

G 08

OIBDA
(IN EUR BILLION)



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 signed a syndicated loan facility of EUR 750 million, which had not been utilised as of 31 December 2018. 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 2023 for the last time in February 2018.

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 2018. 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 up to 2032 and a total volume of EUR 300 million. In February 2018, further promissory notes were issued in various tranches and a registered bond with a total volume of EUR 250 million with various maturities up to 2033 was issued.

Bond liabilities
In February 2014, O2 Telefónica Deutschland Finanzierungs GmbH placed a bond with a nominal amount of EUR 500 million and a term of seven years. In July 2018, this was followed by another bond with a nominal amount of EUR 600 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.
500	10/02/2014	10/02/2021	2.375%
600	05/07/2018	05/07/2025	1.75%

Intercompany loan
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. which had not been utilised as of 31 December 2018. The line of credit serves general business purposes and has a term until 31 July 2019.

Unused credit facilities provide financial flexibility
The Group's financial flexibility remains secure reasoned to the availability of unused credit facilities totalling EUR 2,014 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 of EUR 750 million, available overdraft facilities from Telfisa Global B.V. of EUR 54 million, and the unutilised credit facility with Telfisa Global B.V. 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 54 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 629 million in financial year 2018. The sold receivables were fully derecognised at the time of sale, with the exception of continuing involvement. Further information on silent factoring can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2018 (› NOTE 4.4 TRADE AND OTHER RECEIVABLES).

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.

Financial 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.

Net financial debt as of 31 December 2018 increased year-on-year by EUR 65 million to EUR 1,129 million, resulting in a net leverage ratio[6] for the year under review of 0.6x.

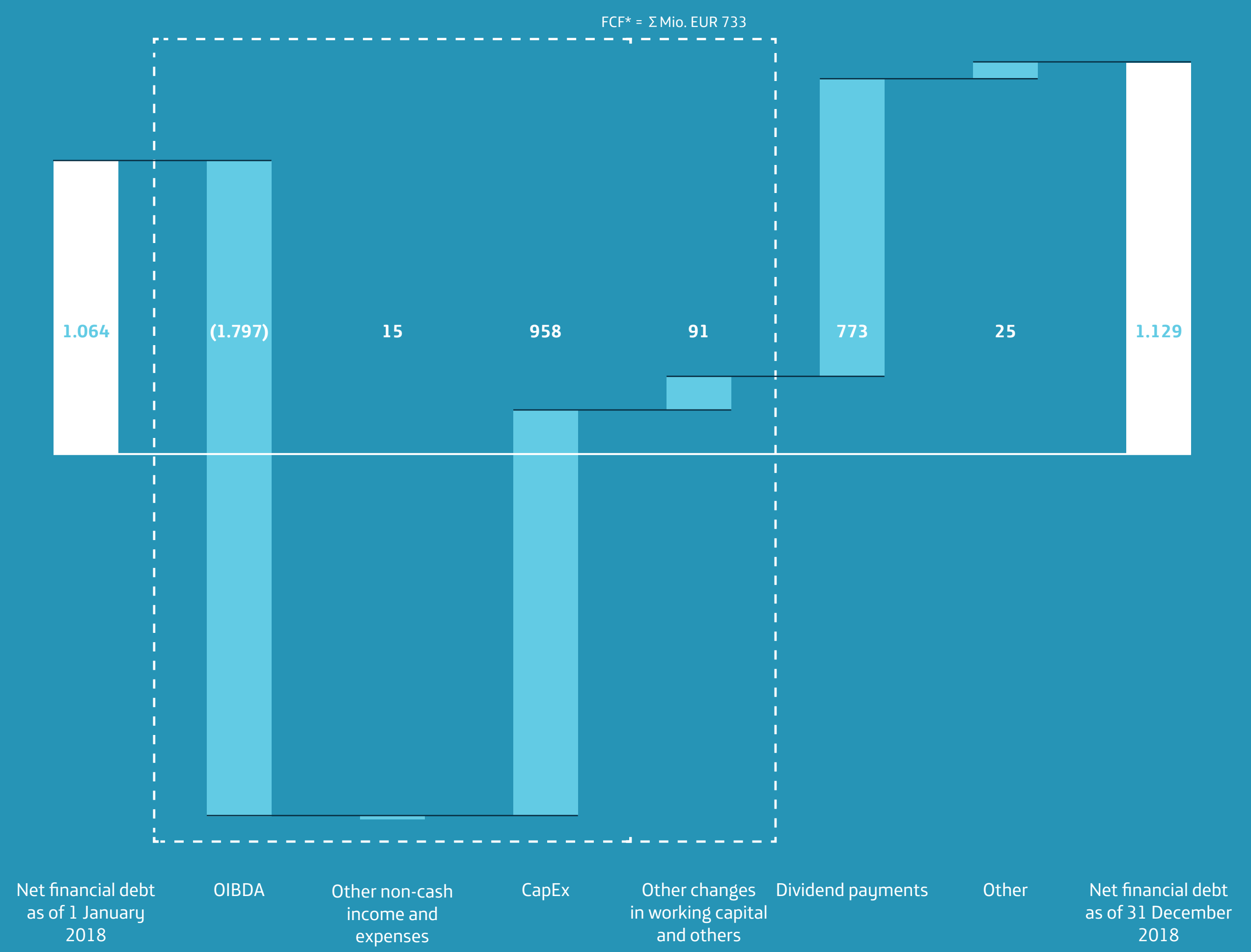
The increase in net financial debt in the 2018 financial year was primarily influenced by the dividend pay-out for financial year 2017 (EUR 773 million) as well as the free cash flow before dividend and spectrum payments of EUR 733 million.

The graphic below illustrates the performance of net financial debt in the 2018 financial year.

[6] The debt ratio is defined as net financial debt divided by the OIBDA adjusted for exceptional effects for the last twelve months

G 09

DEVELOPMENT OF NET FINANCIAL DEBT
(IN EUR MILLION)



* Free cash flow before dividend payments

T 05

DEVELOPMENT OF CONSOLIDATED FINANCIAL DEBT

As of 31 December

(in EUR million)	2018	2017	Change	% change
A Liquidity	751	587	164	28.0
B Current financial assets[1]	182	177	5	2.8
C Current financial debt[2]	145	635	(490)	(77.2)
D=C-A-B Current net financial debt	(788)	(129)	(659)	>100
E Non-current financial assets[1]	87	75	12	15.6
F Non-current financial debt[2]	2,004	1,268	736	58.1
G=F-E Non-current net financial debt	1,917	1,193	724	60.7
H=D+G Net financial debt[3]	1,129	1,064	65	6.1

(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 decreased by EUR 200 million to EUR 2,579 million, especially due to the decrease in future obligations for leased lines. The purchase obligations and other contractual obligations increased by EUR 335 million to EUR 2,538 million, especially due to an increase in hardware commitments. Further information can be found in the Notes to the Consolidated Financial Statements for the year ended 31 December 2018 (> NOTE 18. OPERATING LEASES, PURCHASE AND OTHER CONTRACTUAL OBLIGATIONS).

Liquidity analysis

T 06

CONSOLIDATED STATEMENT OF CASH FLOWS

1 January to 31 December

(in EUR million)	2018	2017
Cash and cash equivalents at the beginning of the period	**587**	**613**
Cash flow from operating activities	1,690	1,702
Cash flow from investing activities	(957)	(1,022)
Cash flow from financing activities	(569)	(706)
Net increase (decrease) in cash and cash equivalents	**164**	**(26)**
Cash and cash equivalents at the end of the period	**751**	**587**

Consolidated Statement of Cash Flows
The following is an analysis of the cash flow development of the Telefónica Deutschland Group in the financial years 2018 and 2017.

Cash flows from operating activities close to previous year
This development is primarily due to the change in working capital, which amounted to EUR -58 million in the reporting period and to EUR -26 million in the 2017 financial year. The decline in working capital was mainly driven by the build-up of inventories. The increase in trade payables had a counteracting effect.

Change in cash flows from investing activities driven by lower cash outflows
Cash outflows of EUR 982 million were EUR 88 million below those of the previous year. This was mainly due to a decline of EUR 59 million in investments in property, plant and equipment and intangible assets.

Cash inflows of EUR 25 million were EUR 23 million below those of the previous year, which were influenced by the sale of intangible assets.

Change in cash flow from financing activities influenced by various transactions
Cash outflows increased by EUR 398 million to EUR 3,095 million and are mainly attributable to the repayment of the EUR 600 million bond due in the reporting year. This was offset by the payment of EUR 111 million made in the previous year to offset the payment obligation from the mobile frequency auction.

Cash inflows from the assumption of interest-bearing debt increased by EUR 535 million year-on-year to EUR 2,526 million, primarily due to the placement of a new bond in the amount of EUR 600 million.

Increase in cash and cash equivalents
As a result of the cash inflows/(outflows) described above, cash and cash equivalents increased EUR 164 million year-on-year and amounted to EUR 751 million on 31 December 2018 (31 December 2017: EUR 587 million).

T 07

CALCULATION OF CASH FLOW AND OIBDA MINUS CAPEX

1 January to 31 December

(in EUR million)	2018	2017	Change	% change
OIBDA	**1,797**	**1,785**	**12**	**0.7**
- CapEx	(958)	(932)	(26)	2.8
= Operating cash flow (OpCF)	**839**	**853**	**(14)**	**(1.7)**
+/- Other non-cash expenses/income	(15)	–	(15)	(>100)
+/- Change in working capital	(79)	(132)	53	(40.2)
+/- Gains/(Losses) from sale of assets	(0)	(30)	29	(98.3)
+/- Proceeds from the change in consolidation scope	21	–	21	>100
+/- Proceeds from sale of property, plant and equipment, and other effects	0	31	(30)	(98.4)
+ Net interest payments	(33)	(27)	(7)	25.4
+/- Proceeds from/payments for financial assets	1	14	(12)	(89.4)
= Free cash flow pre dividends and payments for spectrum [1] as well as pre acquisition of companies, net of cash acquired	**734**	**709**	**25**	**3.5**
- Acquisition of companies, net of cash acquired	(1)	(29)	29	(98.0)
= Free cash flow pre dividends and payments for spectrum [1]	**733**	**680**	**53**	**7.8**
- Payouts for spectrum	–	(111)	111	(100.0)
- Dividends paid	(773)	(744)	(30)	4.0
= Free cash flow after dividends and spectrum payments	**(40)**	**(175)**	**135**	**(77.0)**

[1] 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

(in EUR million)	2018	2017	Change	% Change
Goodwill and other intangible assets	6,687	7,445	(759)	(10.2)
Property, plant and equipment	3,793	4,041	(248)	(6.1)
Trade and other receivables	1,371	1,334	37	2.8
Deferred tax assets	204	162	42	26.0
Other financial assets	111	111	(0)	(0.4)
Other non-financial assets	619	315	304	96.6
Inventories	261	105	156	>100
Cash and cash equivalents	751	587	164	28.0
Total assets = Total equity and liabilities	**13,796**	**14,100**	**(304)**	**(2.2)**
Interest-bearing debt	2,149	1,905	244	12.8
Provisions	714	741	(28)	(3.7)
Trade and other payables	2,438	2,242	196	8.7
Other non-financial liabilities	39	132	(93)	(70.6)
Deferred income	712	782	(70)	(8.9)
Deferred tax liabilities	177	1	176	>100
Equity	**7,569**	**8,297**	**(728)**	**(8.8)**

Decrease in intangible assets due in particular to amortisation

The year-on-year decline of EUR 1,029 million was due to the planned amortisation of intangible assets with a limited useful life. This was partially offset by the additions to intangible assets of EUR 269 million. These were related primarily to investments in software.

Decrease in property, plant and equipment particularly due to depreciation

The development compared to the previous year of EUR 959 million is mainly due to planned depreciation. In contrast, additions in the financial year 2018 amounted to EUR 697 million.

Investment ratio (CapEx/sales ratio) almost unchanged

The investment ratio was 13.2% in 2018 compared to 13.0% in the same period in 2017. Telefónica Deutschland Group primarily continued to invest in the consolidation of the network as well as in the further expansion of the LTE network.

Deferred tax assets

Deferred tax assets increased due to the separately reported increase in deferred tax liabilities, which allow a corresponding proportionate recognition of deferred tax assets (>DEFERRED TAX LIABILITIES).

Increase in other non-financial assets

The increase of EUR 429 million resulted from the first-time application of IFRS 15. The decrease in tax receivables of EUR 78 million and the decrease in advance payments, mainly due to the shortening of the terms of underlying contracts and the regular use of accruals and deferrals over several years, had the opposite effect.

Inventories of mobile devices increase

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

Increase in cash and cash equivalents

The development is due to multiple effects (>FINANCIAL POSITION).

Interest-bearing debt up on previous year

This increase resulted in particular from the taking out of promissory note loans and registered bonds in the amount of EUR 250 million. In addition, the bond due in the reporting year in the amount of EUR 600 million was refinanced.

Provisions almost the same as previous year

The change is mainly attributable to the decline in decommissioning and asset retirement obligations of EUR 30 million and the decrease in restructuring obligations due to consumption of EUR 17 million. In contrast, other provisions of EUR 12 million and pension provisions, which were EUR 6 million higher, developed in the opposite direction.

Increase in trade and other payables

Among other things, this development is attributable to the build-up of inventories at the end of the year.

Decrease in deferred income

The decrease was essentially a result of the utilisation of the 2017 year-end voucher sales and the continued decline in accruals from activation fees.

Deferred tax liabilities

In connection with the first-time application of IFRS 15, deferred tax liabilities were increased by EUR 134 million with no effect on income. In addition, tax-reducing temporary differences, including additional amortisation for tax purposes and longer amortisation periods for tax purposes in connection with intangible assets, were realised as planned.

Equity declines

The changes to equity mainly result from the dividend payment dated 23 May 2018 in the amount of EUR 773 million, from the effects of the initial application of IFRS 15 and IFRS 9 recognised directly in equity in the amount of EUR 274 million, and from the result for the period of EUR -230 million. Further effects captured in equity relate to EUR -4 million in share-based remuneration and EUR 5 million for the revaluation of post-employment benefits as well as related deferred taxes.

EMPLOYEES

The success of Telefónica Deutschland Group is largely based on the commitment and professional qualifications of the company's employees. Only with them can the digital transformation of the company and thus sustainable economic success be achieved.

It is our task to empower our own organisation for this transformation and to make our employees actors in this change. Because digital transformation is not a purely technical challenge, but above all a challenge for our structures, processes and working methods.

After completing the structural integration of the Telefónica Deutschland Group and the E-Plus Group and the associated restructuring program in 2017, we can now start the transformation with full force. We laid the first foundations for this in 2018 by focusing on learning, cooperation and new ways of working, participation and leadership development as part of our human resources strategy. The overriding goal of the Telefónica Deutschland Group is to position itself both internally and externally as an attractive employer against the background of this transformation.

We support our employees with comprehensive offers such as flexible working hours and the opportunity to work from home. This enables us to balance professional and private life, also before and during parental leave and when they return to work afterwards. 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 options for relatives, broker for private tuition or household help. These initiatives are aimed at increasing our employees' satisfaction and further developing their loyalty.

Continued development of our employees
An important goal in 2018 was the further development of the skills of our employees, because only then can we grow as a whole. We constantly need new skills in order to shape digital change ourselves, stay one step ahead of the competition and remain attractive on the labour market. To this end, we promote continuous and self-directed learning in analogue and digital form. This enables employees to integrate learning into their everyday working lives and into their self-image and develop continuously in line with the situation.

In the reporting year, the Telefónica Deutschland Group invested a total of EUR 7.6 million (2017: EUR 6.3 million) in the training and further education of its employees.

Employee satisfaction and employer attractiveness
In order to evaluate the commitment of our employees and the general working climate, we conduct an annual online, anonymous and voluntary survey on employee satisfaction among all employees of the Telefónica Deutschland Group. The results we obtain are communicated and intensively discussed in workshops at all management levels. The aim of this is to allow the organisation and the individual areas to develop and improve continuously.

Our attractiveness as an employer in the market is reflected in the number of external candidates with 10,057 job applications for 1,300 jobs advertised – a rate of 7.7 applications per published job advert. In the past year we made 857 external hires reflecting our hiring needs. (2017: 1,405 external hires).

Number of employees
In the reporting year, the Telefónica Deutschland Group had 8,990 employees (2017: 9,405 employees) based on an average calculation of the number of employees at the end of each quarter in 2018.

As at the reporting date of 31 December 2018, 8,868 staff (2017:9,281 staff) were employed by our company. The staff turnover rate was 14.1% (2017:17.4%).

SUBSEQUENT EVENTS

With regard to business transactions of particular importance that occurred after the end of the reporting year, reference is made to >NOTE 20, SUBSEQUENT EVENTS.

REPORT ON RISKS AND OPPORTUNITIES

The Telefónica Deutschland Group anticipates opportunities that are important for achieving our strategic goals. To take advantage of these opportunities, 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 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.

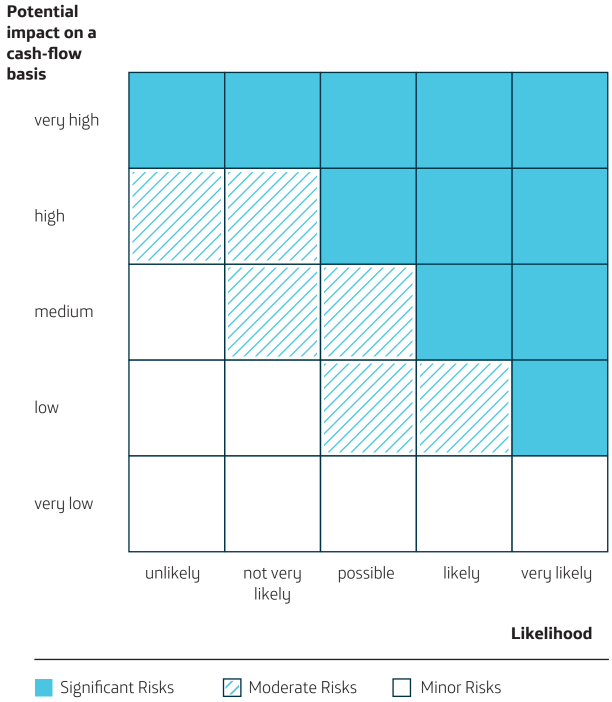
Opportunities are not recorded in the risk management system.

Risk evaluation
The following section illustrates the identified 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.

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 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.

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. We classify this risk 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.

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.

The regulatory authorities could take additional measures at any time in order to curtail 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.

Insurance
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

Reliability of our services
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.

Damage caused by cyberattacks
Cyberattacks on our network or our IT systems that are not detected or averted in good time could lead to disruptions or damage that could also affect our services and thus result in lost revenue and customer dissatisfaction. The availability and confidentiality of data that we process may be impacted by these attacks. In addition to reputational losses, legal consequences would also be possible, and we could be fined. We counter this risk on the one hand by analysing and reducing weaknesses and focusing on an early warning system, and on the other hand we are constantly improving our systems for rectifying faults and establishing increased risk awareness among our employees with regard to cyberattacks. We classify this risk as moderate.

Technical faults
Lasting or repeated disturbances or damages to our mobile telecommunications or fixed networks and in our technical facilities and systems 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. Comprehensive crisis and emergency management should enable the company to continue its core business in the event of a disruption and then ensure the resumption of all business operations in order to achieve its corporate goals. Despite the continuous adjustment of the planned measures, the resumption of business operations could be delayed in the event of disruptions or failures. We consider this risk to be significant because even minor faults can result in substantial losses in sales.

Supply chain disruptions
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 that are primarily related to the IT and network infrastructure and mobile devices. If these suppliers do not provide or are unable to provide their products and services as expected, this could jeopardise the operation and expansion of the network and the sale of telecommunications products, which in turn could adversely affect our company and 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 majority shareholder Telefónica, S.A.
Use of trademark rights
The use of the core brand O_2 in Germany is the subject of a licensing agreement with O2 Worldwide Ltd., a subsidiary of Telefónica S.A. 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
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.

The completion of the project to implement the new requirements of the General Data Protection Regulation will reduce the probability of possible violations of the law and the potential damage that could result from fines, loss of reputation or revenue.

As a result, the risk will no longer be classified as significant; instead, it will now be classified as moderate.

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.

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. The acquisition of the E-Plus Group could also result in additional tax payments in this connection. 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 counter this moderate risk by providing regular training to our employees, discussing matters with our external tax advisors, and taking part in expert discussions and working groups on a regular basis. We are thus able to identify changes regarding the interpretation of the tax laws at an early stage and can initiate respective measures.

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 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 euros 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 (decrease) in the euro of 10% as against all foreign currencies in the financial years 2018 and 2017 would have been as follows:

T 09

CURRENCY RISK

1 January to 31 December

	2018		2017	
(in EUR million)	Risk position	+/(-) 10%	Risk position	+/(-) 10%
USD	(5.7)	0.5/(0.6)	(5.4)	0.5/(0.5)
GBP	1.0	(0.1)/0.1	0.8	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. Interest rate risks are managed as part of interest rate management.

The Telefónica Deutschland Group is exposed to interest rate risks arising from variable-rate loan agreements as borrower and from the variable-rate cash pooling accounts with Telfisa Global B.V. as well as in the form of opportunity costs in connection with the conclusion of fixed-rate debts, the interest rate of which may exceed market interest rates during the term. To reduce these opportunity costs, interest rate swaps in connection with the issue of a bond were concluded on a partial amount of the nominal value of the bond. Under this interest rate swap contract, the Telefónica Deutschland Group pays a variable interest rate on a nominal amount and receives a fixed interest rate on the same amount in return. The nominal amount of this interest rate swap is used to offset the effects of future changes in market interest rates on the fair value of the underlying fixed-rate financial debt from the bond issue (fair value hedge). Hedge accounting for these hedge relationships complies with IFRS 9.

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 was made. The existing hedge is continuously monitored for effectiveness. The hypothetical derivative method is used to measure effectiveness. Since there is always an economic relationship between the underlying and hedging transactions (same term or same payment dates, same hedged nominal volume, etc.), there are no significant inefficiencies. The only driver of possible ineffectiveness is the credit risk adjustment of the derivatives. These are low at the present time and are expected to remain so in the future and are therefore not recorded. For further information on hedging relationships, please refer to > 4.10 INTEREST-BEARING DEBT.

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 2018 and 2017 are shown below. There is no impact recognised directly in equity. This analysis assumes that all other variables remain unchanged.

T 10

INTEREST RATE RISK

1 January to 31 December

(in EUR million)	2018	2017
+100bp	4	2
-100bp	2	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 maximum default risk of the Telefónica Deutschland Group corresponds to the carrying amount of the financial assets.

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 customers 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 for expected credit defaults on receivables.

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 centrally controlled 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 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 2018, Telefónica Deutschland Group had undrawn credit lines from short-term overdraft facilities and revolving credit facilities totalling EUR 2,014 million; as of 31 December 2017, these undrawn credit lines amounted to EUR 2,015 million.

Cash and cash equivalents amounted to EUR 751 million as of 31 December 2018 and to EUR 587 million as of 31 December 2017.

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):

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MATURITIES OF FINANCIAL LIABILITIES

As of 31 December 2018 (in EUR million)	Total carrying amount	Gross cash outflow	Remaining term < 1 year	Remaining term 1–5 years	Remaining term > 5 years
Non-current interest-bearing debt	2,004	2,152	–	1,169	983
Non-current trade and other payables	19	19	–	19	–
Current interest-bearing debt	145	156	156	–	–
Current trade and other payables	2,419	2,419	2,419	–	–
Financial liabilities	**4,587**	**4,745**	**2,575**	**1,188**	**983**

As of 31 December 2017 (in EUR million)	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**

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 implementation, concrete financial objectives in the form of financial and non-financial 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 with greater demand for mobile data and LTE
In the summer of 2018, we further increased the attractiveness of high-quality O_2 Free tariffs by introducing the tariff components Connect (up to 10 SIM cards for any mobile device included in the mobile communications contract) and Boost (double data volume for a surcharge of EUR 5) and by launching O_2 Free Unlimited, a tariff with unlimited data volume. If customer demand for the higher-value tariffs exceeds our expectations, our revenues and operating income could exceed our current forecast.

In addition, an increase in the use of mobile data by customers could further accelerate demand for high-quality O_2 Free tariffs. A significant increase in demand for mobile data may result from several developments. The significant expansion of LTE networks in conjunction with a strong increase in the use of smartphones will enable more customers to use high data transfer rates. At the same time, more mobile services are emerging that are very data-intensive, such as music and video streaming. Both effects can lead to an increase in the average monthly data consumption per customer and thus further increase the demand for tariffs with a larger data volume. If these effects are more positive than forecast in our outlook, they could have a more positive impact on our revenues than expected.

Expansion of our LTE network
In 2019 we will progress further with the expansion of our LTE network. 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.

5G: Auction in 2019 and new business model
The future 5G mobile communications standard will open up completely new areas of application thanks to further increases in transmission speeds and lower latency times. This is particularly important for industrial applications, and the benefits for residential customers will become apparent somewhat later. 5G lays the foundation for new business models in areas such as autonomous driving, virtual reality and the Internet of Things. And thanks to greater efficiency in use, 5G also enables us to optimise our network in operation. The regular launch of 5G in Germany depends not only on the award procedure but also on the mass availability of system technology and devices. Experts do not expect a market launch before 2020. Telefónica Deutschland is already preparing intensively for this start by carrying out pilot projects and driving forward the connection of our network locations with fibre optic with increasing intensity. With 5G Fixed Wireless Access, for example, we are testing a promising, fast and cost-efficient technology that makes it possible to provide broadband access for people throughout the country and thus offers a good alternative to the expensive implementation of fibre optics.

The 5G frequency auction is expected to take place in the first quarter of 2019. We strive to secure the right spectrum to consistently expand our network for our customers and for our business success. If our position in the 5G spectrum improves beyond this, if we can expand the 5G network faster than planned, and if customer demand for 5G services is higher than expected, this could have a positive impact on our revenues and operating results.

Fixed line network in cooperation with Telekom Deutschland GmbH
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 fixed-line products on the basis of our cooperation with Telekom. This would have a positive impact on our revenues 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. We are also developing new digital market segments such as the Internet of Things (IoT) for all our customer groups.

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 processes and use of artificial intelligence
We are moving ahead strongly with the digital transformation of our company and the associated process optimisation. This makes interaction with customers simpler and more intuitive, since customers can, for example, use intuitive self-care offers or identify and buy the desired product more quickly. We are also using digital transformation to reduce, simplify and automate our processes. Our overall goal is to create a consistent customer experience across all contact points.

We are also starting to use artificial intelligence to interact with customers. For example, we use the Telefónica S.A. Group's AURA voice assistant, which can answer a wide range of contract-related questions for our customers on Facebook.

If the digital transformation of our company can take place faster than expected and the customer response is even more positive than expected, this could lead to higher customer satisfaction, revenues and cost savings and thus increase our OIBDA.

Potential in the SME segment of the business customer market
Our planning focuses on the expansion of our still relatively small market share in the segment of small and medium-sized enterprises (SMEs). The size of this market segment makes it attractive for us, so that we expect to be able to win corresponding SME customers with lean, tailor-made mobile communications and fixed-network products and tap the resulting growth potential.

If our renewed product portfolio for business customers, with products such as O_2 Free Business or O_2 Business Fusion, meets the customer needs of small and medium-sized companies even better than expected, demand could be even higher than expected.

Membership of the Telefónica, S.A. Group
As 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 reliable service pose our greatest risks. A new risk arises from the increasing general threat posed by cyberattacks. In addition to the elimination of the risk from lawsuits against the conditions resulting from the merger with E-Plus, we also see the largely completed network consolidation and the elimination of the associated risk as positive changes. There was also a significant reduction in the risk of breaches of data protection regulations.

In our estimation, 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 our corporate strategy will enable us to exploit the market opportunities that present themselves to us and to deploy the necessary resources. Considering our technologically high-value products, our position in the market, our digital innovative power, our committed employees, our stable financial position, the fact that we belong to one of the world's largest telecommunications companies and our structured processes for the early identification of risks and opportunities, we are confident that we will be able to successfully meet the challenges arising from these risks and opportunities in 2019.

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) as adopted by the European Union. 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 Telefónica Deutschland Group, Telefónica Deutschland Holding AG 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

According to initial calculations by the Federal Statistical Office, the German economy grew by 1.5% in real terms in 2018 compared with the previous year. For 2019, however, economists expect a slowdown in the growth of the German economy, with gross domestic growth (GDP) of only 1.2%. Private consumption remains one of the drivers of the economy. This is primarily due to the continued positive development of the labour market and the increasing purchasing power of households.

The international environment and the planned withdrawal of the United Kingdom from the European Union (Brexit) continue to pose a risk to economic development in Europe and especially in Germany.

Source: GfK Konsumklima, Bundesbank, BMWi, Federal Statistics Office, Experts At Economic Research Institutions

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GDP GROWTH 2017 – 2019
GERMANY (CALENDAR-ADJUSTED)

In %	2017	2018	**2019**
Germany	2.2	1.5	**1.2**

Market Expectations

Digitalisation and technologies such as artificial intelligence are increasingly shaping everyday life and bringing change to industries. A large number of trends will continue or gain in importance.

Smartphones will pave the way for new technologies such as augmented and virtual reality, as well as voice control. Voice control is conquering living rooms in the form of stationary digital voice assistants such as Amazon Echo and Google Home. The trend towards connectable products is continuing. This is supported by the introduction of eSIM as the key to the Internet of Things. More and more manufacturers are bringing eSIM-enabled smartphones and wearables onto the market. At the same time, the per capita number of connected mobile devices is increasing. The boundaries between consumer electronics, information and communication services and even traditional household appliances are increasingly disappearing as a result of control via smartphones or digital voice assistants.

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

The market for data consumption is characterised by a steadily growing demand for internet services, such as the use of internet videos across all end devices, but also games and the new applications already mentioned. As a result, the demand for larger data volumes and higher transmission speeds is also increasing. This means that the monetisation of mobile data business will remain a strong focus of telecommunications providers. Analysts expect average data usage per mobile customer to rise to just under 3 GB per month in 2019. This represents an increase of over 50% compared to 2018.

Source: Ovum, Analysys Mason, Bitkom, BMWi, PwC

Financial Outlook 2019[9] and Mid-term expectations

In 2019, Telefónica Deutschland Group will continue to build on its operational and financial achievements of the financial year 2018, which were in line with our expectations. Based on IAS 18 accounting standards, total operating revenue came in flat at +0.5% year-on-year excluding a significant headwind from regulation in the amount of EUR 44 million (-0.1% year-on-year including the negative regulatory effects). OIBDA (based on IAS 18) adjusted for exceptional effects grew slightly at +3.4% year-on-year excluding regulatory effects of EUR 54 million (+0.4% year-on-year including these effects), benefitting from the delivery of approx. EUR 100 million of revenue and OIBDA-relevant synergies. In total, we have now reached EUR 820 million (>90%) of the total synergy target of cumulated Operating Cash Flow savings of EUR 900 million in 2019. Our final integration project, the consolidation of our networks, is now completed and marks a major milestone on our way to becoming Germany's "Mobile Customer and Digital Champion". Furthermore, Telefónica Deutschland Group invested EUR 966 million in CapEx[10] with a C/S ratio of 13.2% in 2018, also in line with our guidance of 12-13% of C/S for the financial year 2018.

The German mobile market remained rational, yet dynamic across segments throughout 2018 with a strong focus on profitable growth by stimulating customer data usage and 'mobile freedom' to maintain a fair market share. Telefónica Deutschland Group successfully relaunched its O_2 Free and Blau portfolios. The new O_2 Free tariffs – with the double-data Boost option and the unique O_2 Connect option for up to 10 devices – support our ARPU-up strategy and help us counteract ongoing legacy base management topics and OTT effects. On the partner side, we continued to leverage our existing partnerships.

In 2019, Telefónica Deutschland Group will continue to pursue our successful multi-brand and multi-channel strategy. We expect pricing in the premium and discount segments to remain stable in 2019 as per the current market environment. Postpaid will remain the strongest value-generator for our business. Prepaid will also remain an important pillar of our operational and financial performance; however, we expect the current trend of lower customer demand in this segment to prevail as a result of the introduction of legitimisation checks, accelerating the pre- to postpaid migration trend in the market.

Regulatory changes are expected to remain major headwinds for the financial performance in 2019. Revenue will be affected by the negative effects of the termination rate cut for mobile voice minutes from EURc 1.07 to EURc 0.95 as of 1 December 2018 and the new regulation for intra-EU calls/SMS, now capped at EUR 0.19 per minute/EUR 0.06 per SMS, as of 15 May 2019. We will also continue to see minor effects from roam-like-home, as customers are still actively switching away from legacy roaming packages. In total, we expect the negative regulatory impact on total revenue to amount to approx. EUR 60-70 million in 2019. Similarly, OIBDA performance will reflect the negative usage elasticity effects from the roam-like-home regulation, the before-mentioned intra-EU calls/SMS and, to a lesser extent, termination rate effects. In total, we expect the negative regulatory impact on OIBDA to amount to approx. EUR 40-50 million.

For 2019 we expect total revenue to remain broadly stable year-on-year, excluding the above-mentioned negative regulatory effects of approx. EUR 60-70 million. Handset revenue continue to depend on market dynamics as well as the launch cycles and availability of new device generations. In the fixed business, the wholesale customer migration as a prerequisite for the decommissioning of our ULL broadband access infrastructure is now completed and we expect returns to normalise over time, as we market fixed broadband and converged products based on our wholesale access to competitors' networks. In the mid-term, we expect to grow our revenues with the market, capturing market share in Internet-of-Things (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. Our assumptions are based on a sustained rational competitive environment as well as stable economic conditions.

[9] The effects from the implementation of IFRS 16 as of 1 January 2019 are not reflected in the financial outlook.
[10] Of which EUR 8 million additions from capitalised financing leases.

With all integration activities completed by 2018 year-end, we reiterate our cumulated total synergy target of approx. EUR 900 million Operating Cash Flow synergies in 2019 with intra-year incremental savings of approx. EUR 40 million at OIBDA level. These are mainly roll-over effects from network consolidation. At CapEx level we expect additional in-year savings of approx. EUR 40 million as a result of the roll-out of one LTE network.

2019 will also mark the first year of Telefónica Deutschland Group's four-year transformation programme Digital4Growth, which we launched at our Capital Markets Day in February 2018. It has a clear focus on customer experience in the digital age. We are striving for continued profitable growth by capturing additional revenue growth opportunities in our core business, while also pushing into new business areas such as those arising from e-SIM capabilities, Advanced Data Analytics (ADA) or the Internet-of-Things (IoT). We also target efficiency gains from the further automation and digitalisation of processes, thus becoming 'simpler, faster and better'. We reiterate our transformation plan of capturing an additional EUR 600 million of gross OIBDA between 2019 & 2022, including growth and efficiency gains. In the first year we foresee an additional EUR 40 million gross gains at OIBDA level, with a significant gradual ramp up in subsequent years.

Against this background, we expect OIBDA adjusted for exceptional effects in 2019 to be broadly stable to slightly positive year-on-year, excluding the afore-mentioned negative regulatory effects of EUR 40-50 million. We thus expect the before-mentioned integration and transformation savings to largely balance our continued market investment. We expect handsets margins to continue to be broadly neutral.

The assumption around market investments are based on an expectation of a rational outcome to the upcoming spectrum auction that is expected to start at the end of Q1 2019 and a continuation of the current rational market environment with continued exponential data growth. In 2018, we have seen a significant stabilisation and quality improvements in our network as a result of our consolidation and ongoing LTE roll-out efforts. Building on these achievements, we are moving ahead with the expansion and optimisation of our mobile network, thus continually improving customer experience. We intend to add further ~10,000 LTE sites (~30,000 LTE cells) in 2019.

In addition, as part of our 4-year transformation programme, we will be investing in our omni-channel capabilities and the end-to-end digitalisation and the harmonisation of our process landscape, e.g. via robotics. The investment needs for our digital transformation are front-end loaded. As a result, we expect C/S to come to approx. 13-14% for the financial year 2019; in the mid-term we expect a stable CapEx envelope of approx. EUR 1 billion. These figures include investment needs for back- and fronthaul for 4G and backhaul only for 5G based on the current regulatory framework.

Since the IPO and throughout the integration of Telefónica Deutschland Group and E-Plus Group, we have maintained a strong balance sheet and a conservative leverage[11] target of at or below 1.0x. This has been reflected in a solid investment grade rating from Fitch and sustained access to capital markets. Over the course of the financial year 2019 we will review our self-defined leverage target for two reasons: Firstly, we will reflect the technical changes triggered by the introduction of the IFRS 16 accounting standard. We expect the implementation of IFRS 16 to have significant effects on margins, the balance sheet and leverage. Secondly, we envisage a move to an increased target leverage, allowing us to utilise our full financial flexibility with regards to the upcoming 5G investments whilst maintaining our BBB investment grade rating from Fitch.

We maintain strong confidence in our ability to generate Free Cash Flow growth in the mid-term on the back of solid momentum in the operating business and further support from the Digital4Growth programme. As such, we continue to target a high dividend pay-out ratio in relation to Free Cash Flow. For the financial year 2018 we reiterate our dividend proposal of EUR 0.27 per share to the Annual General Meeting in May 2019.

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

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FINANCIAL OUTLOOK 2019[12] AND MID-TERM EXPECTATIONS:

	Actual 2018	Outlook 2019	Mid-term outlook
Revenue	EUR 7,320 million	Broadly stable y-o-y (excl. negative regulatory effects of EUR 60-70 million)	Growth in line with German market
OIBDA adjusted for exceptional effects	EUR 1,884 million	Broadly stable to slightly positive y-o-y (excl. negative regulatory effects of EUR 40-50 million)	Ongoing margin improvement
CapEx/Sales ratio	13.2%	Approx. 13-14%	Keeping CapEx stable at approx. EUR 1 billion
Dividend	EUR 0.27/share Proposal for FY 2018 to next AGM	High pay-out ratio over FCF	

[12] The effects from the implementation of 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 2018, 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 disclosed for the 2018 financial year and reported according to integral parts.

The report complies with the requirements of the German Commercial Code (HGB) and the recommendations of the German Corporate Governance Code (GCGC), taking into account German Accounting Standard No. 17 (DRS 17) and International Financial Reporting Standards (IFRS).

Remuneration of members of the Management Board

There were no changes in the composition of the Management Board in 2018. Management Board member Markus Haas was reappointed as a member of the company's Management Board and appointed as the new Chief Executive Officer (CEO) of Telefónica Deutschland Holding AG with effect from 1 January 2017 until the end of 31 December 2019 by a resolution of the Supervisory Board dated 11 December 2016. With a resolution of the Supervisory Board dated 20 July 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 31 July 2020 and the Management Board member, Cayetano Carbajo Martín, with effect from 1 August 2017 until the end of 31 December 2018. The appointment of Management Board member Cayetano Carbajo Martín was extended by resolution of the Supervisory Board of 24 October 2018 by one year until the end of 31 December 2019. The employment contracts were concluded for the respective term of their appointment.

Structure and components of the remuneration of the Management Board

The total remuneration of the Management Board members consists of a fixed remuneration, fringe benefits, a one-year variable remuneration (Bonus I) and long-term remuneration components (Bonus II, Bonus III / PSP, PIP). In addition, the members of the Management Board receive pension commitments.

The fixed, non-performance-related remuneration components (fixed remuneration and fringe benefits) accounted for 57% of total remuneration in 2018. The variable, performance-related remuneration components accounted for 43%. Of this, 34% is attributable to the one-year variable remuneration and 9% to components with a long-term incentive effect.

Fixed remuneration and fringe benefits

The fixed component comprises the annual fixed salary, which is paid in twelve equal monthly instalments, and the fringe benefits. The fringe benefits mainly comprise a company car, life and accident insurance, travel allowances, rent allowances, reimbursement of social security costs, committee fees and expat bonuses. Not all Management Board members receive all of these fringe benefits.

One-year variable remuneration

The one-year variable remuneration component is an annual cash bonus (Bonus I). Bonus I is calculated using the formula target bonus multiplied by the business performance. The target bonus is equivalent to a set percentage of the annual fixed salary. The business performance factor can have a minimum value of 0% and a maximum value of 125%. The members of the Management Board can therefore receive a maximum payment of 125% of the respective target bonus (CAP).

The business performance factor consists of two components: The first component is based on the success of Telefónica Deutschland Holding AG (Telefónica Deutschland component) and has a weighting of 70%. The second component is based on the success of Telefónica, S.A. (Telefónica, S.A. component) and has a weighting of 30%.

The parameters for the calculation of the Telefónica Deutschland component, their weighting and the respective target achievements 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 2018. 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 target value is exceeded, the factor increases up to an upper limit, which for 2018 is 140% for one financial target and 125% for all other targets. Intermediate values of target achievement are not linearly interpolated, but calculated according to a payout curve set by the Supervisory Board. The payout 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. In order to create an increased incentive for the simultaneous achievement of all annual targets, the Supervisory Board has decided for 2018 that those factors below 120% will be increased to 120% if all targets are achieved. The sum of the weighted company performance factors determines the Telefónica Deutschland component.

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.

Components with a long-term incentive effect

The multi-year variable remuneration of the members of the Management Board consists of several components. All members of the Management Board participate in the Deferred Bonus Plan (Bonus II) of Telefónica Deutschland Holding AG.

The CEO is also generally entitled to participate in a long-term variable remuneration plan of Telefónica, S.A. These are the "Performance & Investment Plan" (PIP) and its successor plan, the "Performance Share Plan" (PSP). The Supervisory Board has approved participation in the Performance Share Plan (PSP) for 2018.

For the other Management Board members, however, it has been agreed as Bonus III that the Supervisory Board will decide annually whether they will receive an additional allocation from the Deferred Bonus Plan (Bonus II) or an allocation from a long-term variable remuneration plan of Telefónica, S.A. or an allocation from another long-term variable remuneration plan to be approved by the Supervisory Board of the company. The grant value corresponds to a certain portion of the annual fixed salary. For 2018, the Supervisory Board approved an allocation from the current long-term variable remuneration plan of Telefónica, S.A., the Performance Share Plan (PSP).

Deferred Bonus Plan (Bonus II): Bonus II is a deferred bonus. The members of the Management Board are promised an amount equal to a percentage of their annual fixed salary as a bonus. The Management Board member has the right to the full amount (CAP) 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 receive 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 median and the upper quartile, 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.

In 2018, the grant value equals 80% of the annual fixed salary for the CEO and 33% for each of the other Management Board members. Participation in Bonus II for the period from 2015 to 2018 did not result in any payment.

Performance & Investment Plan (PIP): The Performance & Investment Plan was approved by the Annual General Meeting of Telefónica, S.A. on 30 May 2014 and consists of three allocation cycles starting on 1 October 2014, 1 October 2015 and 1 October 2016. The term is three years in each case. There are two versions, 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 annual fixed salary of the relevant Management Board member by the average share price of Telefónica, S.A. (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 is still employed by a company of Telefónica, S.A. Group at the end of the time period and that the total shareholder return of Telefónica, S.A. over the three-year "vesting period" is at least equal to the median of the total shareholder return of a peer group of global telecommunication companies. 30% of the performance shares are 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 median and the upper quartile, the number of awarded shares is calculated on a linear proportional basis. If Telefónica, S.A.'s total shareholder return is below the median of the peer group, the entitlements are forfeited. Members of the ExComm of Telefónica, S.A. earn 125% if the total shareholder return of Telefónica, S.A. reaches at least the total shareholder return of the upper decile of the peer group. The members of the Management Board can therefore receive a maximum entitlement to 100% or 125% of the originally allocated performance shares in the form of real shares (CAP).

As an alternative to the Core Award, the PIP also provides for an Enhanced Award whereby the number of performance shares is increased by 25% in comparison with the Core Award. To be entitled to receive the Enhanced Award, a 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.

In 2018, no shares were earned by the members of the Management Board from the 2015 allocation cycle.

Performance Share Plan (PSP): The Performance Share Plan was approved by the Annual General Meeting of Telefónica, S.A. on 8 June 2018 and consists of three allocation cycles starting on 1 January 2018, 1 January 2019 and 1 January 2020. The term is three years in each case. At the beginning of the term, with the approval of the Supervisory Board, a certain number of performance shares are allocated to the members of the Management Board corresponding to a certain proportion of the annual fixed salary of the respective member of the Management Board. The number of shares actually earned at the end of the three-year term is calculated as the product of the number of allocated performance shares and a target achievement factor that depends on the fulfilment of certain performance conditions and can reach a minimum value of 0% and a maximum value of 100%. The members of the Management Board can therefore receive a maximum entitlement to 100% of the originally allocated performance shares in the form of real shares (CAP). For plan participants who are also members of the Executive Committee of Telefónica, S.A. (Markus Haas), a holding period of 12 months for at least 25% of the shares earned is provided for.

The target achievement factor for the 2018 allocation cycle consists of two components: The first component is based on the total shareholder return of Telefónica, S.A. (TSR target achievement factor) and has a weighting of 50%. The second component is based on the achievement of free cash flow targets (FCF target achievement factor) and also has a weighting of 50%.

The TSR target achievement factor depends on how the total shareholder return of Telefónica, S.A. has developed over the three years compared to the total shareholder return of selected global telecommunication companies: If Telefónica, S.A.'s total shareholder return is below the median of the peer group, the TSR target achievement factor is 0%. If the median is reached, the TSR target achievement factor is 30%. The TSR target achievement factor is increased by linear interpolation to up to 100% if the total shareholder return of Telefónica, S.A. reaches the upper quartile of the peer group.

The FCF target achievement factor corresponds to the average of annual target achievement factors, which can be between 0% and 100% depending on the achievement of annual targets for free cash flow. The respective annual targets for free cash flow and the associated target achievement curve are generally calculated annually by the Board of Directors of Telefónica, S.A.

All members of the Management Board received performance shares from the 2018 allocation cycle after approval by the Supervisory Board of the company.

Pension commitments
Markus Haas, Markus Rolle, Guido Eidmann, Valentina Daiber, Wolfgang Metze and Nicole Gerhardt participate in the company's pension plan. Alfons Lösing receives a fixed contribution for a reinsured commitment from 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 member 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.

Commitments in the event of premature termination of business activities
Early termination of the service agreement: In the event of premature termination of the employment contract without good cause, the Management Board contracts contain a clause within the meaning of section 4.2.3 of the GCGC that any payments to be made to the Management Board member, including fringe benefits, should not exceed the value of two years' remuneration and the value of the remuneration for the remaining term of the Management Board member service agreement. This is to be based on the total remuneration for the past financial year and, if applicable, also on the expected total remuneration for the current financial year.

Change of Control In the event of a change of control, the Management Board member has the right to terminate the employment relationship extraordinarily with a notice period of three months to the end of the month and to resign from office as a Management Board member with this notice period. In this case, the company shall pay the Management Board member a one-time remuneration equal to a fixed annual salary and the last annual cash bonus received (Bonus I), but not exceeding the remuneration that would have been payable up to the end of the employment contract.

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 annual fixed 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.

Other remuneration components
Discretionary bonus: The Supervisory Board is authorised, at its discretion, to award members of the Management Board a discretionary bonus, 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. As in previous years, the Supervisory Board did not grant any discretionary bonus to members of the Management Board in 2018.

D&O insurance: The company has taken out D&O insurance (Directors & Officers Liability Insurance) for the benefit of the members of the Management Board with a deductible of 10% of the loss up to one and a half times the annual fixed salary of the respective Management Board member.

Collateral/loans/guarantees: 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.

Post-contractual non-competition covenant: 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 entitled to waive compliance at any time.

Return of company property: Members of the Management Board must immediately 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.

Management Board remuneration in accordance with HGB
The members of the Management Board received the following compensation in 2018:

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MANAGEMENT BOARD REMUNERATION 2018

	Non-performance-related components			Performance-related components	Components with a long-term incentive effect				
2018	Fixed remuneration	Fringe benefits	TOTAL	One-year variable remuneration	Multi-year cash remuneration	Multi-year share remuneration[1] Number[2]	Multi-year share remuneration[1] Fair Value	TOTAL: Components with a long-term incentive effect	**Total remuneration**
Markus Haas	700,000	16,616	716,616	594,020	–	27,570	145,979	145,979	**1,456,615**
Markus Rolle	400,000	18,602	418,602	243,599	–	12,998	68,820	68,820	**731,021**
Wolfgang Metze	400,000	17,496	417,496	243,599	–	12,998	68,820	68,820	**729,914**
Alfons Lösing	400,000	61,193	461,193	243,599	–	12,998	68,820	68,820	**773,611**
Cayetano Carbajo Martín	300,000	225,099[3]	525,099	192,215	–	9,748	51,616	51,616	**768,929**
Nicole Gerhardt	300,000	18,550	318,550	182,699	–	9,748	51,616	51,616	**552,865**
Valentina Daiber	300,000	16,538	316,538	182,699	–	9,748	51,616	51,616	**550,853**
Guido Eidmann	300,000	64,607	364,607	182,699	–	9,748	51,616	51,616	**598,922**

[1] The share-based remuneration for the members of the Management Board recorded in accordance with IFRS for the financial year amounted to EUR 130,795. The following amounts were attributable to the members of the Management Board: Markus Haas EUR 34,162, Markus Rolle EUR 16,105, Wolfgang Metze 16,105, Alfons Lösing EUR 16,105, Cayetano Carbajo Martín EUR 12,079, Nicole Gerhardt EUR 12,079, Valentina Daiber EUR 12,079, Guido Eidmann EUR 12,079.

[2] The number shown takes account of the fact that under IFRS 2, only those performance shares for which corresponding target values were fixed at the time of granting are considered to be allocated

[3] The fringe benefits for Mr Cayetano Carbajo Martín include various expatriate allowances, in particular rental costs, cost-of-living allowance, school fees, tax compensation.

Disclosure of Management Board remuneration
Management Board remuneration is reported both on the basis of the requirements of the German Commercial Code (HGB) and in accordance with the recommendations of the German Corporate Governance Code (GCGC). This results in deviation for individual remuneration components and total remuneration.

In accordance with the GCGC, the presentations follow the recommended model tables 1 and 2, which show the total remuneration of the remuneration components granted and received for the year under review. The overview of the benefits granted also shows the minimum and maximum achievable values. In contrast to the table about granted benefits, the table about received benefits does not show the target values granted for the short-term and long-term variable remuneration components, but instead the values actually received for 2018.

The following remuneration was paid to the members of the Management Board who were active in 2017:

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MANAGEMENT BOARD REMUNERATION 2017

		Non-performance-related components		Performance-related components	Components with a long-term incentive effect				
2017	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 remuneration[2]**
Markus Haas	700,000	18,236	718,236	642,150	–	–	–	–	**1,360,386**
Markus Rolle	166,667	5,003	171,670	108,333	–	–	–	–	**280,003**
Wolfgang Metze	166,667	5,943	172,610	108,333	–	–	–	–	**280,943**
Alfons Lösing	166,667	22,336	189,003	108,333	–	–	–	–	**297,336**
Cayetano Carbajo Martín	125,000	66,108	191,108	81,250	–	–	–	–	**272,358**
Nicole Gerhardt	125,000	4,787	129,787	81,250	–	–	–	–	**211,037**
Valentina Daiber	125,000	5,555	130,555	81,250	–	–	–	–	**211,805**
Guido Eidmann	125,000	25,114	150,114	81,250	–	–	–	–	**231,364**
Rachel Empey (until 31 July 2017)	350,000	159,535	509,535	228,992	–	–	–	–	**738,527**

[1] The expense from share-based payment for the former members of the Management Board recognised in accordance with IFRS in the 2017 financial year amounted to EUR 85,740. The following amounts were attributable to the former members of the Management Board: Markus Haas EUR 102,141, Rachel Empey EUR -16,401.

[2] For Markus Haas the information is given for 12 months, for Rachel Empey pro rata temporis until 31 July 2017, for the other members of the Management Board pro rata temporis from 1 August 2017.

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PENSION COMMITMENTS AND OTHER BENEFITS

	Service cost according to IFRS		Service cost according to HGB[1]		Project unit credit value of the pension benefit commitment according to IFRS		Project unit credit value of the pension benefit commitment according to HGB	
	2018	2017	**2018**	2017	**2018**	2017	**2018**	2017
Markus Haas	142,308	66,131	250,263	65,502	860,277	602,284	622,074	358,646
Markus Rolle	37,574	17,828	68,573	31,985	481,681	472,009	311,446	234,265
Wolfgang Metze	37,869	–	22,531	10,398	45,877	15,945	33,300	10,398
Alfons Lösing	97,934	80,937	206,453	372,877	2,352,689	2,368,472	1,793,862	1,531,102
Cayetano Carbajo Martín	86,804	58,550	86,898	58,878	1,108	847	1,093	819
Nicole Gerhardt	196	–	8,449	179	13,429	2,163	10,683	2,159
Valentina Daiber	39,619	21,154	57,909	24,551	194,831	135,610	145,244	84,243
Guido Eidmann	26,736	23,646	36,208	9,567	92,092	47,569	72,716	35,228
Rachel Empey (until 31 July 2017)	–	–	–	(362)	–	–	–	–

[1] Personnel expenses recognised in the respective financial year without interest effect

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MANAGEMENT BOARD REMUNERATION IN ACCORDANCE WITH GERMAN CORPORATE GOVERNANCE CODE (BENEFITS GRANTED AND INFLOWS)

	Markus Haas Chief Executive Officer (CEO) Since: 1 January 2017				Markus Rolle Chief Financial Officer Since: 1 August 2017				Wolfgang Metze Chief Consumer Officer Since: 1 August 2017			
Benefits granted	2017	**2018**	**2018 (min)**	**2018 (max)**	2017	**2018**	**2018 (min)**	**2018 (max)**	2017	**2018**	**2018 (min)**	**2018 (max)**
Fixed remuneration	700,000	700,000	700,000	700,000	166,667	400,000	400,000	400,000	166,667	400,000	400,000	400,000
Fringe benefits	18,236	16,616	16,616	16,616	5,003	18,602	18,602	18,602	5,943	17,496	17,496	17,496
Total	**718,236**	**716,616**	**716,616**	**716,616**	**171,669**	**418,602**	**418,602**	**418,602**	**172,609**	**417,496**	**417,496**	**417,496**
One-year variable remuneration	**700,000**	**700,000**	**–**	**875,000**	**108,333**	**260,000**	**–**	**325,000**	**108,333**	**260,000**	**–**	**325,000**
Multi-year variable remuneration	**700,001**	**705,979**	**–**	**n.a.**	**109,000**	**200,820**	**–**	**n.a.**	**119,167**	**200,820**	**–**	**n.a.**
Bonus II (2017-2020)	700,001	–	–	–	109,000	–	–	–	119,167	–	–	–
PIP / Bonus III (2017-2020)	–	–	–	–	–	–	–	–	–	–	–	–
Bonus II (2018-2021)	–	560,000	–	560,000	–	132,000	–	132,000	–	132,000	–	132,000
PSP / Bonus III (2018 - 2020)[1]	–	145,979	–	n.a.	–	68,820	–	n.a.	–	68,820	–	n.a.
Total	**2,118,237**	**2,122,595**	**716,616**	**n.a.**	**389,003**	**879,422**	**418,602**	**n.a.**	**400,110**	**878,316**	**417,496**	**n.a.**
Pension expenses	66,131	142,308	142,308	142.308	17,828	37,574	37,574	37,574	–	37,869	37,869	37,869
Total remuneration	**2,184,368**	**2,264,903**	**858,924**	**n.a.**	**406,831**	**916,996**	**456,176**	**n.a.**	**400,110**	**916,185**	**455,365**	**n.a.**

	Alfons Lösing Chief Partner and Business Officer Since: 1 August 2017				Cayetano Carbajo Martín Chief Technology Officer Since: 1 August 2017				Nicole Gerhardt Chief Human Resources Officer Since: 1 August 2017			
Benefits granted	2017	**2018**	**2018 (min)**	**2018 (max)**	2017	**2018**	**2018 (min)**	**2018 (max)**	2017	**2018**	**2018 (min)**	**2018 (max)**
Fixed remuneration	166,667	400,000	400,000	400,000	125,000	300,000	300,000	300,000	125,000	300,000	300,000	300,000
Fringe benefits	22,336	61,193	61,193	61,193	66,108	225,099	225,099	225,099	4,787	18,550	18,550	18,550
Total	**189,002**	**461,193**	**461,193**	**461,193**	**191,108**	**525,099**	**525,099**	**525,099**	**129,787**	**318,550**	**318,550**	**318,550**
One-year variable remuneration	**108,333**	**260,000**	**–**	**325,000**	**81,250**	**195,000**	**–**	**243,750**	**81,250**	**195,000**	**–**	**243,750**
Multi-year variable remuneration	**130,000**	**200,820**	**–**	**n.a.**	**97,500**	**150,616**	**–**	**n.a.**	**82,500**	**150,616**	**–**	**n.a.**
Bonus II (2017-2020)	130,000	–	–	–	97,500	–	–	–	82,500	–	–	–
PIP / Bonus III (2017 - 2020)	–	–	–	–	–	–	–	–	–	–	–	–
Bonus II (2018-2021)	–	132,000	–	132,000	–	99,000	–	99,000	–	99,000	–	99,000
PSP / Bonus III (2018 - 2020)[1]	–	68,820	–	n.a.	–	51,616	–	n.a.	–	51,616	–	n.a.
Total	**427,336**	**922,012**	**461,193**	**n.a.**	**369,858**	**870,714**	**525,099**	**n.a.**	**293,537**	**664,166**	**318,550**	**n.a.**
Pension expenses	80,937	97,934	97,934	97,934	58,550	86,804	86,804	86,804	–	196	196	196
Total remuneration	**508,273**	**1,019,946**	**559,127**	**n.a.**	**428,408**	**957,519**	**611,903**	**n.a.**	**293,537**	**664,362**	**318,746**	**n.a.**

[1] Under the PSP, the maximum number of shares to be earned is limited. The maximum is 100% of the originally allotted performance shares. However, there is no limitation on the development of the share price. Consequently, it is not possible to specify a maximum value.

	Valentina Daiber Chief Officer for Legal and Corporate Affairs Since: 1 August 2017				Guido Eidmann Chief Information Officer Since: 1 August 2017				Rachel Empey Chief Financial Officer Until: 31 July 2017			
Benefits granted	2017	**2018**	**2018 (min)**	**2018 (max)**	2017	**2018**	**2018 (min)**	**2018 (max)**	2017	**2018**	**2018 (min)**	**2018 (max)**
Fixed remuneration	125,000	300,000	300,000	300,000	125,000	300,000	300,000	300,000	350,000	–	–	–
Fringe benefits	5,555	16,538	16,538	16,538	25,114	64,607	64,607	64,607	159,535	–	–	–
Total	**130,555**	**316,538**	**316,538**	**316,538**	**150,114**	**364,607**	**364,607**	**364,607**	**509,535**	**–**	**–**	**–**
One-year variable remuneration	**81,250**	**195,000**	**–**	**243,750**	**81,250**	**195,000**	**–**	**243,750**	**280,000**	**–**	**–**	**–**
Multi-year variable remuneration	**97,500**	**150,616**	**–**	**n.a.**	**97,500**	**150,616**	**–**	**n.a.**	**–**	**–**	**–**	**–**
Bonus II (2017-2020)	97,500	–	–	–	97,500	–	–	–	–	–	–	–
PIP / Bonus III (2017-2020)	–	–	–	–	–	–	–	–	–	–	–	–
Bonus II (2018-2021)	–	99,000	–	99,000	–	99,000	–	99,000	–	–	–	–
PSP / Bonus III (2018 - 2020)[1]	–	51,616	–	n.a.	–	51,616	–	n.a.	–	–	–	–
Total	**309,305**	**662,154**	**316,538**	**n.a.**	**328,864**	**710,223**	**364,607**	**n.a.**	**789,535**	**–**	**–**	**–**
Pension expenses	21,154	39,619	39,619	39,619	23,646	26,736	26,736	26,736	–	–	–	–
Total remuneration	**330,459**	**701,773**	**356,157**	**n.a.**	**352,510**	**736,959**	**391,343**	**n.a.**	**789,535**	**–**	**–**	**–**

[1] Under the PSP, the maximum number of shares to be earned is limited. The maximum is 100% of the originally allotted performance shares. However, there is no limitation on the development of the share price. Consequently, it is not possible to specify a maximum value.

	Markus Haas Chief Executive Officer (CEO) Since: 1 January 2017		Markus Rolle Chief Financial Officer Since: 1 August 2017		Wolfgang Metze Chief Consumer Officer Since: 1 August 2017	
Benefits received	**2018**	2017	**2018**	2017	**2018**	2017
Fixed remuneration	700,000	700,000	400,000	166,667	400,000	166,667
Fringe benefits	16,616	18,236	18,602	5,003	17,496	5,943
Total	**716,616**	**718,236**	**418,602**	**171,669**	**417,496**	**172,609**
One-year variable remuneration[1]	**717,500**	**594,020**	**266,500**	**91,932**	**266,500**	**91,932**
Multi-year variable remuneration	**–**	**–**	**–**	**–**	**–**	**–**
Bonus II (2014-2017)	–	–	–	–	–	–
PIP / Bonus III (2014-2017)	–	–	–	–	–	–
Bonus II (2015-2018)	–	–	–	–	–	–
PIP / Bonus III (2015-2018)	–	–	–	–	–	–
Other	–	–	–	–	–	–
Total	**1,434,116**	**1,312,256**	**685,102**	**263,601**	**683,996**	**264,541**
Pension expenses	142,308	66,131	37,574	17,828	37,869	–
Total remuneration	**1,576,424**	**1,378,387**	**722,676**	**281,429**	**721,865**	**264,541**

[1] At the time the report was prepared, the Supervisory Board had not yet decided on the amounts to be paid for the one-year variable remuneration. The one-year variable remuneration is reported on the basis of the estimated amount paid out.

Benefits received	Alfons Lösing Chief Partner and Business Officer Since: 1 August 2017 2018	2017	Cayetano Carbajo Martín Chief Technology Officer Since: 1 August 2017 2018	2017	Nicole Gerhardt Chief Human Resources Officer Since: 1 August 2017 2018	2017
Fixed remuneration	400,000	166,667	300,000	125,000	300,000	125,000
Fringe benefits	61,193	22,336	225,099	66,108	18,550	4,787
Total	**461,193**	**189,002**	**525,099**	**191,108**	**318,550**	**129,787**
One-year variable remuneration[1)]	**266,500**	**91,932**	**199,875**	**68,949**	**199,875**	**68,949**
Multi-year variable remuneration	**–**	**–**	**–**	**–**	**–**	**–**
Bonus II (2014-2017)	–	–	–	–	–	–
PIP / Bonus III (2014 - 2017)	–	–	–	–	–	–
Bonus II (2015-2018)	–	–	–	–	–	–
PIP / Bonus III (2015 - 2018)	–	–	–	–	–	–
Other	–	–	–	–	–	–
Total	**727,693**	**280,934**	**724,974**	**260,057**	**518,425**	**198,736**
Pension expenses	97,934	80,937	86,804	58,550	196	–
Total remuneration	**825,627**	**361,871**	**811,778**	**318,607**	**518,621**	**198,736**

Benefits received	Valentina Daiber Chief Officer for Legal and Corporate Affairs Since: 1 August 2017 2018	2017	Guido Eidmann Chief Information Officer Since: 1 August 2017 2018	2017	Rachel Empey Chief Financial Officer Until: 31 July 2017 2018	2017
Fixed remuneration	300,000	125,000	300,000	125,000	–	350,000
Fringe benefits	16,538	5,555	64,607	25,114	–	159,535
Total	**316,538**	**130,555**	**364,607**	**150,114**	**–**	**509,535**
One-year variable remuneration[1)]	**199,875**	**68,949**	**199,875**	**68,949**	**–**	**280,000[2)]**
Multi-year variable remuneration	**–**	**–**	**–**	**–**	**–**	**–**
Bonus II (2014-2017)	–	–	–	–	–	–
PIP / Bonus III (2014-2017)	–	–	–	–	–	–
Bonus II (2015-2018)	–	–	–	–	–	–
PIP / Bonus III (2015-2018)	–	–	–	–	–	–
Other	–	–	–	–	–	–
Total	**516,413**	**199,504**	**564,482**	**219,063**	**–**	**789,535**
Pension expenses	39,619	21,154	26,736	23,646	–	–
Total remuneration	**556,032**	**220,658**	**591,218**	**242,709**	**–**	**789,535**

[1)] At the time the report was prepared, the Supervisory Board had not yet decided on the amounts to be paid for the one-year variable remuneration. The one-year variable remuneration is reported on the basis of the estimated amount paid out.

[2)] Here, the one-year variable remuneration is reported on a pro rata basis based on 100% target achievement.

Remuneration of members of the 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 and one former member 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) 2018**	Remuneration (in EUR) 2017
Eva Castillo Sanz*	since 5 October 2012 to 25 May 2018	26,849	80.000
Laura Abasolo García de Baquedano**	since 12 May 2015	2,000	2.000
Angel Vilá Boix	from 18 September 2012 to 4 October 2017	–	2,000
María García-Legaz Ponce	since 7 June 2018	2,000	–
Patricia Cobian González	since 18 September 2012	2,000	2.000
Michael Hoffmann	since 5 October 2012	70,000	70.000
Enrique Medina Malo	from 18 September 2012 to 24 July 2018	2,000	2.000
Pablo de Carvajal Gonzalez	since 25 July 2018	2,000	–
Sally Anne Ashford	since 18 September 2014	20,000	20.000
Peter Erskine	since 19 May 2016	20,000	20.000
Julio Linares López	since 16 October 2017	20,000	4.219
Christoph Braun***	since 1 July 2016	38,575	40.000
Thomas Pfeil	since 3 June 2013	20,000	20.000
Dr. Jan-Erik Walter	since 3 June 2013	20,000	20.000
Marcus Thurand	from 3 June 2013 to 17 May 2018	7,507	20.000
Martin Butz	since 17 May 2018	12,548	–
Christoph Heil	from 3 June 2013 to 17 May 2018	7,507	20.000
Sandra Hofmann	since 17 May 2018	12,548	–
Claudia Weber	since 3 June 2013	20,000	20.000
Joachim Rieger****	since 31 October 2014	24,500	24.500
Jürgen Thierfelder****	since 31 October 2014	23,168	24.500

*Ms Castillo Sanz was Chairperson of the Supervisory Board until 25 April 2018 (inclusive) and an ordinary member of the Supervisory Board from 26 April 2018.

**Ms Abasolo García de Baquedano has been Chairperson of the Supervisory Board since 3 May 2018.

***Mr Braun was no longer Deputy Chairperson after the end of his first term of office at the close of the Annual General Meeting on 17 May 2018 until his re-election as Deputy Chairperson on 13 June 2018.

****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 TGCS Essen & Potsdam GmbH and Telefónica Germany Retail GmbH. Such remuneration amounts to EUR 4,500 each and is already included in the table (pro rata if applicable). Mr Thierfelder is no longer a member of the Supervisory Board of Telefónica Germany Retail GmbH as of 14 September 2018.

The members of the Supervisory Board received remuneration for their activities on the Supervisory Board of Telefónica Deutschland Holding AG of EUR 346 thousand in 2018 and EUR 382 thousand in 2017.

As of 31 December 2018, 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.

Separate combined non-financial 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 289b 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 Holding AG 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 2018 and at the time this Management Report was prepared, Telefónica Deutschland Holding AG did not hold any of its own shares. In accordance with section 6 (2) of the articles of association, the shareholders do not have the right to securitise shares. Each no par value share grants one vote at the Annual General Meeting. The shares are in general freely transferable.

Voting restrictions and restrictions on the transferability of shares
There are no general limitations on voting rights. We are not aware of any contractual agreements with Telefónica Deutschland Holding AG or other agreements about limitations on voting rights or the transferability of shares. In addition to the statutory provisions on insider trading 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 2018, 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 2018, the Management Board of Telefónica Deutschland Holding AG consisted of eight 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 sections 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 2018, the following authorisations of the Management Board for the issuing of shares exist:

Authorised capital
As of 31 December 2018, 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 Holding AG's significant agreements containing a change-of-control clause relate to financing.

In the event of a change of control, the rating of Telefónica Deutschland or of 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 O_2 Telefónica Deutschland Finanzierung 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 rate will be increased by 1.25% p.a. until maturity or by 3.0% p.a. for the bond issued on 5 July 2018.

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 Holding AG grant the right to terminate these contracts in the event of a takeover offer by a third party with three months' notice to the end of the month; however, this termination must occur within six months of a change of control. In this 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, and the outlook for the coming financial year are the same as for the Telefónica Deutschland Group. As at 31 December 2018, Telefónica Deutschland has no employees.

Results of Operations

Telefónica Deutschland generates its revenues from compensation for services, which it provides for its subsidiaries.

In fiscal year 2018 the charging on of the respective costs resulted in revenues in the amount of EUR 10 million.

The revenue development for the 2018 financial year is below that of the previous year's forecast due to a lower cost base and the associated lower costs charged on in the reporting year.

Revenue and expenses decreased compared to the previous year and resulted in an annual net loss in the amount of around EUR 2 million, which was at the same level as the previous year.

The prior year forecasted break-even was achieved.

Revenues below previous year's level
In the financial year, revenues of EUR 10 million (2017: EUR 15 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 in accordance with compensation agreements for 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 includes the remuneration of the Management Board including social expenses and amounted to EUR 8 million during the financial year (2017: EUR 6 million). The year-on-year increase is mainly due to the change in the composition of the Management Board in financial year 2017.

Other operating expenses below the previous year's level
At EUR 4 million, other operating expenses are significantly below the previous year's level. They essentially include legal and consulting expenses from external service providers. The change compared to the previous year mainly results from lower external consulting services in financial year 2018.

Net loss for the year at the previous year's level
As in 2017, in 2018 the Company generated a net loss for the year of around EUR 2 million.

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INCOME STATEMENT

Income Statement

1 January to 31 December

(in EUR million)	2018	2017	Change	% change
Revenues	**10**	**15**	**(5)**	**(34.9)**
Other income	0	1	(0)	(55.0)
Operating expenses	(12)	(18)	6	(32.8)
Personnel expenses	(8)	(6)	(1)	19.6
Other expenses	(4)	(11)	7	(64.5)
Operating income	**(1)**	**(2)**	**0**	**(20.5)**
Financial result	0	0	(0)	>100.0
Profit/(loss) before tax	**(2)**	**(2)**	**0**	**(9.2)**
Income tax	0	0	0	>100.0
Profit/(loss) after tax	**(2)**	**(2)**	**0**	**(9.8)**
Other current taxes	**(0)**	**–**	**(0)**	**(100.0)**
Profit/(loss) for the period	**(2)**	**(2)**	**0**	**(7.4)**

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 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.

Bond for corporate financing

In November 2013 and 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 and seven years. The bond due in 2018 was repaid as scheduled in November 2018.

In July 2018, O2 Telefónica Deutschland Finanzierungs GmbH placed a seven-year bond with a volume of EUR 600 million. The bond served to refinance the bond due and repaid in November 2018 and for general business purposes.

The nominal amount of the loan was made available to Telefónica Germany GmbH & Co. OHG by means of a loan.

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 any other additional amounts which are payable under the bond.

Investment projects

There are 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 9,340 million (2017: EUR 10,113 million) were comprised of the shares in Telefónica Germany GmbH & Co. OHG, Munich. On the basis of a shareholders' resolution dated 3 May 2018, a withdrawal totalling EUR 773 million took place in the financial year from Telefónica Deutschland, in accordance with section 4 (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.

Decline of receivables from affiliated companies
The decline in receivables from affiliated companies resulted mainly from the decrease in receivables from Telefónica Germany GmbH & Co. OHG, Munich, of EUR 3 million.

Slight decline in provisions
The decline in other provisions from EUR 7 million in 2017 to EUR 5 million at the end of the reporting period mainly results from increased provisions for outstanding invoices for consulting services. At EUR 3 million, pension provisions are slightly above the previous year's level.

Liabilities slightly below previous year's level
Trade payables, liabilities to affiliated companies and other liabilities were slightly below those of the previous year at EUR 2 million. This is mainly due to lower trade payables and lower tax liabilities. This is offset by increased liabilities to affiliated companies.

Decline in equity
In financial year 2018 equity decreased by EUR 775 million or 7.7% to EUR 9,349 million (2017: EUR 10,125 million). The changes in equity mainly resulted from the dividend payment decided on 17 May 2018 in the amount of EUR 773 million and from the result for the period of EUR -2 million.

In financial year 2018, a capital increase from company funds, a subsequent ordinary capital reduction in the same amount, the re-capitalisation of Conditional Capital 2014/I and related amendments to the Articles of Association were resolved. The capital measure was implemented in order to enable efficient equity management in line with capital market requirements and to provide the conditions for a flexible dividend policy. As a result, the tied capital reserve of EUR 4,535,097,828.00 was converted into a free capital reserve (Section 272 (2) No. 4 of the HGB [Handelsgesetzbuch; German Commercial Code]). The capital measure was entered in the commercial register on 4 June 2018.

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STATEMENT OF FINANCIAL POSITION

As of 31 December

(in EUR million)	**2018**	2017	Change	% change
Fixed assets				
Financial assets				
Shares in affiliated companies	9,350	10,124	(773)	(7.6)
Current assets				
Receivables from affiliated companies	9	12	(3)	(23.1)
Other assets and miscellaneous assets	0	1	(0)	(64.9)
Total assets	**9,360**	**10,136**	**(777)**	**(7.7)**
Equity	**9,349**	**10,125**	**(775)**	**(7.7)**
Provisions	**8**	**9**	**(1)**	**(11.7)**
Liabilities	**2**	**3**	**(0)**	**(11.1)**
Total equity and liabilities	**9,360**	**10,136**	**(777)**	**(7.7)**

Employees

As in 2017, Telefónica Deutschland Holding AG had no employees in financial year 2018.

Subsequent Events

With regard to business transactions of particular importance that occurred after the end of the reporting year, reference is made to >NOTES, SUBSEQUENT EVENTS IN THE 2018 ANNUAL FINANCIAL STATEMENTS OF TELEFÓNICA DEUTSCHLAND HOLDING AG.

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 (5) HGB for Telefónica Deutschland Holding AG is given in > INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM BASED ON THE CONSOLIDATED FINANCIAL REPORTING PROCESS.

Outlook 2019

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 below the level of financial year 2018. For the 2019 financial year, Telefónica Deutschland Holding AG expects a result in a similar amount to 2018.

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-2018)** 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, 15 February 2019

Telefónica Deutschland Holding AG

The Management Board

Markus Haas

Markus Rolle

Valentina Daiber

Guido Eidmann

Nicole Gerhardt

Alfons Lösing

Cayetano Carbajo Martín

Wolfgang Metze

CONSOLIDATED FINANCIAL STATEMENTS

for the Financial Year 2018

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Consolidated Financial Statements

Notes to the Consolidated Financial Statements

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As of 31 December

Assets (in EUR million)	Notes	**2018**	2017
A) Non-current assets		**11,061**	**11,940**
Goodwill	[4.1]	1,960	1,960
Other intangible assets	[4.2]	4,727	5,485
Property, plant and equipment	[4.3]	3,793	4,041
Trade and other receivables	[4.4]	70	69
Other financial assets	[4.5]	101	94
Other non-financial assets	[4.4], [4.6]	206	129
Deferred tax assets	[5.7]	204	162
B) Current assets		**2,736**	**2,160**
Inventories	[4.7]	261	105
Trade and other receivables	[4.4]	1,301	1,265
Other financial assets	[4.5]	9	17
Other non-financial assets	[4.4], [4.6]	413	186
Cash and cash equivalents	[4.8]	751	587
Total assets (A+B)		**13,796**	**14,100**

Equity and Liabilities (in EUR million)	Notes	**2018**	2017
A) Equity		**7,569**	**8,297**
Subscribed capital	[4.9]	2,975	2,975
Additional paid-in capital	[4.9]	4,800	4,800
Retained earnings		(205)	523
Total equity attributable to owners of the parent		7,569	8,297
B) Non-current liabilities		**2,901**	**2,141**
Interest-bearing debt	[4.10]	2,004	1,268
Trade and other payables	[4.11]	19	19
Provisions	[4.12]	526	599
Deferred income	[4.11]	176	255
Deferred tax liabilities	[5.7]	177	1
C) Current liabilities		**3,326**	**3,662**
Interest-bearing debt	[4.10]	145	637
Trade and other payables	[4.11]	2,419	2,224
Provisions	[4.12]	188	142
Other non-financial liabilities	[4.6]	39	132
Deferred income	[4.11]	535	527
Total equity and liabilities (A+B+C)		**13,796**	**14,100**

CONSOLIDATED INCOME STATEMENT

1 January to 31 December

(in EUR million)	Notes	**2018**	2017
Revenues	[5.1]	7,320	7,296
Other income	[5.2]	177	159
Supplies		(2,459)	(2,396)
Personnel expenses	[5.3]	(610)	(642)
Impairment losses in accordance with IFRS 9[1]		(79)	(73)
Other expenses	[5.4]	(2,552)	(2,560)
Operating income before depreciation and amortisation (OIBDA)		**1,797**	**1,785**
Depreciation and amortisation	[5.5]	(1,987)	(1,869)
Operating income		**(190)**	**(84)**
Finance income		2	5
Exchange gains		1	1
Finance costs		(44)	(39)
Exchange losses		(1)	(1)
Financial result	[5.6]	**(42)**	**(34)**
Profit/(loss) before tax		**(233)**	**(118)**
Income tax	[5.7]	3	(262)
Profit/(loss) for the period		**(230)**	**(381)**
Profit/(loss) for the period attributable to owners of the parent		**(230)**	**(381)**
Profit/(loss) for the period		**(230)**	**(381)**
Earnings per share	[8]		
Basic earnings per share in EUR		**(0.08)**	**(0.13)**
Diluted earnings per share in EUR		**(0.08)**	**(0.13)**

[1] The rules of IAS 39 were applicable to the comparison period.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

1 January to 31 December

(in EUR million)	Notes	2018	2017
Profit/(loss) for the period		**(230)**	**(381)**
Items that will not be reclassified to profit/(loss)			
Remeasurement of benefits after termination of employment	[4.12]	7	8
Income tax impact	[5.7]	(2)	(3)
Other comprehensive income/(loss)		**5**	**5**
Total comprehensive income/(loss)		**(225)**	**(375)**
Total comprehensive income/(loss) attributable to owners of the parent		(225)	(375)
Total comprehensive income/(loss)		**(225)**	**(375)**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(in EUR million)	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Total equity attributable to owners of the parent	Equity
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**
Financial position as of 1 January 2018		**2,975**	**4,800**	**523**	**8,297**	**8,297**
Adjustment due to first-time application of IFRS 9 and IFRS 15 (after taxes)		–	–	274	274	274
Financial position as of 1 January 2018, adjusted		**2,975**	**4,800**	**797**	**8,571**	**8,571**
Profit/(loss) for the period		–	–	(230)	(230)	(230)
Other comprehensive income/(loss)		–	–	5	5	5
Total comprehensive income/(loss)		**–**	**–**	**(225)**	**(225)**	**(225)**
Dividends	[4.9]	–	–	(773)	(773)	(773)
Other movements	[4.4], [13]	–	–	(4)	(4)	(4)
Financial position as of 31 December 2018		**2,975**	**4,800**	**(205)**	**7,569**	**7,569**

CONSOLIDATED STATEMENT OF CASH FLOWS

1 January to 31 December

(in EUR million)	Notes	2018	2017
Cash flow from operating activities			
Profit/(loss) for the period		**(230)**	**(381)**
Adjustments to profit/(loss)			
Financial result	[5.6]	42	34
Gains on disposals of assets		(0)	(30)
Income taxes	[5.7]	(3)	262
Depreciation and amortisation	[5.5]	1,987	1,869
Other non-cash expenses/income		(15)	–
Change in working capital and others			
Other non-current assets	[4.4], [4.5], [4.6], [4.7]	18	7
Other current assets	[4.4], [4.5], [4.6], [4.7]	(160)	58
Other non-current liabilities and provisions	[4.11], [4.12]	(166)	(116)
Other current liabilities and provisions	[4.11], [4.12]	249	24
Others			
Interest received		6	9
Interest paid		(40)	(36)
Cash flow from operating activities		**1,690**	**1,702**
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets		0	31
Payments from the disposal of consolidated entities	[7]	21	–
Payments on investments in property, plant and equipment and intangible assets	[4.2], [4.3]	(979)	(1,037)
Acquisition of companies, net of cash acquired		(1)	(29)
Proceeds from financial assets		4	18
Payments for financial assets		(3)	(4)
Cash flow from investing activities		**(957)**	**(1,022)**

1 January to 31 December

(in EUR million)	Notes	2018	2017
Cash flow from financing activities			
Payments made relating to frequency auctions		–	(111)
Proceeds from interest-bearing debt	[4.10]	2,526	1,975
Payments made for the repayment of interest-bearing debt[1]	[4.10]	(2,302)	(1,843)
Dividends paid		(773)	(744)
Other payments/proceeds from financing activities		(19)	16
Cash flow from financing activities		**(569)**	**(706)**
Net increase/(decrease) in cash and cash equivalents		**164**	**(26)**
Cash and cash equivalents at the beginning of the period	[4.8]	**587**	**613**
Cash and cash equivalents at the end of the period	[4.8]	**751**	**587**

[1] Payments made for repayment of interest-bearing debt related to finance leases of EUR 22 million in financial year 2018 and EUR 17 million in financial year 2017.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

for the Financial Year 2018

1.Reporting Entity

The Consolidated Financial Statements of Telefónica Deutschland Holding AG have been prepared as of and for the year ending 31 December 2018 and comprise Telefónica Deutschland Holding AG (also referred to as "Telefónica Deutschland") and its subsidiaries as well as joint operations (together referred to as the "Telefónica Deutschland Group" or the "Group").

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 German Securities Identification Number (WKN) is A1J5RX, the International Securities Identification Number (ISIN) is DE000A1J5RX9.

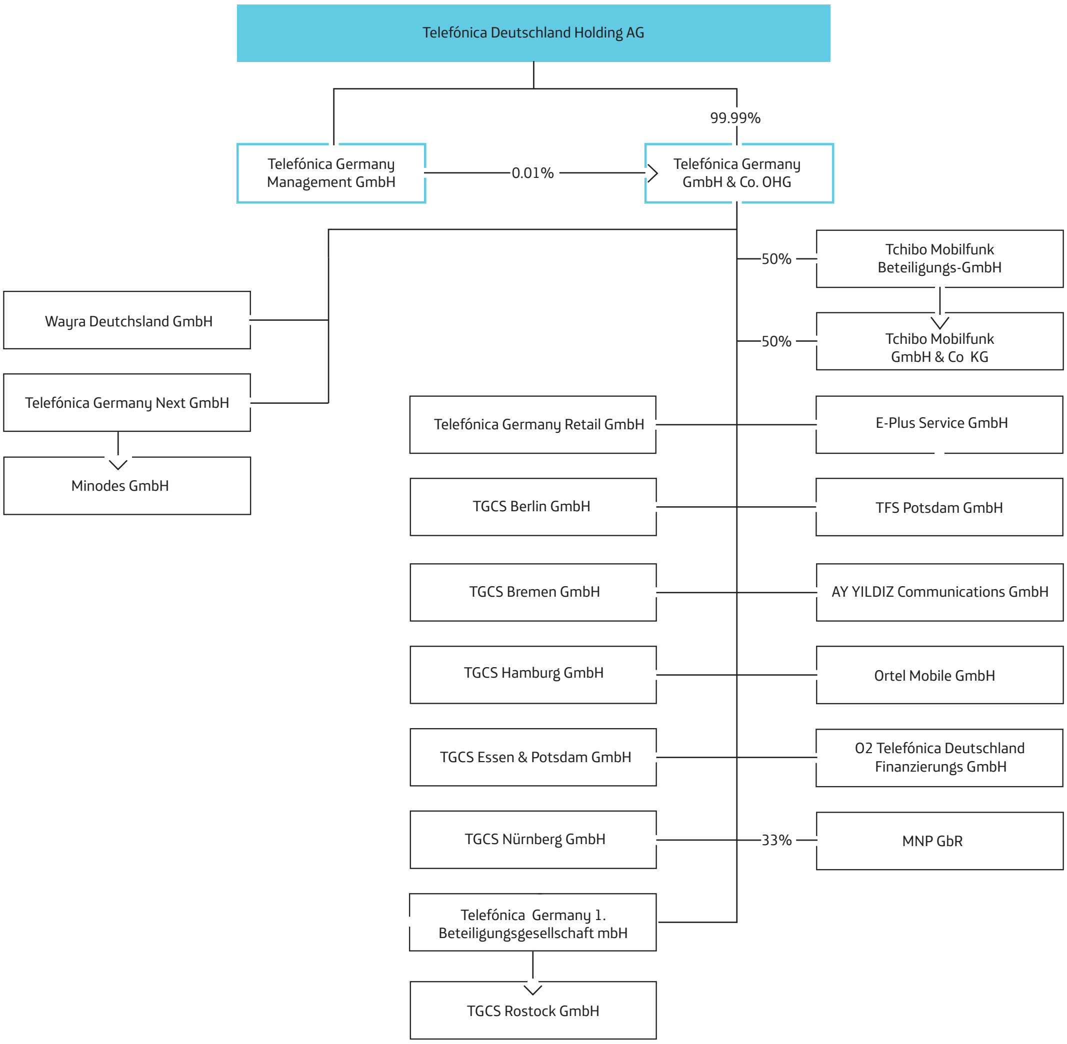
As of 31 December 2018, 26.4% of the shares were in free float. 69.2% were held by Telefónica Germany Holdings Limited, Slough, United Kingdom (Telefónica Germany Holdings Limited), an indirect wholly owned subsidiary of Telefónica, S.A., Madrid, Spain (Telefónica, S.A.). According to a press release for Koninklijke KPN N.V. dated 30 January 2019, the remaining 4.4% were held by Koninklijke KPN N.V., The Hague, Netherlands (KPN).

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 50, 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 2018, 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%. For changes in the Group structure, please refer to Note 10 Group companies of the Telefónica Deutschland Group.

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 2017. Exceptions are the amendments to the IFRS and the measurement changes as presented in Note 3 (letters o) and q) 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 18 February 2019.

Functional currency and presentation currency
These Consolidated Financial Statements are presented in euros, which is the functional currency of Telefónica Deutschland Holding AG and its subsidiaries.

Unless stated otherwise, the figures in these Consolidated Financial Statements are presented in millions of euros (in EUR million) and rounded according to established commercial principles. Therefore, recalculations may slightly differ from the totals shown in the tables.

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 acquisition 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 Group 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 transferred 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 must be reviewed for impairment annually. 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.

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 are amortised on a straight-line basis beginning with the period of commercial use throughout their useful lives (mostly between ten and 17 years).

Customer bases

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. Amortisation takes 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 useful life. The estimated useful life 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 their expected useful lives (generally, between three and 20 years).

d) Property, plant and equipment

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

Costs include external and internal costs comprising purchased capital goods and services and 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.

Costs include also, where appropriate, the estimate of the costs at initial recognition for dismantling and removing the item and restoring the site on which it is located to the extent that the entity incurs the obligation 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.

Repair 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 progress 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, office equipment, tools and other items	2 – 10

The estimated residual values of assets and depreciation methods are also regularly reviewed and, where appropriate, adjusted 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 2018, the Telefónica Deutschland Group comprises one single cash-generating unit, the reportable segment Telecommunications. Within the Telefónica Deutschland Group, there are no further identifiable groups of assets below Group level that generate cash inflows that are largely independent of the cash inflows from other assets. 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 conditions 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 for which 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 Supplies.

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 in accordance with IFRS 9, is a contract that simultaneously gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments are recognised as soon as Telefónica Deutschland Group becomes a contractual party to the financial instrument. All standard purchases of financial assets are recognised using trade date accounting, i.e. the date on which the Telefónica Deutschland Group commits to purchase the asset. Upon initial recognition, financial instruments are measured at fair value, which generally corresponds to the transaction price. Transaction costs directly attributable to the acquisition or issuance are considered in determining the initial value if the financial instruments are not measured at fair value through profit or loss.

For the purpose of subsequent measurement, financial instruments are subdivided into the following categories:

— Financial assets measured at fair value through profit or loss

— Financial liabilities at fair value through profit or loss

— Financial assets and liabilities measured at amortised cost

— Financial assets measured at fair value through other comprehensive income (debt instruments)

Telefónica Deutschland Group does not make use of the option to classify financial assets at fair value through profit or loss upon initial recognition ("fair value option"). Likewise, the option to classify equity instruments at fair value through other comprehensive income upon initial recognition is currently not used.

In accordance with IFRS 9 financial assets are classified depending on the business model and cash flow characteristics. Reclassification of financial assets is only permitted if the business model has changed; financial liabilities may not be reclassified.

<u>Financial assets: Assessment of the cash flow criterion</u>
The cash flow criterion involves assessing whether the contractually agreed cash flows are solely interest and principal payments on the outstanding principal amount. Principal payments imply the outstanding principal repayments and interest represents remuneration for the time value of money, credit and liquidity risk and other costs and profit margins incurred during the life of the financial instrument in the course of "holding" it. In the assessment, the contractual terms of the individual instruments are analysed in detail. This also includes an analysis of possible agreements that may affect the amount or timing of contractual cash flows and jeopardise non-compliance with the criterion.

<u>Financial assets: Assessment of the business model</u>
If the cash flow criterion is met, the Telefónica Deutschland Group uses the business model criterion to assess how the financial assets are managed at portfolio level. This decision is made by persons in key positions. In particular, the objectives for the portfolio, the guidelines and practical and concrete instructions for action are taken into account. In principle, three types of business model are possible: "Hold", "Hold and Sell" and "Other". Decisive for the classification into these business models are, in particular, the frequency, volume, reasons and timing of sales of financial assets from previous periods as well as expectations regarding future sales. If the business model of financial assets is "hold" in order to collect contractual cash flows, these are measured at amortised cost. All financial assets whose main purpose is to be collected and sold are measured at fair value through other comprehensive income. If the conditions for the aforementioned business models are not met, for example if the intention to trade exists, the financial assets are allocated to the measurement category "at fair value through profit or loss".

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 or loss
Financial assets at fair value through profit or loss are primarily investments in start-ups. Initial and subsequent measurement is at fair value through profit or loss.

Financial assets measured at amortised cost
These mainly relate to trade receivables and other receivables as well as loans. After initial recognition, these financial assets are 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 financial assets are sold, amortised or impaired. Interest effects from the application of the effective interest method are also recognised in profit or loss.

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 measured at fair value through other comprehensive income
These assets are primarily trade receivables for which the “hold and sell” business model applies. These receivables are subject to the factoring program and are resold depending on the capital requirements. These are subsequently measured at fair value. Changes in fair value are recognised in other comprehensive income. However, interest income, foreign currency gains and losses, impairment losses and reversals of impairment losses are recognised in the income statement. Upon derecognition, the accumulated gains and losses in other comprehensive income are reclassified to the profit and loss statement.

Impairment of financial assets
The Telefónica Deutschland Group recognises impairment losses on all financial assets that are debt instruments and that are measured at amortised cost or at fair value through other comprehensive income in the amount of the expected credit loss, unless the loss is considered to be immaterial.

Impairment losses on financial assets measured at amortised cost are deducted from the gross carrying amount of the assets.

In the case of financial assets in the measurement category through other comprehensive income, the impairment is recognised in profit or loss and derecognised from the other comprehensive income.

In determining the impairment, a distinction must be made between the expected loss within the next 12 months and the total term. Upon initial recognition, the expected loss within the next 12 months is initially recognised as an impairment loss. This does not apply to trade receivables, contract assets and receivables from leases. If a significant increase in credit risk becomes apparent, the recognition of impairment losses is extended to the entire term.

The Telefónica Deutschland Group believes that a debt instrument has a low credit risk if its credit risk rating meets the global definition of investment grade. Accordingly, a decrease in the rating below investment grade is considered a significant increase in credit risk. In addition, the Telefónica Deutschland Group assumes that the credit risk for a financial asset has increased significantly if it is more than 30 days past due.

The Telefónica Deutschland Group continuously assesses whether financial assets carried at amortised cost or at fair value through other comprehensive income are impaired and whether the receivables are transferred to external collection partners. The Group generally assumes this to be the case if an internal collection measure has been unsuccessful.

At each reporting date, the Telefónica Deutschland Group assesses whether financial assets carried at amortised cost or at fair value through other comprehensive income are at risk of default. The Telefónica Deutschland Group generally assumes that a financial asset is at risk of default if:

— It is unlikely that the borrower will settle its loan obligations to the Telefónica Deutschland Group in full without the Telefónica Deutschland Group resorting to measures such as the realisation of collateral (if any).

— The financial asset is 90 days or more past due.

— A debtor is in severe financial difficulty or is unwilling to pay.

The gross carrying amount of a financial asset is derecognised in full or in part unless there is a realistic prospect of recovery. This is generally the case if the Telefónica Deutschland Group determines that the debtor does not have any assets or sources of income that could generate sufficient cash to repay the amounts due. Write-downs of financial assets may continue to be subject to foreclosure proceedings.

Impairment losses on trade receivables and contract assets are generally recognised at the amount of the expected credit loss over the entire term using the simplified approach. In estimating expected credit losses, the Telefónica Deutschland Group considers appropriate information that is relevant and reasonably available. This includes both quantitative and qualitative information and analyses based on the Telefónica Deutschland Group's historical experience and credit ratings, as well as forward-looking information. Expected credit losses are derived from a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all defaults and late payments (i.e. the difference between the cash flows due to the entity under the contract and the expected cash flows).

Financial liabilities
Financial liabilities include primarily trade and other liabilities and interest-bearing debt. Depending on their maturity, they are reported as current or non-current liabilities or debts. In addition, embedded derivatives are separated from financial liabilities if they are not closely related to the host contract.

<u>Financial liabilities measured at amortised cost</u>
After initial recognition, financial liabilities are subsequently remeasured at amortised cost using the effective interest method described above.

<u>Financial liabilities at fair value through profit or loss</u>
A financial liability is recognised at fair value through profit or loss if it does not follow the measurement category of amortised cost. In the case of the Telefónica Deutschland Group, derivative liabilities are included here unless they are accounted for as hedging relationships. 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. If the option to measure at fair value through profit or loss is exercised, the resulting realised or unrealised gains or losses are recognised in the consolidated income statement unless they result from a change in the Group's own credit risk. These changes are recognised directly in equity. Telefónica Deutschland Group does not make use of the option of designating financial liabilities on first recognition at fair value through profit or loss ("fair value option").

Derecognition of financial assets and liabilities
Financial assets are derecognised when the rights to receive cash flows from the assets expire or when the financial assets have been transferred and the Telefónica Deutschland Group has transferred substantially all the risks and rewards incidental to ownership of the financial asset. Financial assets are also derecognised if substantially all the risks and rewards incidental to ownership of the financial assets are neither transferred nor retained.

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.

Netting
Financial assets and financial liabilities are offset and the net amount recognised in the Consolidated Statement of Financial Position if, and only if, the Telefónica Deutschland Group currently has a legally enforceable right to set off the amounts and intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Derivative financial instruments
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.

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 the expected future payments over the remaining term of the contract using current market interest rates and yield curves.

Hedging transactions: Are all requirements in accordance with IFRS 9.6.4.1 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 amortised 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 IFRS 9.

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 below. 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 remeasurement component includes 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 recognised 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. If 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 if 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 or when the entity is effectively no longer able to avoid the obligations. 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
Dismantling obligations arise from the contractual obligation to return the leased property in the condition in which it was when the contract commenced. Since the costs for the future decommissioning have not yet been determined at the time the contract is concluded, these costs are estimated.

The estimated costs of dismantling the network as well as branches and office locations, and interest rate movements are evaluated annually.

j) Revenues and expenses

Revenues and expenses are recognised in the Consolidated Income Statement in accordance with the accrual method (i.e. when the respective performance obligation has been met), irrespective of whether payment has actually been received or paid.

k) Revenues from contracts with customers

The Telefónica Deutschland Group mainly generates revenues from service contracts and sales of mobile devices.

In accordance with IFRS 15, revenue is recognised in an amount that reflects the consideration for the performance obligations. To implement this principle, a five-step model is used to determine the amount and timing of sales:

- Identification of the contract,
- Identification of the distinct performance obligations
- Determination of the transaction price,
- Allocation of the transaction price,
- Revenue recognition with satisfaction of the performance obligation

<u>Revenues from service and multi-component contracts</u>
Telefónica Deutschland Group provides both mobile and fixed-line services that are satisfied over a specified period of time. The progress of the performance obligation is determined using output-based methods. Applying output-based methods, revenue is recognised on the basis of the value of services transferred to date relative to the remaining services promised under the contract. Accordingly, unsteady discounts on this service are recognised over the term of the contract on a straight-line basis.

In addition to pure service contracts, Telefónica Deutschland Group offers its customers products under multi-component contracts. In particular, discounts are granted on mobile services if a mobile device is purchased together with the mobile services. There is no discount on the mobile device.

The discounts are allocated, whereby all the contractual components which affect the transaction price of a contract are considered when calculating the allocation factor. Connection fees to be paid by the end customer are included in the allocation of contractual components as part of the overall assessment and are recognised as revenue accordingly over the underlying contract term. Discounts granted for the simultaneous usage of a mobile contract and a DSL contract are reported as a reduction of mobile service revenue and fixed line/DSL revenue based on the relative stand-alone selling price of the underlying tariffs.

In determining the date of satisfaction of the performance obligations (e.g. in the case of mobile device sales), the transfer of control to the end customer was defined as the relevant assessment criterion.

When determining the transaction price, significant financing components must be taken into account. In accordance with the Standard, Telefónica Deutschland Group does not consider these financing components because the analysis of the underlying contracts showed that they are insignificant.

In accordance with IFRS 15, it is generally possible to apply the accounting rules to a portfolio of similarly structured contracts if no material effects are expected compared with the individual contract consideration. The Telefónica Deutschland Group analysed the existing contracts and aggregated them into portfolios. The Group applies the sales regulations at the level of these defined portfolios.

<u>Capitalisation of costs of obtaining a contract</u>
The Telefónica Deutschland Group pays commissions to dealers and agents for the acquisition of customers. These costs are capitalised as costs of obtaining a contract if they are incurred in connection with the obtaining of a contract and can be directly allocated to a customer.

Amortisation will depend on how the performance obligations to which the costs relate are transferred to the customer under the relevant contract. Under this method, the costs of obtaining a contract will be recognised in Consolidated Income Statement on a straight-line basis over the underlying amortisation period.

Within the capitalisation of costs of obtaining a contract, the Telefónica Deutschland Group makes use of the practical expedient defined in the standard and only capitalises costs of obtaining a contract with an underlying amortisation period of more than one year. With an amortisation period of up to one year, the costs are expensed as incurred.

In addition to the capitalisation of costs of obtaining a contract, the standard also regulates the capitalisation of costs to fulfil a contract. The analysis of the underlying contracts showed that there are no costs to fulfil a contract that Telefónica Deutschland Group is required to report in the Consolidated Statement of Financial Position.

<u>Accounting for contract modifications</u>
According to IFRS 15, there are more complex requirements with regard to the reporting of contract modifications compared to the regulations contained in IAS 18. In some cases, contract modifications are accounted for prospectively, forming a separate contract. In other cases, the contract modifications result in a modification of the existing contract. As a result, various cumulated income adjustments may occur.

<u>Principal versus agent considerations</u>
According to IFRS 15, the assessment if Telefónica Deutschland Group is the principal or the agent is based on whether the Group has control of particular goods or services before they are transferred to the customer.

l) 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.

m) 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 further leased 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.

n) 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, particularly in connection with the timing and scope of future technological advances.

The Telefónica Deutschland Group regularly evaluates the recoverable amount of its cash-generating unit to identify potential impairment of assets or goodwill. 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 carried forward 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 the 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. These benefits are recognised at the amount of the obligation regardless of its term.

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
Determining the stand-alone selling price of the performance obligation mobile service tariff postpaid
Every mobile service tariff postpaid is classified as a distinct performance obligation as part of the identification of the distinct performance obligations in the five-step model of IFRS 15. To determine the stand-alone selling price of this performance obligation, the transaction price specified on the invoice is used first. Taking into account the average discounts granted to customers of Telefónica Deutschland Group, this transaction price is then reduced by a lump sum rate.

The reduced transaction price corresponds with the stand-alone selling price of the performance obligation concerned.

Determination of the average term of the lease
The Telefónica Deutschland Group offers customers the option of concluding contracts with a fixed minimum term. When concluding such a term contract, both Telefónica and the customer are initially bound by the respective contract term. However, Telefónica grants the customer the right to extend the contract prematurely. The contract extensions regularly exercised by customers within this framework lead to an overall shortening of the legally enforceable minimum contract term.

The reduction in the term is determined on the basis of past values and taken into account accordingly when determining the transaction price.

Potential changes in estimates could lead to changes in both the amount and timing of future recognition of revenues.

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.

o) 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.

As of 31 December 2018, the network consolidation was largely completed.

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

p) 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.

q) Standards and IFRIC interpretations issued and effective as of 31 December 2018

IFRS 15 and IFRS 9 – Effects of first-time adoption
Since 1 January 2018, Telefónica Deutschland Group has applied IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments.

For further information on IFRS 9, please refer to Note 9 Further information on financial assets and financial liabilities.

The following table presents the effects which arise from the first-time application of the two standards:

(in EUR million)	31 December 2017	Adjustment due to IFRS 15	Adjustment due to IFRS 9	**1 January 2018**
Non-current assets				
Trade and other receivables	69	1	–	70
Other non-financial assets	129	107	–	236
Deferred tax assets	162	(33)	–	129
Current assets				
Trade and other receivables	1,265	(49)	(2)	1,214
Other non-financial assets	186	329	–	515
Equity				
Retained earnings	523	276	(2)	797
Non-current liabilities				
Deferred income	255	2	–	257
Deferred tax liabilities	1	101	–	102
Current liabilities				
Deferred income	527	(25)	–	502

IFRS 15: Revenue from Contracts with Customers
IFRS 15 anchors the rules from various standards and interpretations with a cross-industry approach into one unified standard. IFRS 15 has therefore superseded IAS 18 – Revenue and IAS 11 – Construction Contracts in particular. IFRS 15 defines a comprehensive framework to determine whether revenue is reported, the amount of the revenue and the time said revenue must be reported.

The first-time application of the new standard commencing on 1 January 2018 required an analysis of the contracts concluded in previous financial years that were not yet completed as of 1 January 2018. The standard gives the user the choice between two methods for the time of the first-time application:

— fully retrospectively to each prior reporting period with certain practical expedients,

— modified retrospectively by cumulative adjustments to the opening balance of equity in the reporting period.

During the transition to IFRS 15, the Telefónica Deutschland Group decided to apply the modified retrospective method, according to which the accumulated adjustment must be recognised as of 1 January 2018. As a result, the Group did not apply the requirements of IFRS 15 to the comparative period presented. The comparative period 2017 has been set up in line with the accounting policies presented in the Consolidated Financial Statements of the financial year ended 31 December 2017 (see Note 3 Accounting Policies).

With the introduction of IFRS 15, it was partially necessary to adjust certain accounting processes. In particular, the requirements for the analysis of the customer contracts as part of the product creation process needed to be specified further in order to meet the requirements of IFRS 15. An IT tool was also introduced to calculate the adjustments within the scope of IFRS 15.

The total adjustment of equity (after taxes) in the opening balance arising from the first-time application of IFRS 15 was EUR 276 million as of 1 January 2018.

The biggest effect of the adjustments resulted from the capitalisation of cost of obtaining contracts in other non-financial assets. For contracts which had not yet ended as of 31 December 2017, an amount of EUR 419 million was capitalised.

However, costs of obtaining a contract are not capitalised in the tax base relevant for the Group, but are recognised directly in the Income Statement. To ensure proper representation of this temporary difference, deferred taxes amounting to EUR 134 million were recognised as at the first-time application, which reduces equity accordingly. These were partially offset against existing deferred tax assets.

In addition to the two largest effects resulting from the capitalisation of costs of obtaining a contract and the deferred taxes formed thereon, the application of IFRS 15 also resulted in further effects on the Consolidated Statement of Financial Position due to the differences in the recognition of contracts with customers. Trade and other receivables fell by EUR 48 million with an effect on equity. The other non-financial assets increased by EUR 17 million recognised directly in equity. Deferred income decreased by EUR 22 million, recognised directly in equity.

The following table shows the balances as of 31 December 2018 for which a change arises due to the application of IFRS 15.

(in EUR million)	**Consolidated Statement of Financial Position as of 31 December 2018**	Adjustments	Value without application of IFRS 15
Non-current assets			
Trade and other receivables	70	(3)	67
Other non-financial assets	206	(107)	99
Deferred tax assets	204	33	236
Current assets			
Trade and other receivables	1,301	34	1,335
Other non-financial assets	413	(345)	68
Equity			
Retained earnings[1]	(205)	(307)	(512)
Non-current liabilities			
Deferred income	176	37	214
Deferred tax liabilities	177	(104)	72
Current liabilities			
Deferred income	535	(14)	521

[1] The adjustment as of 31 December 2018 includes the effects recognised in equity in connection with the first-time application of IFRS 15 and the adjustment of the result for the period as of 31 December 2018 due to the first-time application of IFRS 15.

Without the first-time application of IFRS 15, the following differences in the Consolidated Income Statement would arise for the period from 1 January to 31 December 2018.

(in EUR million)	**Consolidated Income Statement for the period from 1 January to 31 December 2018**	Adjustments	Value without application of IFRS 15
Revenues	**7,320**	**(30)**	**7,290**
Mobile business	6,539	(28)	6,512
Mobile service revenues	5,267	(22)	5,245
Handset revenues	1,272	(6)	1,266
Fixed line/DSL business revenues	767	(12)	755
Other revenues	13	10	23
Impairment losses in accordance with IFRS 9	(79)	1	(77)
Other expenses	**(2,552)**	**(7)**	**(2,559)**
Operating income before depreciation and amortisation (OIBDA)	**1,797**	**(35)**	**1,762**
Financial result	**(42)**	**2**	**(41)**
Income tax	**3**	**3**	**5**

r) New standards and IFRIC interpretations issued, but not yet effective as of 31 December 2018

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
IFRS 16	Leases	1 January 2019
IFRIC 23	Uncertainty over Income Tax Treatment	1 January 2019
Amendments to IFRS 9	Financial instruments' - on prepayment features with negative compensation	1 January 2019
Amendments to IAS 28	Investments in associates' - on long term interests in associates and joint ventures	1 January 2019[1]
Annual Improvements to the IFRS 2015 – 2017 Cycle	Amendments to IFRS 3 and 11 as well as IAS 12 and 23	1 January 2019[1]
Amendments to IAS 19	Plan Amendment, Curtailment or Settlement	1 January 2019[1]
Various	Amendments to References to the Conceptual Framework in IFRS Standards	1 January 2020[1]
Amendments to IFRS 3	Definition of business	1 January 2020[1]
Amendments to IAS 1 and IAS 8	Definition of material	1 January 2020[1]
IFRS 17	Insurance Contracts	1 January 2021[1]

[1] Endorsement by EU still outstanding, information for first-time adoption under IASB.

IFRS 16: Leases
On 13 January 2016, the IASB issued IFRS 16 – Leases, which will replace IAS 17 and other existing interpretations. The standard was adopted into European law on 9 November 2017. Application of the standard is mandatory for financial years beginning on or after 1 January 2019.

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 in accordance with IAS 17 will no longer apply to the lessee. Using the interest rate implicit in the lease, the present value of the lease payments that are not paid is to be recognised as a lease liability. If that cannot be readily determined, the incremental borrowing rate is applied. The right-of-use asset acquired in this context is to be recognised as an asset. The lease liability and the right-of-use asset are reduced by lease payments made or depreciation over the lease term. Liabilities are measured using the effective interest method. As a rule, this method and the resulting interest effects lead to higher expenses at inception of the lease contract. Recognition exemptions are possible for leases for which the underlying assets is of low value or short-term leases (lease term of 12 months or less). The assessment of the term of the lease in which the Telefónica Deutschland Group acts as lessee or lessor is generally based on the non-cancellable period of a lease. If a lease contains extension options or termination options for the lessee, these are taken into account if they are assessed as reasonably certain on the reporting date. All relevant facts and circumstances (e.g. technology, regulation, competition, business model) are taken into account. If the lease contract contains a mutual right of termination, the lessor's right is also taken into account in determining the lease term. IFRS 16 requirements for lessors are similar to the current standard IAS 17. In the event of subleasing by the Telefónica Deutschland Group, which is classified as a finance lease in accordance with IFRS 16.61 et seqq., the net investment is initially measured by discounting the lease payments not yet received. The lessor's allocation of contractual payments to non-leasing components will in future be explicitly regulated by reference to IFRS 15. 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.

As of 1 January 2019, the Telefónica Deutschland Group will make use of the option not to recognise a right-of-use asset for leases for which the underlying assets is of low value or short-term leases (lease term of 12 months or less). The Telefónica Deutschland Group uses a practical expedient of IFRS 16.15 to separate lease components from non-lease components in exceptional cases. In particular, the non-lease components are separated for the following areas: Roof locations and site areas for the construction of antennas, shops, office buildings and car leasing.

The remaining lease payments are discounted using the incremental borrowing rate. The interest rate of the head lease is used for discounting lease payments from subleases that have not yet been received.

The Telefónica Deutschland Group does not exercise the option of early application of IFRS 16. The changeover to IFRS 16 for accounting as lessee is based on the modified retrospective approach, according to which the cumulative effect of first-time application is an adjustment to the opening balance of retained earnings in the 2019 reporting period. The Telefónica Deutschland Group will not adjust the comparative figures for the prior-year period. For the opening balance as of 1 January 2019, the practical expedient of IFRS 16.C3 is applied with regard to the classification of leases. This means that at the time of first-time application it is not reassessed whether a contract constitutes or contains a lease. Instead, IFRS 16 is applied to contracts that were previously identified as leases under IAS 17 and IFRIC 4. IFRS 16 is not applied to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4. In addition, the Telefónica Deutschland Group will make use of the option to account for leases that end within 12 months of initial application as short-term leases during the transition period. IFRS 16.C8 provides an option for recognition of right-of-use assets as of 1 January 2019 for leases previously classified as an operating lease, which can be exercised on lease-by-lease basis. The Telefónica Deutschland Group will apply the alternative IFRS 16.C8 (b) (ii) for the majority of its contracts, so that the right-of-use assets are measured in the amount equal to the lease liabilities, adjusted by the amount of any prepaid or accrued lease payments. In the transition phase, valuation is carried out excluding the initial direct costs. As of 1 January 2019 existing finance leases for which Telefónica Deutschland Group is the lessee are recognised at the carrying amount determined as at 31 December 2018.

The Telefónica Deutschland Group has analysed and evaluated the standard for possible effects in a Group-wide project. Contracts, processes and systems were analysed as part of this project. The Group is a lessee with a very high number of leasing contracts for various assets. A significant portion of these contracts is accounted for as operating lease under the current standard IAS 17, with lease payments being recognised generally on a straight-line basis over the contract term.

Based on the results of the project, the Group expects the following effects:

— In the opening balance as of 1 January 2019, right-of-use-assets in a bandwith between EUR 2.6 billion and EUR 3.2 billion and lease liabilities in a bandwith between EUR 2.5 billion and EUR 3.1 billion will approximately be recognised. The difference of EUR 84 million, respectively EUR 87 million, between the right-of-use-assets and the lease liabilities results mainly from the adjustment of the right-of-use assets on the basis of the lease payments already made and deferred.

— The total estimated adjustment of equity in the Telefónica Deutschland Group's opening balance as of 1 January 2019 is EUR -1 million.

— Upon implementation of IFRS 16, obligations from contracts previously classified as operating leases must be recognised as right-of-use assets and corresponding liabilities. The leases mainly affected by this change relate to: Roof locations for the construction of antennas, leased lines (Dark Fiber) and shop and office buildings. As a result, there will be a significant increase in lease liabilities, fixed assets and net financial debt in the 2019 financial year. Deferred expenses for lease payments made in advance will be significantly reduced. Payments for the principal portion of the lease liability will be shown in future 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 lease liabilities will replace lease expense in the Consolidated Income Statement. This will have a positive effect on the operating result before depreciation and amortisation (OIBDA) and the operating income in the 2019 financial year. The financial result, on the other hand, will be negatively impacted in the 2019 financial year.

The conversion to IFRS 16 does not have any significant effects on the Telefónica Deutschland Group as lessor. There is one exception for subleases of shop space. These were previously accounted for as operating leases. In accordance with IFRS 16, the majority of these subleases are classified as finance leases. The estimated amount of net investments will be between EUR 10 million and EUR 20 million.

With regard to the obligations from operating leases, which are presented in the Notes (see Note 18 Operating Leases Purchase and Other Contractual Obligations), the Telefónica Deutschland Group expects that the main differences in the valuation of the new lease liabilities will result from the following circumstances:

— Deviation in the population of the contracts: The lease liabilities do not include leases for which the underlying assets are of a low value or short-term leases (lease term of 12 months or less).

— Extension options and termination options: Options whose exercise or non-exercise is considered reasonably certain are included in the measurement of the lease liability. The measurement of obligations from operating leases may depend on a different assessment of those options. One example is contracts that can be terminated by the Telefónica Deutschland Group without payment of a contractual penalty. Potential payments beyond the date of termination are not taken into account for the purpose of measuring of the obligations from operating leases. Under IFRS 16, on the other hand, the term beyond the termination date can be taken into account if the non-exercise of the termination option is deemed reasonably certain. In this case, the lease liabilities are higher than the obligations from operating leases.

— Provisions for restructuring relating to operating leases: Restructuring provisions already recognized in the Consolidated Statement of Financial Position are not to be recognized again in obligations from operating leases. On the other hand, the payments still to be made are to be taken into account in lease liabilities.

— Legal obligation before inception date of the contract: With both parties signing the agreement, the Telefónica Deutschland Group has a reportable obligation from operating leases. Under IFRS 16, on the other hand, lease liabilities are not recognized until the inception date.

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 Notes to the Consolidated Statement of Financial Position

4.1. Goodwill

(in EUR million)	2018	2017
Carrying amount of goodwill at 1 January	**1,960**	**1,932**
Additions due to acquisition	–	28
Carrying amount of goodwill at 31 December	**1,960**	**1,960**

The increase of EUR 28 million in financial year 2017 resulted from the acquisition of two companies.

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 financial year 2018 for goodwill because the recoverable amount of EUR 10,088 million (2017: EUR 12,373 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 2017.

The impairment test is described in Note 3 Accounting Policies.

4.2. Other intangible assets

(in EUR million)	Service concession arrangements and licences	Customer bases	Software	Thereof own work capitalised	Brand names	Others	Construction in progress/ prepayments on intangible assets	Other intangible assets
Cost								
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**
As of 1 January 2018	**11,574**	**3,076**	**1,379**	**173**	**101**	**44**	**342**	**16,516**
Additions	–	–	263	30	–	0	6	269
Disposals	–	–	(65)	(1)	–	(2)	–	(66)
Reclassifications	–	–	4	(0)	–	–	(3)	1
As of 31 December 2018	**11,574**	**3,076**	**1,582**	**201**	**101**	**42**	**344**	**16,719**
Accumulated amortisation								
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)**
As of 1 January 2018	**(8,879)**	**(1,190)**	**(875)**	**(121)**	**(54)**	**(33)**	**–**	**(11,030)**
Additions	(412)	(328)	(278)	(26)	(3)	(7)	–	(1,029)
Disposals	–	–	65	1	–	2	–	66
Reclassifications	–	–	–	–	–	–	–	–
As of 31 December 2018	**(9,291)**	**(1,518)**	**(1,089)**	**(146)**	**(57)**	**(38)**	**–**	**(11,993)**
Net book value								
As of 31 December 2017	**2,695**	**1,886**	**504**	**52**	**48**	**11**	**342**	**5,485**
As of 31 December 2018	**2,283**	**1,557**	**493**	**56**	**45**	**4**	**344**	**4,727**

Licences
As of 31 December 2018, 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 2018 is EUR 439 million (2017: EUR 646 million). The 3G licences are amortised on a straight-line basis over the respective useful life. The remaining useful lives are between two and seven 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 the E-Plus Group 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 successfully bid for two paired blocks in the 1.8 GHz range, which have been used from 1 January 2017 and are limited until December 2033. Furthermore, there are LTE licences with terms until December 2025/December 2033. The carrying amount of the usage rights as of 31 December 2018 is EUR 1,504 million (2017: EUR 1,686 million). The 4G licences are amortised on a straight-line basis over the respective useful life. The remaining useful lives are between seven and 15 years.

In June 2015, Telefónica Germany GmbH & Co. OHG successfully bid 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 2018 is EUR 340 million (2017: EUR 363 million). The licences are amortised on a straight-line basis over their useful lives. The remaining useful life is 15 years.

Customer bases
The customer bases are primarily a result of the acquisition of the E-Plus Group by Telefónica Deutschland. The customer bases acquired in the E-Plus acquisition on 1 October 2014 are amortised mainly over a remaining useful lives of five to six years.

Software
Software mainly includes developments and licences for IT and office applications. In financial years 2018 and 2017, 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 useful life of 16 years.

Construction in progress/ prepayments on intangible assets
In financial year 2015, the Telefónica Deutschland Group acquired additional frequencies. The use of 700 MHz frequencies (EUR 337 million) reported in construction in progress/prepayments is dependent, on the broadcasting companies, among other things.

4.3. Property, plant and equipment

(in EUR million)	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 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**
As of 1 January 2018	**722**	**8,809**	**260**	**146**	**9,938**
Additions	5	607	33	51	697
Disposals	(99)	(313)	(25)	–	(438)
Reclassifications	5	69	12	(86)	(1)
Other	6	8	–	–	14
As of 31 December 2018	**639**	**9,180**	**280**	**112**	**10,210**
Accumulated depreciation					
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)**
As of 1 January 2018	**(607)**	**(5,127)**	**(163)**	**–**	**(5,896)**
Additions	(52)	(865)	(41)	–	(959)
Disposals	99	313	25	–	438
Reclassifications	(0)	0	–	–	–
As of 31 December 2018	**(561)**	**(5,678)**	**(178)**	**–**	**(6,417)**
Net book value					
As of 31 December 2017	**114**	**3,683**	**98**	**146**	**4,041**
As of 31 December 2018	**78**	**3,502**	**101**	**112**	**3,793**

Property, plant and equipment comprise land and buildings, technical equipment and machinery, furniture, tools and other items as well as construction in progress.

The additions to property, plant and equipment related to the decommissioning and dismantling respectively asset retirement obligations amounted to EUR 19 million (2017: EUR 16 million) mainly due to the changing interest rates, higher cost estimates as well as increases in the volume structure.

Property, plant and equipment from finance leases amount to EUR 76 million as of 31 December 2018 and EUR 124 million as of 31 December 2017. The change of EUR 48 million resulted primarily from planned depreciation. The most significant finance leases are disclosed in Note 4.10 Interest-Bearing Debt.

PP&E in progress resulted mainly from the expansion of the network.

4.4. Trade and other receivables

As of 31 December (in EUR million)	**2018** **Non-current**	 **Current**	2017 Non-current	 Current
Trade receivables	70	1,268	76	1,272
Receivables from related parties (Note 12 Related Parties)	–	40	–	77
Other receivables	–	62	–	58
Loss allowance	–	(68)	(7)	(142)
Trade and other receivables	**70**	**1,301**	**69**	**1,265**

In order to measure the expected credit loss, trade receivables and contract assets were grouped into homogeneous customer segments. The allowance rate is calculated for each segment based on days past due and actual credit losses incurred in prior years. The value also reflects current and forward-looking information and analysis of the expected economic situation during the term of the financial assets from the point of view of the Group. Observable forward-looking information may include disposable income, gross domestic product and inflation indices.

Compared to the previous year, there were no significant changes in trade receivables in the reporting year, which would lead to a material change in loss allowances for the 2018 financial year. However, there was a change in presentation due to adoption of IFRS 9. This change in presentation is a major factor of the decrease in the loss allowance compared to the previous year.

The following table provides information on exposure to credit risk and on expected credit losses for trade receivables (excluding O_2 My Handy) per days past due as of 31 December 2018. A credit risk of EUR 1 million from trade receivables measured in the category fair value through other comprehensive income is included in the days past due analysis below.

As of 31 December 2018 (in EUR million)	Gross carrying amount	Loss allowance	Average expected default rate
This presentation follows the simplified approach:			
Not due	708	8	1.1%
Overdue for 1-30 days	117	2	1.8%
Overdue for 31-60 days	13	2	11.4%
Overdue for 61-90 days	6	2	35.6%
Overdue for 91-180 days	70	8	12.0%
Overdue for 181-360 days	20	12	62.6%
Overdue for more than 360 days	37	30	80.0%
Total	**972**	**64**	

In addition, the customer segment O_2 My Handy has trade receivables in the amount of EUR 441 million whose impairment adjustment in the amount of EUR 74 million was not determined on the basis of days past due. Instead, a fixed percentage of the receivables was recognised for the expected credit loss.

Trade receivables at amortised cost have a gross carrying amount of EUR 586 million and loss allowances of EUR 63 million.

Current trade receivables at fair value through other comprehensive income (including O_2 My Handy receivables) have a carrying amount of EUR 682 million and non-current receivables of EUR 70 million. No separate loss allowances have been recorded for this valuation category, as the credit default risk of EUR 75 million (of which EUR 74 million O_2 My Handy) is implicitly included in the reported fair value.

The Loss allowance includes also EUR 5 million provisions for the utilisation of guarantee accounts in connection with transactions.

When calculating the expected credit losses, a collection rate of 23% is taken into account.

For trade receivables with a contractual volume of EUR 78 million, which were transferred to collection companies during the 2018 financial year and have not yet been paid, enforcement measures continue to be taken.

The breakdown of trade receivables is as follows:

As of 31 December		**2018**		2017
(in EUR million)	**Non-current**	**Current**	Non-current	Current
Trade receivables billed	70	779	76	715
Trade receivables unbilled	–	488	–	557
Trade receivables	**70**	**1,268**	**76**	**1,272**

The following table shows the development of the allowances for the years ending as of 31 December 2018 and 2017.

						2018		2017
	Trade receivables measured at amortised cost		**Trade receivables measured at fair value through other comprehensive income**		**Contract assets****		Trade receivables	
(in EUR million)	**Non-current**	**Current**	**Non-current**	**Current**	**Non-current**	**Current**	Non-current	Current
31 December 2017 (IAS 39)*	**–**	**(88)**	**(7)**	**(54)**	**–**	**–**	**(7)**	**(192)**
Adjustment based on IFRS9	**–**	**(1)**	**–**	**(1)**	**–**	**–**	**–**	**–**
1 January 2018 (IFRS 9)	**–**	**(89)**	**(7)**	**(55)**	**(0)**	**(1)**	**(7)**	**(192)**
Additions	–	(28)	–	(47)	(0)	(1)	–	(73)
Release	–	–	–	–	–	0	–	–
Utilisation	–	49	–	33	–	1	–	123
Reclassifications	–	–	(5)	5	0	(0)	–	–
31 December 2018	**–**	**(68)**	**(13)**	**(63)**	**(0)**	**(1)**	**(7)**	**(142)**

*Categories in accordance with IFRS 9, which were included in IAS 39 in the category "Loans and receivables".
**In accordance with IFRS 15

As of 1 January 2018, there were no material changes in the impairment losses as a result of the implementation of IAS 39 to IFRS 9, apart from changes in presentation.

In 2018 and 2017, 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 transactions concluded in 2018 amounts to EUR 632 million (2017: EUR 624 million), and the carrying amount is EUR 625 million (2017: EUR 618 million). The buyers of the receivable take over part of the risk of these receivables. The receivables sold were fully derecognised at the time of sale, with the exception of the continuing involvement of EUR 70 million. A liability of the same amount was recognised in the amount of the maximum remaining loss risk.

The continuing involvement results from guarantees granted. The utilisation is expected to result in a loss of EUR 5 million.

There were no material impairments of other receivables as of 31 December 2018.

4.5. Other financial assets

As of 31 December	**2018**		2017	
(in EUR million)	**Non-current**	**Current**	Non-current	Current
Investments in start-ups	1	–	18	–
Interest rate swaps	5	2	6	4
Reimbursement rights from insurance contracts	70	–	57	–
Silent factoring deposit	12	8	10	12
Deposits	0	–	0	–
Loans	14	0	2	1
Other financial assets	**101**	**9**	**94**	**17**

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. In the event of default of the underlying receivables, a part of this receivable shall be reimbursed. The deposit provides security for the bank's losses on the sale of receivables.

The interest rate swap is part of the bond issued in 2014 (for further information see Note 4.10 Interest-bearing debt).

The reimbursement rights in 2018 arose to cover the pension and partial benefit obligations, but do not represent plan assets except for a surplus of EUR 8 million 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.

Loan receivables mainly include a loan from the sale of shares in Shortcut I GmbH & Co. KG. Furthermore loan receivables also includes 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 Further information on financial assets and financial liabilities.

With regard to other financial assets, there were no indications of material impairment as at 31 December 2018.

4.6. Other non-financial assets and other non-financial liabilities

Other non-financial assets were comprised as follows as at 31 December 2018:

As of 31 December	2018		2017	
(in EUR million)	Non-current	Current	Non-current	Current
Prepayments	99	68	129	107
Prepayments to related parties	–	0	–	0
Capitalised costs of obtaining contracts	103	326	–	–
Contract asset	4	19	–	–
Other tax receivables	–	0	–	79
Other non-financial assets	**206**	**413**	**129**	**186**

Non-financial assets relate mainly to prepayments for fees charged for rental of antenna sites and VAT. For prepayments to affiliated companies, please refer to Note 12 Related Parties.

As already presented in the Accounting Policies, costs of obtaining a contract are capitalised subject to certain requirements of IFRS 15. These contain costs for commissions which can be directly attributed to contracts with customers.

Capitalised costs of obtaining a contract are amortised on a straight-line basis over the underlying amortisation period. In the reporting period, amortisation of EUR 437 million was recorded in this connection.

According to IAS 18, costs of obtaining a contract were not capitalised, but were recognised directly as expenditure.

The contract asset contains contracts for which Telefónica Deutschland Group fulfilled its performance obligations by transferring mobile devices, performing mobile services or fixed line/DSL services before consideration was paid or became due.

For contract assets, a loss allowance of EUR 1 million is already recognised directly in their present value. Contract assets exist primarily with private customers.

Other non-financial liabilities were comprised as follows as at 31 December 2018:

As of 31 December	2018	2017
(in EUR million)	Current	Current
Payroll taxes and social security	10	10
Current tax payables for indirect taxes	22	119
Other current taxes	7	3
Other non-financial liabilities	**39**	**132**

4.7. Inventories

As of 31 December

(in EUR million)	**2018**	2017
Merchandise	264	109
Allowances	(3)	(4)
Inventories	**261**	**105**

Inventories comprise smartphones and accessories in particular. The increase compared to prior year was in particular due to higher inventories of smartphones.

The total cost of inventories recognised as expenses in the financial year 2018 amounted to EUR 1,275 million (2017: EUR 1,145 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.

As of 31 December

(in EUR million)	**2018**	2017
Cash at bank and in hand	14	14
Cash pooling	737	573
Cash and cash equivalents	**751**	**587**

Telefónica has entered into cash pooling and deposit agreements with Telfisa Global B.V., a subsidiary of Telefónica, S.A. Group, and deposits its cash surpluses there. Telefónica, S.A. is rated by international rating agencies with an investment grade rating. Therefore, no significant credit losses are expected.

4.9. Equity

Subscribed capital
As of 31 December 2018, 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. Each no par value share has one vote at the Annual General Meeting. The registered share capital is fully paid.

As of 31 December 2018, Telefónica Deutschland Holding AG did not hold any of its own shares.

In accordance with section 6 (2) of the articles of association, the shareholders do not have the right to securitise shares. 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 authorised capital 2016/I of EUR 1,487,277,496 as of 31 December 2018.

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 2018, in the amount of EUR 4,800 million.

With the entry in the commercial register on 4 June 2018, the part of the tied capital reserve of EUR 4,535,097,828.00 was converted into a free capital reserve (section 272 (2) no. 4 HGB).

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 (2017: EUR 0.014 million).

Proposed dividend for financial year 2018 to be paid in 2019

On 29 October 2018, the Management Board of Telefónica Deutschland resolved to propose a total cash dividend of EUR 803 million or EUR 0.27 per share at the next Annual General Meeting, which is scheduled for 21 May 2019.

Dividend distribution in the financial year

On 17 May 2018, the Annual General Meeting of Telefónica Deutschland resolved to distribute a dividend of EUR 0.26 for each no par value share for financial year 2017, in total around EUR 773 million.

Dividend distribution in the previous 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.

4.10. Interest-bearing debt

As of 31 December		**2018**		2017
(in EUR million)	**Non-current**	**Current**	Non-current	Current
Bonds	1,099	16	504	613
Promissory notes and registered bonds	474	79	299	4
Loans	408	42	450	0
Finance leases	22	8	15	19
Contribution and compensation obligations	–	–	–	2
Interest-bearing debt	**2,004**	**145**	**1,268**	**637**

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 five years remains in the amount of EUR 931 million.

Bonds

In February 2014, Telefónica Deutschland Group placed a bond with a nominal value of EUR 500 million. The bond will mature on 10 February 2021. The senior unsecured seven-year bond was issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The coupon for the fixed interest bond is 2.375% and the issue price was at 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 made the net proceeds of the bond issue available to Telefonica Germany GmbH & Co. OHG in the form of a loan.

Another bond of the Telefónica Deutschland Group was issued on 5 July 2018 with a nominal value of EUR 600 million. The fixed interest rate is 1.75% and the bond matures on 5 July 2025. The senior unsecured seven-year bond was also issued by O2 Telefónica Deutschland Finanzierungs GmbH, Munich, and is guaranteed by Telefónica Deutschland Holding AG. The bond is used to refinance the bond due in November, which has been meanwhile repaid, and it is for general business purposes. O2 Telefónica Deutschland Finanzierungs GmbH, Munich, has made the net proceeds of the bond issue available to Telefonica Germany GmbH & Co. OHG in the form of a loan.

The bond is recognised at amortised cost using the effective interest method.

An interest rate swap in the amount of EUR 150 million was concluded on part of the nominal value of the aforementioned bond of February 2014, which is recognised as a fair value hedge. 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 of EUR 150 million and receives a fixed interest rate of 1.268% on the same amount in return. This interest rate swap has a positive clean fair value (i.e. excluding accrued interest) of EUR 5 million and is recognised in the Consolidated Statement of Financial Position under Other financial assets. The adjustment of the carrying amount of non-current financial liabilities results in a cumulative loss of EUR 5 million (cumulative loss in 2017 EUR 8 million and gain of EUR 3 million in 2018), while the related clean price of the interest rate swap results in a cumulative gain of EUR 5 million (cumulative gain in 2017 EUR 8 million and loss of EUR 4 million in 2017). The fair value of the dirty price (i.e. including accrued interest) of the interest rate swap that hedges the financial debt as of 31 December 2018 is EUR 6 million (2017: EUR 10 million) and is recognised in the balance sheet item Other financial assets.

The fair value of the swap, changes in its fair value and the amortisation of the fair value are recognised in Financial result.

The hedged nominal value of the financial liabilities amounts to EUR 150 million. This means that 14% of the company's bond portfolio was switched from fixed interest to variable interest.

The adjustment of the carrying amount of the bonds is determined by discounting the contractual future cash flows at currently applicable interest rates with comparable conditions and residual terms.

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 the expected future payments over the remaining term of the contract using current market interest rates and yield curves.

For further information on hedge accounting, please refer to the comments in the Combined Management Report, Risk Management and Financial Instruments.

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 the tranches with fixed interest rates is 1.38% p.a. The variable tranches bear interest at Euribor money market conditions 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.

The Telefonica Deutschland Group also placed promissory note loans in various tranches and a registered bond with a total volume of EUR 250 million via Telefónica Germany GmbH & Co. OHG in February 2018. The promissory note loans placed have tranches with terms of 1 year with fixed interest rates as well as terms of 5 and 7 years with variable and fixed interest rates and a 10-year tranche with a fixed interest rate. The respective interest rates for the fixed tranches with terms of 1, 5, 7 and 10 years are 0.03%, 1.051%, 1.468% and 1.962% p.a. respectively. The registered bond has a term of 15 years and a fixed interest rate of 2.506% p.a. The interest on the variable tranches is based on Euribor money market terms plus an agreed margin. 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 2023 for the last time in February 2018. The RCF bears a variable interest rate at Euribor money market conditions plus an agreed margin. As of 31 December 2018, 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 2018, 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. The facility serves general business purposes. In 2018, its term was extended by one year to 31 July 2019. As of 31 December 2018, the credit facility was not used.

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 related assets under property, plant and equipment in the Consolidated Financial Statements as of 31 December 2018 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 (in EUR million)	Future minimum lease payment obligations	Unamortised interest expense	2018 Present value of future minimum lease payment obligations
Due within one year	8	0	8
Due between 1 and 5 years	23	0	22
Due in more than 5 years	–	–	–
Total	**31**	**1**	**30**

As of 31 December (in EUR million)	Future minimum lease payment obligations	Unamortised interest expense	2017 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**

Reconciliation of debt movements to cash flow from financing activities

As of 31 December (in EUR million)	2017	Cash flow from financing activities**	Acquisitions	Fair Value Amendments	Other move-ments	2018
Bonds*	1,117	(4)	–	(3)	6	1,115
Promissory notes and registered bonds	303	250	–	–	1	554
Loans	450	–	–	–	0	450
Finance leases	33	(22)	19	–	–	30
Contribution and compensation obligations	2	–	–	–	(2)	–
Interest-bearing debt	**1,905**	**224**	**19**	**(3)**	**4**	**2,149**

* For significant movements, please refer to Note 4.10 Interest-bearing debt (bonds).
** The related interest paid from Interest-bearing debt is reported under Cash flow from operating activities and not included in the reconciliation.

4.11. Trade and other payables and deferred income

As of 31 December (in EUR million)	2018 Non-current	2018 Current	2017 Non-current	2017 Current
Trade payables to third parties	–	1,102	–	773
Accruals	17	697	17	842
Payables to related parties (Note 12 Related Parties)	–	362	–	374
Trade payables	**17**	**2,160**	**17**	**1,989**
Other payables non-trade	1	158	1	125
Other payables to related parties (Note 12 Related Parties)	1	45	–	40
Miscellaneous payables	–	56	–	69
Other payables	**1**	**260**	**1**	**235**
Trade and other payables	**19**	**2,419**	**19**	**2,224**
Deferred income	**176**	**535**	**255**	**527**

Accruals relate mainly to outstanding invoices for goods and services and for non-current assets.

Other payables non-trade mainly consists of liabilities due to personnel and payables from silent factoring.

Miscellaneous payables mainly comprise debtors with credit balances.

For the maturity profile of the listed liabilities, see the disclosures in the Combined Management Report, Risk Management and Financial Instruments.

Deferred income primarily contains contract liabilities from customer payments already made on prepaid credit and other advance payments received for future services. Deferred income also includes the contract liability to make payments early, before the contractual services have been fully performed. For further information, see Note 5.1 Revenues.

It also includes customer payments from MS Mobile Service GmbH (Drillisch) received in connection with the Mobile Bitstream Access Mobile Virtual Network Operator (MBA MVNO) contract.

Other contract liabilities are broken down by maturity according to their expected utilisation. Advance payments received for prepaid credits are classified exclusively as current.

4.12. Provisions

As of 31 December (in EUR million)	2018 Non-current	2018 Current	2017 Non-current	2017 Current
Net defined benefit liability	157	–	151	–
Restructuring	23	67	43	64
Asset retirement obligations	310	111	378	73
Other provisions	36	10	28	6
Provisions	**526**	**188**	**599**	**142**

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 reinsurance 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 reinsurance 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 assert 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 dependants.

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 reinsurance policies. In addition, the pledging of the reinsurance 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 concluded with an insurance company.

In the financial year 2018, the employer's contribution to the statutory pension insurance amounts to EUR 40 million (2017: EUR 39 million).

Telefónica Deutschland Group concludes additional defined contribution plans. The contribution recognised for the defined contribution plan is EUR 2 million (2017: EUR 2 million).

The following table contains the key data for the defined benefit plans:

As of 31 December

(in EUR million)	**2018**	2017
Present value of defined benefit obligation from funded plans	(114)	(108)
Present value of defined benefit obligation from unfunded plans	(125)	(128)
Present value of the defined benefit obligation	**(239)**	**(235)**
Fair value of plan assets	90	84
thereof: surplus	**8**	**–**
Net defined benefit liability	**(157)**	**(151)**
Reimbursement rights from insurance contracts	**62**	**57**

The development of the present value of the defined benefit obligations in 2018 and 2017 was as follows:

As of 31 December

(in EUR million)	**2018**	2017
Present value of the defined benefit obligation as of 1 January	**(235)**	**(233)**
Current service costs (personnel expenses)	(9)	(9)
Interest expense (financial result)	(4)	(4)
Remeasurement of the present value of the defined benefit obligation	6	8
thereof: actuarial gains/(losses) arising from changes in financial assumptions	*(4)*	*5*
thereof: experience-based adjustments	*11*	*3*
thereof: adjustment of the demographic assumption	*(1)*	*–*
Benefits paid	3	3
Other	(0)	–
Present value of the defined benefit obligation as of 31 December	**(239)**	**(235)**

The development of the fair value of the plan assets was as follows in 2018 and 2017:

(in EUR million)	**2018**	2017
Fair value of plan assets as of 1 January	**84**	**128**
Return on plan assets excluding amounts included in interest income/(expense)	1	0
Interest income (financial result)	1	2
Employer contributions	3	6
Benefits paid	(2)	(2)
Other	2	(50)
Fair value of plan assets as of 31 December	**90**	**84**

The fair value of the reimbursement rights from insurance contracts developed in 2018 and 2017 as follows:

(in EUR million)	**2018**	2017
Fair value of reimbursement rights from insurance contracts as of 1 January	**57**	**8**
Return on reimbursement rights excluding amounts included in interest income/(expense)	0	(0)
Interest income (financial result)	1	0
Employer contributions	6	0
Benefits paid	(1)	(0)
Other	(2)	50
Fair value of reimbursement rights from insurance contracts as of 31 December	**62**	**57**

The amounts recognised under "Other" in 2017 for defined benefit obligations and the plan assets originate from the transfer of pension obligations and the related plan assets.

The amounts recognised under 'Other' in 2018 for plan assets and for reimbursement rights are a result of the ban on setoffs of reimbursement rights that have not been pledged against plan assets.

In 2018, as in the previous year, there was no asset ceiling. This year there is a surplus of EUR 8 million, which is presented under other financial assets.

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

	2018	2017
Discount rate	1.95%	1.75%
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 at the balance sheet dates is based are Heubeck's 2005G mortality tables for 2017 and Heubeck's 2018G mortality tables for 2018.

As of 31 December

(in years)	**2018**	2017
Life expectancy at age 65 for a retiree currently	22	21
Life expectancy of a currently aged 40 plan member at age 65	25	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 2018:

(in EUR million)	Increase in parameters	Decrease in parameters
Discount rate (+0.25%/-0.25%)	(12)	13
Pension increase (+0.50%/-0.50%)	9	(10)
Turnover rate (+1.00%/-1.00%)	–	–
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:

1 January to 31 December

(in EUR million)	**2018**	2017
Benefits expected to be paid within year 1	3	2
Benefits expected to be paid within year 2	3	3
Benefits expected to be paid within year 3	3	3
Benefits expected to be paid within year 4	4	3
Benefits expected to be paid within year 5	4	3
Benefits expected to be paid within 6 to 10 years	29	24

The average expected term of the defined benefit obligation for the 2018 financial year is 21.8 years (2017: 22.8 years).

The best estimate of the contributions that will be paid into the plans in the financial year ending 31 December 2018 amounts to EUR 9 million (2017: EUR 9 million).

Other provisions

(in EUR million)	Restructuring	Asset retirement obligations	Others	Total
As of 1 January 2018	**106**	**450**	**33**	**590**
Additions	40	19	10	69
Utilisation	(51)	(49)	(0)	(101)
Release	(6)	–	(1)	(7)
Reclassifications	0	–	4	4
Interest effect	–	0	–	0
As of 31 December 2018	**90**	**421**	**46**	**556**
thereof: non-current	*23*	*310*	*36*	*369*
thereof: current	*67*	*111*	*10*	*188*

The provision for restructuring primarily reflect activities 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 90 million as of 31 December 2018 (2017: EUR 106 million) relates mainly to severance payments in connection with personnel headcount reductions, network consolidation, the termination of contracts with commercial agents and other activities.

In addition, there was a decline of EUR 51 million due to planned utilisation, which was offset by additions of EUR 40 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

(in EUR million)	2018	2017
Rendering of services	6,034	6,149
Other revenues	1,286	1,147
Revenues	**7,320**	**7,296**

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.

The breakdown of revenues according to mobile business and fixed line/DSL business is shown in the following table:

None of the Telefónica Deutschland Group's customers accounts for more than 10% of total revenues.

1 January to 31 December

(in EUR million)	2018	2017
Mobile business	6,539	6,415
Mobile service revenues	5,267	5,287
Handset revenues	1,272	1,128
Fixed line/DSL business revenues	767	862
Other revenues	13	19
Revenues	**7,320**	**7,296**

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 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. In addition, one-time connection charges are included insofar as these have been allocated to mobile communications services.

Handset revenues

Handset revenues include the income from the sale of mobile phones as part of the "O_2 My Handy" model, the mobile devices portion of bundled packages (mobile devices bundled offerings) for the former E-Plus brands and cash sales. Also included are revenues from the sale of mobile devices to distributors and partners and from the sale of 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.

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 mobile devices 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 DSL products, from services and from mobile devices 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 IoT ADA business field.

Contract assets and Contract liabilities from customer contracts

(in EUR million)	31 December 2018	1 January 2018
Contract asset	23	17
Contract liabilities	522	513

(in EUR million)	2018	2017*
Amounts recognised in contract liabilities at the beginning of the period that resulted in revenue in the reporting period.	445	–

* No information for comparative period, as application of IFRS 15.C (3b)

The Telefónica Deutschland Group receives payments from customers on the basis of a billing schedule which is part of the individual contracts. The contract asset refers to the entitlement to consideration for the performance of the contractual services to be rendered. The contract asset contains contracts for which Telefónica Deutschland Group satisfied its performance obligations by transferring mobile devices and performing mobile services or fixed line/DSL services before consideration was paid or became due. Amounts already reported as receivables are not taken into account in the recognition of the contract asset.

Receivables are recognised when the right to receive the consideration becomes unconditional, as the payment due date is dependent only on the course of time.

The contract liability relates to payments received prematurely, i.e. before the contractual services have been fully performed. Contract liabilities are recognised as revenue as soon as (or when) the Telefónica Deutschland Group provides the contractual services.

The changes in the contract assets or contract liabilities mainly result from the (not yet effected) satisfaction of the respective performance obligations.

Future revenues from (partially) unsatisfied performance obligations

(in EUR million)	Of which expected to be fulfilled in ≤ 12 months	Of which expected to be fulfilled in > 12 months
Total amount of contract liabilities contracted but not yet (fully) settled as of 31 December 2018	1,120	269

Within the scope of the disclosures according to IFRS 15.120, the practical expedient in accordance with IFRS 15.121 was applied. In this context, performance obligations resulting from contracts with a maximum contract term of one year and performance obligations for which revenues were realised corresponding to the invoicing were not taken into account. Accordingly, the portion of the transaction price allocated to these partially unsatisfied performance obligations is not included in the disclosure.

5.2. Other income

1 January to 31 December

(in EUR million)	**2018**	2017
Own work capitalised and ancillary income	177	128
Gain on disposal of assets	0	31
Other income	**177**	**159**

Own work capitalised includes direct labour costs as well as the allocable portion of indirect costs in connection with investments in non-current assets.

5.3. Personnel expenses

In financial year 2018, personnel expenses amounted to EUR 610 million (2017: EUR 642 million). Thereof, EUR 518 million (2017: EUR 552 million) related to wages and salaries, social security EUR 80 million (2017: EUR 78 million) and EUR 11 million (2017: EUR 11 million) to pensions. 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 19 million (2017: EUR 44 million) are recognised in personnel expenses. For further information, see Note 4.12 Provisions.

5.4. Other expenses

1 January to 31 December

(in EUR million)	**2018**	2017
Other third-party services	2,190	2,168
Other operating expenses	103	94
Allowance for current assets	7	7
Advertising	253	291
Other expenses	**2,552**	**2,560**

Other third-party services include commissions, among other things.

Other expenses as of 31 December 2018 included restructuring expenses of EUR 66 million (2017: EUR 38 million) (for further information, see Note 4.12 Provisions).

5.5. Depreciation and amortisation

1 January to 31 December

(in EUR million)	**2018**	2017
Depreciation of property, plant and equipment	959	862
Amortisation of intangible assets	1,029	1,008
Depreciation and amortisation	**1,987**	**1,869**

5.6. Financial result

1 January to 31 December

(in EUR million)	**2018**	2017
Interest income from financial assets	2	5
Interest expenses from financial liabilities	(42)	(37)
Interest component from measurement of provisions and other liabilities	(3)	(2)
Other exchange (losses)/gains	(0)	0
Financial result	**(42)**	**(34)**

Interest income from financial assets mainly consists of interest income from late payments.

Interest expenses from financial debt primarily comprise the interest for the bonds issued in November 2013, February 2014 and July 2018, the financing agreement signed on 13 June 2016 with the European Investment Bank (EIB), the bilateral revolving credit facility signed with the financing company of Telefonica S.A. Group, Telfisa Global B.V. on 31 July 2017, as well as for the promissory notes and registered bonds issued in March 2015 and February 2018.

Interest from finance lease obligations is also included.

5.7. Income tax

Consolidated income tax group

As of 31 December 2018, the consolidated income tax entity of Telefónica Deutschland Group comprised 17 companies (2017: 17).

Current and deferred taxes

1 January to 31 December

(in EUR million)	**2018**	2017
Current tax expense	0	(0)
Deferred tax income/(expense)	3	(262)
Income tax/(expense)	**3**	**(262)**

The movements in deferred tax assets are as follows:

(in EUR million)	**2018**	2017
As of 1 January	**162**	**427**
Deferred tax income/(expense)	3	(262)
Amount of deferred taxes recognised directly in equity as shown in the Consolidated Statement of Comprehensive Income	(2)	(3)
Adjustment due to initial application of IFRS 15	(134)	–
As of 31 December	**27**	**162**

Tax loss carried forward and temporary differences

The tax losses carried forward for which no deferred tax assets were recognised as of 31 December 2018 amounted to EUR 14,693 million for corporate income tax and EUR 14,284 million for trade tax (2017: EUR 14,439 million and EUR 14,060 million). For temporary differences of EUR 263 million in 2017 no deferred tax assets were recognised. For entities or the income tax group which had a negative taxable income in the previous year or in the current period, deferred tax assets of EUR 204 million (2017: EUR 162 million) were capitalised after setting them off against deferred tax liabilities, as the future realisation of this tax claim is to be supported by the tax income projection. The total deferred tax assets and liabilities amount to EUR 27 million (2017: EUR 162 million).

The capitalisation of tax losses carried forward 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 forward is as follows:

As of 31 December (in EUR million)	2018 Deferred tax assets	2018 Deferred tax liabilities	2017 Deferred tax assets	2017 Deferred tax liabilities
Goodwill and other intangible assets	600	(534)	853	(685)
Tangible assets	–	(200)	–	(210)
Trade and other receivables	1	(172)	10	(16)
Other current financial assets	3	(0)	8	(8)
Financial liabilities, trade and other payables	14	(5)	28	(7)
Provisions including pension provisions	111	(1)	88	(18)
Other current financial liabilities	12	(6)	23	(6)
Tax losses carried forward	204	–	102	–
Deferred tax assets/(liabilities) gross	**945**	**(918)**	**1,112**	**(951)**
Netting	(741)	741	(951)	951
Deferred tax assets/(liabilities) after netting according to Consolidated Statement of Financial Position	**204**	**177**	**162**	**–**
The total deferred tax assets/(liabilities)	**27**	**–**	**162**	**–**

The deferred taxes in the amount of EUR 945 million (2017: EUR 1,112 million) are primarily non-current deferred tax assets. The deferred tax liabilities in the amount of EUR 814 million (2017: EUR 951 million) are primarily non-current deferred tax liabilities and EUR 104 million are current deferred tax liabilities in connection with the capitalisation of short-term amortisable costs of obtaining a contract in accordance with IFRS 15, shown in Note 3 q) Standards and IFRIC interpretations issued and effective as of 31 December 2018.

Reconciliation of earnings before tax to income tax expense recognised

1 January to 31 December

(in EUR million)	2018	2017
Profit/(loss) before tax	**(233)**	**(118)**
Tax expense at prevailing statutory rate (32%)	74	38
Non-deductible expenses	(12)	(11)
Change in unrecognised temporary differences and tax losses carried forward	(60)	(289)
Other	–	(0)
Income tax	**3**	**(262)**
Current tax income/(expense)	0	(0)
Deferred tax income/(expense)	3	(262)
Income tax income/(expense)	**3**	**(262)**

6. Business Combinations

No transactions affecting the basis of consolidation were conducted by the Telefónica Deutschland Group in financial year 2018 (for more information, please see Note 10 Group Companies of the Telefónica Deutschland Group.

7. Disposal Groups

Disposal group in 2018: Sale of Shares in Shortcut I GmbH & Co. KG
By contract dated 14 September 2018, E-Plus Service GmbH sold all shares in Shortcut I GmbH & Co. KG. The sale of all shares in Shortcut I GmbH & Co. KG was completed formally and legally effective on 8 October 2018. Given the loss of control associated with the transaction, the company was deconsolidated from this date onwards. The carrying amount of the net assets sold and their impact on the consolidated financial statements were of minor significance.

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

(in EUR million)	**2018**	2017
Total profit/(loss) attributable to equity holders of the parent for basic = diluted earnings	(230)	(381)
Weighted average number of ordinary shares issued (in million units)	2,975	2,975
Earnings per share in EUR (basic = diluted)	**(0.08)**	**(0.13)**

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. Further information on 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 IFRS 9 with regard to the requirements of IFRS 13.

As of 31 December 2018, the carrying amount of current financial assets and financial liabilities represents an appropriate approximation of fair value.

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. The review is performed successively from level to level. The first stage is given priority and the subsequent stages are only used for evaluation if the requirements for the input factors of the first stage could not be fulfilled. For this purpose, three levels or measurement hierarchies are defined:

- **Level 1:** Input factors at this level are quoted (unadjusted) prices for identical assets or liabilities in active markets accessible to the entity at the measurement date.
- **Level 2:** Second level input factors are market prices other than those quoted at level one that are observable either directly or indirectly for the asset or liability.
- **Level 3:** Input factors that are not observable for the asset or liability.

As of 31 December 2018
Financial assets

(in EUR million)	Hedging accounting relationships (no measurement category according to the meaning of IFRS 9)	Financial assets measured at fair value through profit or loss	Financial assets measured at fair value through other comprehensive income	Financial assets measured at amortised cost	Not in the scope of IFRS 7	Total carrying amount	Measurement hierarchy: Level 1 (Quoted prices)	Measurement hierarchy: Level 2 (Significant other observable input parameters)	Measurement hierarchy: Level 3 (Significant unobservable input parameters)	Measurement hierarchy: Total fair value
Non-current trade and other receivables (Note 4.4)	–	–	70	–	–	70	–	70	–	70
Other non-current financial assets (Note 4.5)	5	1	–	26	70	101	–	31	1	31
thereof: derivatives	*5*	–	–	–	–	*5*	–	*5*	–	*5*
thereof: investments in start-ups	–	*1*	–	–	–	*1*	–	–	*1*	*1*
thereof: other	–	–	–	*26*	*70*	*96*	–	*26*	–	*26*
Current trade and other receivables (Note 4.4)	–	–	682	618	1	1,301	–	1,300	–	1,300
Other current financial assets (Note 4.5)	2	–	–	8	–	9	–	9	–	9
thereof: derivatives	*2*	–	–	–	–	*2*	–	*2*	–	*2*
thereof: other	–	–	–	*8*	–	*8*	–	*8*	–	*8*
Cash and cash equivalents (Note 4.8)	–	–	–	751	–	751	–	751	–	751
Total	**6**	**1**	**752**	**1,402**	**72**	**2,233**	**–**	**2,160**	**1**	**2,161**

As of 31 December 2017
Financial assets*

(in EUR million)	Hedging accounting relationships (no measurement category according to the meaning of IAS 39)	Available-for-sale financial assets	Held-to-maturity financial assets	Loans and receivables	Not in the scope of IFRS 7	Total carrying amount	Measurement hierarchy: Level 1 (Quoted prices)	Level 2 (Significant other observable input parameters)	Level 3 (Significant unobservable input parameters)	Total fair value
Non-current trade and other receivables (Note 4.4)	–	–	–	69	–	69	–	69	–	69
Other non-current financial assets (Note 4.5)	6	18	–	12	57	94	–	18	–	18
thereof: derivatives	*6*	–	–	–	–	*6*	–	*6*	–	*6*
thereof: investments in start-ups	–	*18*	–	–	–	*18*	–	–	–	–
thereof: other	–	–	–	*12*	*57*	*69*	–	*12*	–	*12*
Current trade and other receivables (Note 4.4)	–	–	–	1,263	2	1,265	–	1,263	–	1,263
Other current financial assets (Note 4.5)	4	–	–	13	–	17	–	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**	**59**	**2,032**	**–**	**1,955**	**–**	**1,955**

* The prior year's presentation was amended to improve ease of reading.

As of 31 December 2018, EUR 5 million of other non-current financial assets and EUR 2 million of other current financial assets were designated to a hedge relationship. These relate to the swap that the Group entered into in connection with the bond issuance in 2014 (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 using current market interest rates, including credit risk spreads observable on the market.

New classification of financial assets according to IFRS 9:

(in EUR million)	Footnote	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 / Non-current	Original carrying amount under IAS 39 / Current	**New carrying amount under IFRS 9 / Non-current**	**New carrying amount under IFRS 9 / Current**
Trade and other receivables (factoring)	a	Loans and receivables	Financial assets measured at fair value through other comprehensive income	69	488	70	487
Trade and other receivables (other)	b	Loans and receivables	Financial assets measured at amortised cost	–	775	–	774
Investments in start-ups	c	Available-for-sale financial assets	Financial assets measured at fair value through profit or loss	18	–	18	–
Other financial assets, thereof other		Loans and receivables	Financial assets measured at amortised cost	12	13	12	13
Cash and cash equivalents		Loans and receivables	Financial assets measured at amortised cost	–	587	–	587

The reporting requirements of the Group in regard to the classification of financial instruments under IFRS 9 are described in Note 3h Accounting Policies. The adoption of the requirements led to the above mentioned reclassifications which are explained below:

a) Trade and other receivables that arise from factoring transactions were classified as loans and receivables in accordance with IAS 39. For these, the company intends to collect the contractual cash flows as well as to sell the asset. The cash flows relate exclusively to interest and principal payments on the outstanding principal amount and thus meet the cash flow criterion. Therefore, they were classified in accordance with IFRS 9 as financial assets measured at fair value through other comprehensive income.

b) The remaining part of the trade and other receivables, which was classified as loans and receivables in accordance with IAS 39 is now classified as financial assets measured at amortised cost. A decrease in impairment of EUR 1 million was recognised at the time of the transition to IFRS 9 and recorded under retained earnings as of 1 January 2018.

c) The equity instruments which were classified as available-for-sale financial assets under IAS 39 do not meet the cash flow criterion under IFRS 9. These assets are therefore classified in accordance with IFRS 9 as financial assets measured at fair value through profit or loss.

As of 31 December 2018
Financial liabilities

(in EUR million)	Financial liabilities measured at amortised cost	Finance leases	Not in the scope of IFRS 7	Total carrying amount	Measurement hierarchy: Level 1 (Quoted prices)	Level 2 (Significant other observable input parameters)	Level 3 (Significant un-observable input parameters)	Total fair value
Non-current interest-bearing debt (Note 4.10)	1,981	22	–	2,004	1,130	907	–	2,036
Non-current trade and other payables (Note 4.11)	17	–	1	18	–	17	–	17
Current interest-bearing debt (Note 4.10)	137	8	–	145	–	145	–	145
Current trade and other payables (Note 4.11)	2,376	–	43	2,419	–	2,376	–	2,376
Total	**4,512**	**30**	**44**	**4,586**	**1,130**	**3,445**	**–**	**4,575**

As of 31 December 2017
Financial liabilities*

(in EUR million)	Financial liabilities measured at amortised cost	Finance leases	Not in the scope of IFRS 7	Total carrying amount	Measurement hierarchy: Level 1 (Quoted prices)	Level 2 (Significant other observable input parameters)	Level 3 (Significant unobservable input parameters)	Total fair value
Non-current interest-bearing debt (Note 4.10)	1,253	15	–	1,268	537	778	–	1,315
Non-current trade and other payables (Note 4.11)	17	–	1	18	–	17	–	17
Current interest-bearing debt (Note 4.10)	620	17	–	637	615	25	–	639
Current trade and other payables (Note 4.11)	2,161	–	62	2,223	–	2,161	–	2,161
Total	**4,051**	**31**	**64**	**4,147**	**1,152**	**2,981**	**–**	**4,133**

* The prior year's presentation was amended to improve ease of reading.

As of 31 December 2018, non-current interest-bearing debts with a carrying amount of EUR 155 million are designed to a hedging relationship. These relate 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 other non-current interest-bearing debt is determined by discounting future cash flows using current market interest rates, including credit risk spreads observable on the market.

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.

The following table shows the net gains and losses per measurement category in accordance with IFRS 9:

	Amortised cost		At fair value through profit or loss		At fair value through other comprehensive income
1 January to 31 December 2018 (in EUR million)	Financial assets	Financial liabilities	Financial assets	Financial liabilities	Financial assets
Net result from disposals	–	–	16	–	–
Result from valuations	1	(1)	–	–	–
Impairment/reversal of impairment losses	(31)	–	–	–	(46)
Effective interest income	2	–	–	–	–
Effective interest expense	–	(42)	–	–	–
Fee income/expenditure	–	–	–	–	–
Total	**(29)**	**(42)**	**16**	**–**	**(46)**

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 2018.

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.

31 December 2018

Company name, registered office	Country	Consolidation	Share in % as of
Parent company			
Telefónica Deutschland Holding AG, Munich, Germany	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[2]	Germany	Full financial year	100%
Telefónica Germany Retail GmbH, Dusseldorf[2]	Germany	Full financial year	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, Dusseldorf[2]	Germany	Full financial year	100%
TGCS Essen & Potsdam GmbH, Potsdam[2]	Germany	Full financial year	100%
TGCS Berlin GmbH, Dusseldorf[2]	Germany	Full financial year	100%
AY YILDIZ Communications GmbH, Dusseldorf[2]	Germany	Full financial year	100%
Ortel Mobile GmbH, Dusseldorf[2]	Germany	Full financial year	100%
TFS Potsdam GmbH, Potsdam[2]	Germany	Full financial year	100%
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, Dusseldorf[4]	Germany	Full financial year	33%

[1]These entities use the exemption provisions pursuant to section 264b HGB.

[2]These entities use 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 205 thousand as of 31 December 2017. Net income amounted to EUR +102 thousand for financial year 2017.

During the third quarter of 2018, co-trade GmbH was merged into Telefónica Germany Retail GmbH and Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH into E-Plus Service GmbH retrospective as of 1 January 2018.

In addition, E-Plus Service GmbH has sold all shares in Shortcut I GmbH & Co. KG in the third quarter of 2018. The sale was formally and legally completed in the fourth quarter of 2018.

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 mobile devices.

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 supplies the company with mobile communications devices, on the other.

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 Group Companies of the Telefónica Deutschland Group provides an overview of the companies making up the Telefónica Deutschland Group. In 2017 and 2018, 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 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:

As of 31 December

(in EUR million)	2018	2017
Receivables from the Telefónica, S.A. Group	**778**	**650**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Cash and cash equivalents (cash pooling)	737	573
Trade and other receivables	40	77
Liabilities to the Telefónica, S.A. Group	**408**	**415**
that are recognised in the following items in the Consolidated Statement of Financial Position:		
Trade and other payables	408	415
Interest-bearing debt	–	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 4 million in 2018 (2017: EUR 2 million).

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 7 million in 2018 (2017: EUR 3 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

1 January to 31 December	Revenues, other income and interest income		Expenses	
(in EUR million)	**2018**	2017	**2018**	2017
Telefónica, S.A. Group	39	44	(148)	(176)

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 37 million in 2018 (2017: EUR 36 million), 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. IT services.

12.2. Transactions with Management Board and Supervisory Board

a) Management Board
In financial year 2018, the key management personnel included the following members of the Management Board:

- Markus Haas (CEO)
- Markus Rolle
- Wolfgang Metze
- Alfons Lösing
- Cayetano Carbajo Martín
- Nicole Gerhardt
- Valentina Daiber
- Guido Eidmann

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 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 activities 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 2018 amounted to EUR 6,163 thousand. The total remuneration in the reporting year includes share-based compensation for the transfer of shares without consideration with a fair value at the time they were granted of EUR 559 thousand, with 105,556 shares.

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 2017 amounted to EUR 4,147 thousand. The total remuneration in financial year 2017 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

(in EUR thousand)	2018	2017
Total remuneration	**6,883**	**4,611**
thereof:		
Short-term employee benefits	5,604	3,884
Other long-term employee benefits	679	367
Share-based payments	131	93
Service cost	469	268

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)	2018	2017
Share options as of 1 January	**60,345**	**111,242**
Forfeited share options	(60,345)	(65,990)
Newly issued share options	105,556	–
Change in composition of Management Board	–	37,345
Actual share assignment	–	(22,252)
Share options as of 31 December	**105,556**	**60,345**

The defined benefit pension obligations for the Management Board members in financial year 2018 amounted to EUR 2,980 thousand (2017: EUR 2,248 thousand).

As of 31 December 2018 and 2017, the pension obligations for the members of the former management and their surviving dependants amounted to EUR 16,195 thousand (2017: EUR 14,448 thousand).

For further details of the pension obligations of the Telefónica Deutschland Group, please refer to Note 4.12 Provisions.

As of 31 December 2018, the total remuneration expense for the members of the former management and their surviving dependants amounted to EUR 468 thousand (2017: EUR 182 thousand).

b) Supervisory Board

Name	Member of the Supervisory Board	Remuneration in EUR
Eva Castillo Sanz*	since 5 October 2012 to 25 May 2018	27
Laura Abasolo García de Baquedano**	Since 12 May 2015	2
María García-Legaz Ponce	Since 7 June 2018	2
Patricia Cobian González	Since 18 September 2012	2
Michael Hoffmann	Since 5 October 2012	70
Enrique Medina Malo	since 18 September 2012 to 24 July 2018	2
Pablo de Carvajal Gonzalez	Since 25 July 2018	2
Sally Anne Ashford	Since 18 September 2014	20
Peter Erskine	Since 19 May 2016	20
Julio Linares López	Since 16 October 2017	20
Christoph Braun***	Since 1 July 2016	39
Thomas Pfeil	Since 3 June 2013	20
Dr. Jan-Erik Walter	Since 3 June 2013	20
Marcus Thurand	since 3 June 2013 to 17 May 2018	8
Martin Butz	Since 17 May 2018	13
Christoph Heil	since 3 June 2013 to 17 May 2018	8
Sandra Hofmann	Since 17 May 2018	13
Claudia Weber	Since 3 June 2013	20
Joachim Rieger****	Since 31 October 2014	25
Jürgen Thierfelder****	Since 31 October 2014	23

* Ms Castillo Sanz was Chair of the Supervisory Board until 25 April 2018 (inclusive) and has been an ordinary member of the Supervisory Board since 26 April 2018.

** Ms Abasolo García de Baquedano has been Chair of the Supervisory Board since 3 May 2018.

*** Mr Braun was no longer Deputy Chairman after the end of his first term of office at the close of the Annual General Meeting on 17 May 2018 until his re-election as Deputy Chairman on 13 June 2018.

**** 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 TGCS Essen & Potsdam GmbH and Telefónica Germany Retail GmbH. Such remuneration amounts to EUR 4,500 each and is already included in the table (pro rata where applicable). Mr Thierfelder is no longer a member of the Supervisory Board of Telefónica Germany Retail GmbH as of 14 September 2018.

The members of the Supervisory Board received remuneration of EUR 346 thousand for their activities in 2018 (2017: EUR 382 thousand)

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 for the period of appointment to the Supervisory Board:

1 January to 31 December

(in EUR thousand)	2018	2017
Total remuneration	**755**	**721**
thereof:		
Short-term employee benefits	730	693
Share-based payments	7	7
Service cost	18	21

As of 31 December 2018, 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 2018, the Telefónica Deutschland Group had made various agreements regarding share-based payments. Share-based payment transactions are accounted for as equity-settled share-based payment transactions. The financial effects of the share-based remuneration systems are, however, of minor importance for the Telefónica Deutschland Group:

- In financial year 2018, personnel expenses arising from share-based payment transactions amounted to EUR 1 million (2017: EUR 7 million).
- As of 31 December 2018, liabilities arising from share-based payment transactions amounted to EUR 4 million (2017: EUR 0 million) against Telefónica S.A. Group.

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	**2018**	2017
Office staff	8,650	9,024
thereof from joint operations	12	12
Temporary staff	340	381
Total	**8,990**	**9,405**

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 2018, the equity ratio amounted to 54.9% compared with 58.8% as of 31 December 2017. OIBDA was EUR 1,797 million in 2018 (2017 EUR 1,785 million).

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 to the obligations from operating leases, purchase and contractual obligations:

As of 31 December

(in EUR million)	**2018**	2017
Less than 1 year	475	554
1 to 5 years	1,240	1,451
Over 5 years	864	774
Obligation from operating leases	**2,579**	**2,779**

As of 31 December

(in EUR million)	**2018**	2017
Less than 1 year	1,584	1,351
1 to 5 years	758	698
Over 5 years	195	154
Purchase and other contractual obligations	**2,538**	**2,203**
Total	**5,116**	**4,982**

Obligations from operating leases are recognised when the contracts become legally effective.

The following amounts are recognised in the Consolidated Income Statement:

1 January to 31 December

(in EUR million)	**2018**	2017
Expenses for operating leases	626	642

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.

The guarantees amounted to EUR 96 million as of 31 December 2018 (2017: EUR 111 million).

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:

As of 31 December

(in EUR million)	**2018**	2017
Less than 1 year	10	13
1 to 5 years	15	17
Over 5 years	5	4
Income from subleases	**30**	**35**

The following amounts are recognised in the Consolidated Income Statement:

1 January to 31 December

(in EUR million)	**2018**	2017
Income from subleases	11	22

19. Total Auditor's Fees

In the financial years 2018 and 2017, the services listed below provided by the Group's auditors, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, are 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

(in EUR million)	**2018**	2017
Types of fee:		
Audit services	2	2
Other certification 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 years 2018 and 2017 only to a minor extent.

20. Subsequent Events

Change in the Supervisory Board
Supervisory Board member Jürgen Thierfelder resigned from office with effect of as the end of 31 December 2018.

Sandra Hofmann informed the Chairman of the Supervisory Board that she is resigning as a member of the Supervisory Board with effect from the end of the Supervisory Board meeting on 18 February 2019.

Mobile frequency auction
The Telefónica Deutschland Group submitted an application to the BNetzA for participation in the auction for the allocation of frequencies in the 2 GHz and 3.6 GHz ranges in due time by 25 January 2019.

On 4 February 2019, the Telefónica Deutschland Group instigated urgent procedings against Presidential Chamber Decisions III and IV of the BNetzA regarding the frequency usage regulations and the auction rules of 26 November 2018, after it had already filed an action against the decisions in December 2018. A decision on the urgent procedings is expected in the first quarter of 2019.

No additional events subject to disclosure requirements occurred after the end of the 2018 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 and 15 October 2018. The complete wording of the declaration of compliance is available on Telefónica Deutschland's website at **www.telefonica.de/declaration-of-compliance-2018.**

Munich, 15 February 2019

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 net assets, financial position and results of operations 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, 15 February 2019

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 2018, 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 January 1 to December 31, 2018, 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 January 1 to December 31, 2018. 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 of December 31, 2018, and of its financial performance for the financial year from January 1 to December 31, 2018, 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 January 1 to December 31, 2018. 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 the assets attributable to the "Telecommunications" cash-generating unit
❷ Recoverability of the deferred tax assets on loss carryforwards
❸ Appropriateness of revenue recognition and the effects of the initial application of IFRS 15

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 the assets attributable to the "Telecommunications" cash-generating unit**

① Goodwill and other intangible assets totaling € 6.7 billion (48.6% of total assets) and property, plant and equipment amounting to € 3.8 billion (27.5% of total assets) are reported in the Company's consolidated financial statements. These items include, among others, goodwill, network licenses, customer bases, one unused network license and the technical infrastructure relating to transmission masts. These assets mainly reflect own investments made in previous financial years and investments made in the current financial year and, in part, the acquisition of the E-Plus Group in financial year 2014, and – primarily with the exception of the unused network license for which amortization had not yet begun as of the balance sheet date and of goodwill – are recognized at cost less amortization and write-downs. Depreciation and amortization is recognized over the expected useful economic lives. The nused network license and goodwill are not amortized. All tangible and intangible assets are tested for impairment annually or when there are indications of impairment. The impairment tests are performed at Group level, as no separable groups of assets exist below Group level – in other words below the level of "Telecommunications" – that generate cash inflow that is largely independent of the cash inflow of other assets or other groups of assets below Group level. For this reason the whole Group is considered to be a cash-generating unit.

The outcome of the impairment tests performed by the Company 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 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 first assessed the procedure for identifying and evaluating issues and developments that could affect the recoverability of goodwill, other intangible assets or property, plant and equipment, including established controls. On this basis, we evaluated, among other things, 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 in general, and the development of the customer figures provided to us, in order to determine whether they form an appropriate basis for the executive directors' assessment of the recoverability of the assets attributed to the "Telecommunications" CGU. In addition we also assessed whether the CGU was properly identified. We based our assessment on, among other things, 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 by the discounted future cash flows. In our view, the assumptions and inputs used by the executive directors were properly derived overall.

③ The Company's disclosures on the "Telecommunications" CGU and on the performed impairment test are included in Sections 4.1 "Goodwill" and 4.2 "Other intangible assets" of the notes to the consolidated financial statements.

❷ Recoverability of deferred tax assets on loss carryforwards

① After netting, deferred tax assets of € 204 million 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 that will enable the deductible temporary differences and unused tax losses to be utilized. For this purpose, future taxable profits are projected on the basis of the adopted business plan if insufficient deferred tax liabilities are available. The negative earnings in prior years were mainly the result of non-recurring restructuring expenses and expenses 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, for the most part, come to an end 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, we, in collaboration with internal specialists from Tax Accounting, 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 and the effects of the initial application of IFRS 15

① In the Company's consolidated financial statements, revenues of € 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.

This financial year, the initial application of the new accounting standard on revenue recognition (IFRS 15) had a significant impact on the consolidated financial statements and the systems and processes of revenue recognition and revenue deferral implemented at the Group. The Company exercised the option to use a practical expedient on initial application and recognized the cumulative effect of the transition directly in equity as of January 1, 2018, in accordance with the transitional provisions. The cumulative adjustment to equity (after deferred taxes) in the Company's opening balance sheet as of January 1, 2018 amounts to € 276 million. The largest portion of this effect amounting to € 285 million (after deferred taxes) resulted from the initial recognition of the costs of obtaining contracts and led to a corresponding increase in retained earnings.

The application of IFRS 15 required some accounting processes to be adjusted and some existing contracts to be re-assessed. In particular, requirements concerning the analysis of customer contracts within the scope of the new product process had to be defined in further detail in order to meet the requirements of IFRS 15. In addition, an IT tool was introduced to calculate adjustments within the scope of IFRS 15. The initial application of IFRS 15 also resulted in a significant increase in disclosure requirements.

As significant items in terms of volume, revenue and capitalized costs of obtaining contracts under other non-financial assets are based to a large extent on assessments and assumptions made by the executive directors. In addition, correct revenue recognition and deferral under the Group-wide application of the new IFRS 15 standard is to be considered a complex task. Against this background, the accounting for revenues was of particular importance in the context of 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, we, as part of our audit, 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 and the measurement and billing systems, to entry in the general ledger. Our audit also covered the changes made to the systems and the controls implemented for this purpose. Furthermore, our audit also involved assessing the effects of the initial application of IFRS 15. For this purpose, we assessed, among other things, the implementation work and also evaluated the design of the processes set up to report the transactions in accordance with IFRS 15 as well as the IT tool developed to support the implementation of the new regulations. Our audit also covered the changes made to the systems and the controls implemented for this purpose. In addition, we assessed the appropriateness of the methods used to determine the impact of the initial application of IFRS 15. As part of this assessment, we inspected customer contracts, verified the identification of service obligations and evaluated whether these services were performed over time or at a particular point in time. 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. In relation to the disclosure requirements under the initial application of IFRS 15, we also assessed the appropriateness of the procedure used, including the impact analysis conducted within the Group, and assessed the estimates and discretionary decisions made by the executive directors with regard to revenue recognition and deferral.

Furthermore, we examined customer invoices and the associated contracts and payments received on a sample basis and obtained balance confirmations for private and business customers. 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 accounted for under the first-time application of IFRS 15.

③ The disclosures provided by the Company with regard to revenue and the effects of the initial application of IFRS 15 are included in Section 3/p Accounting policies, IFRS 15: Revenue from Contracts with Customers and Section 5.1 Revenue.

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 "Statement on Corporate Governance" 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 skepticism 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, as to 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 May 17, 2018. We were engaged by the supervisory board on November 23, 2018. We have been the group auditor of Telefónica Deutschland Holding AG, Munich, without interruption since 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).

We have provided the following services in addition to the audit of the consolidated financial statements to the audited entity and its controlled undertakings, which have not been disclosed in the consolidated financial statements or the group management report: We have audited the annual financial statements of the company and performed several financial statement audits of subsidiaries. In addition, we have rendered other contractual attestation services mainly in connection with a capital markets transaction.

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Stefano Mulas.

Munich, February 15, 2019

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Stefano Mulas German Public Auditor	p.p. Gabor Krüpl German Public Auditor

SUPERVISORY BOARD REPORT FOR THE 2018 FINANCIAL YEAR

Laura Abasolo García de Baquedano,

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

In the beginning of the financial year 2018, the Supervisory Board comprised the following members: Eva Castillo Sanz (Chairperson), Laura Abasolo García de Baquedano, Sally Anne Ashford, Patricia Cobián González, Peter Erskine, Michael Hoffmann, Julio Linares López and Enrique Medina Malo from shareholder representative side, and from employee representative side Christoph Braun (Deputy Chairperson), Christoph Heil, Thomas Pfeil, Joachim Rieger, Jürgen Thierfelder, Marcus Thurand, Dr. Jan-Erik Walter and Claudia Weber.

In the beginning of the business year 2018, Eva Castillo Sanz was chairperson of the Supervisory Board. On 25 April 2018, she resigned from her office as chairperson of the Supervisory Board as well as from her respective memberships in the Supervisory Board committees with immediate effect. Laura Abasolo García de Baquedano was elected as chairperson of the Supervisory Board on 3 May 2018.

Moreover, Eva Castillo Sanz resigned from her office as member of the Supervisory Board with effect as of the end of 25 May of 2018. María García Legaz-Ponce was appointed member of Supervisory Board as her successor by court resolution dated 7 June 2018.

Enrique Medina Malo resigned from his office as member of the Supervisory Board with effect as of end of 24 July 2018. With effect as of 25 July 2018 Pablo de Carvajal González was appointed as new member of the Supervisory Board by court resolution.

On 26 April 2018, the elections of the employee representatives took place as their respective terms of office ended with the end of the Annual General Meeting on 17 May 2018. Christoph Braun, Thomas Pfeil, Joachim Rieger, Jürgen Thierfelder, Dr. Jan-Erik Walter and Claudia Weber were re-elected. The respective office periods of Christoph Heil and Marcus Thurand ended on 17 May 2018. Martin Butz and Sandra Hofmann were newly elected to the Supervisory Board.

As of 31 December 2018, the Supervisory Board comprised the following members: Laura Abasolo García de Baquedano (Chairperson), Sally Anne Ashford, Pablo de Carvajal, Patricia Cobián González, Peter Erskine, María García-Legaz Ponce, Michael Hoffmann, Julio Linares López, González from shareholder representative side, and from employee representative side Christoph Braun (Deputy Chairperson), Martin Butz, Sandra Hofmann, Thomas Pfeil, Joachim Rieger, Jürgen Thierfelder, Dr. Jan-Erik Walter and Claudia Weber.

On 21 December 2018, Jürgen Thierfelder informed the Chairperson of the Supervisory Board that he resigns as a member of the Supervisory Board with effect as of the end of 31 December 2018.

On 4 February 2019, Sandra Hofmann informed the Chairperson of the Supervisory Board that she resigns as a member of the Supervisory Board with effect as of the end of the supervisory board meeting on 18 February 2019.

In the Supervisory Board of Telefónica Deutschland Holding AG, the independent member Michael Hoffmann performs the function of financial expert with the expertise as requested by section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

The Management Board of Telefónica Deutschland Holding AG comprises the following members:

Markus Haas, CEO (Vorstandsvorsitzender)
Markus Rolle,CFO (Finanzvorstand)
Wolfgang Metze (Chief Consumer Officer)
Alfons Lösing (Chief Partner and Business Officer)
Cayetano Carbajo Martín (Chief Technology Officer)
Guido Eidmann (Chief Information Officer)
Valentina Daiber (Chief Officer Legal & Corporate Affairs) and
Nicole Gerhardt (Chief Human Resources Officer as well as Labour Director (Arbeitsdirektorin)).

Cooperation between the Management Board and Supervisory Board

The Management Board and Supervisory Board cooperate in a trusting manner in all relevant matters within and outside supervisory board meetings.

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.

The Management Board also provides the Supervisory Board with a written 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 status and future development of the company as well as the progress of current material projects. The chairperson of the Supervisory Board informs the other members of the Supervisory Board of important issues discussed in that context.

Meetings of the Supervisory Board

In 2018, five regular meetings of the Supervisory Board took place, namely on 19 February (meeting on the financial statements for the 2017 financial year; “Bilanzsitzung”), 23 April, 23 July, 24 October and 18 December 2018. Moreover, there were four extraordinary meetings on 2 February, 25 April, 3 May und 13 June 2018.

In addition, there were further resolutions of the Supervisory Board outside of meetings.

In 2019, there was one meeting so far, on 18 February 2018 (meeting on the financial statements for the financial year 2018, “Bilanzsitzung”).

Fundamental issues dealt with by the Supervisory Board

The first (extraordinary) meeting of the Supervisory Board in the 2018 financial year took place on 2 February 2018 to prepare the so-called Capital Market Day.

On 19 February 2018 the meeting on financial statements of the financial year 2017 (Bilanzsitzung) took place. In addition to the items associated therewith, such as the review and approval of the corporation and group financial statements and the combined management report for the 2017 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), in particular the agenda and resolution motions for the Annual General Meeting on 17 May 2018 were discussed.

The agenda of the Supervisory Board meeting on 23 April 2018 comprised in addition to the financial data for Q1 and the outlook also operation and financial topics, inter alia decisions regarding the issuance of a bond and the merger of co-trade GmbH into Telefónica Germany Retail GmbH. Furthermore, Corporate Governance and Compliance topics as well as Audit and Risk Management were dealt with.

Moreover, there were three extraordinary Supervisory Board Meetings on 25 April, 3 May and 13 June 2018. These concerned the resignation of Eva Castillo Sanz as chairperson of the Supervisory Board, the election of Laura Abasolo García de Baquedano as new chairperson of the Supervisory Board, the re-election of Christoph Braun as deputy chairperson as well as the succession to the committees of the Supervisory Board.

Among other things, the meeting on 23 July 2018 addressed the half-yearly financial numbers, merger of Erste MVV Mobilfunk Vermögensverwaltungsgesellschaft mbH into E-Plus Service GmbH and the transfer of its spectrum to Telefónica Germany GmbH & Co. OHG, Compliance topics as well as the efficiency of the Supervisory Board.

The topics discussed at the meeting on 24 October 2018 included financial issues (especially the Q3 results and the business plan), the results of the Supervisory Board efficiency survey as well as the new version of the By-Laws for the Management Board. The appointment of Management Board member Cayetano Carbajo Martín was extended by resolution of the Supervisory Board by one year until the end of 31 December 2019.

Moreover, the date for the Annual General Meeting for the business year 2018 was determined (21 May 2019).

At the meeting on 18 December 2018, in particular, the budget for the financial year 2019 was approved and the participation in the upcoming frequency auction was covered.

At every 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 addressed.

In July 2018, the Supervisory Board also held a strategy workshop together with the Management Board.

All Supervisory Board members in office for the entire 2018 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) was passed this way as well as the final agenda of the Annual General Meeting (including the conclusion of a control agreement and capital measures) – following respective preparation at presence meetings.

Committees of the Supervisory Board

The Supervisory Board has installed the following 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.

Currently, the Audit Committee consists of the following four members:

— Michael Hoffmann (Chairperson)

— Laura Abasolo García de Baquedano

— Thomas Pfeil and

— Martin Butz (since 13 June 2018).

Christoph Heil was a member of the Audit Committee until 17 May 2018.

In 2018, the Audit Committee met five times. It dealt with the regular topics financial results, auditing, risk management and compliance.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:

— Laura Abasolo García de Baquedano (since 3 May 2018; chairperson)

— Christoph Braun

— Julio Linares López and

— Sandra Hofmann (since 13 June 2018)

Eva Castillo Sanz was a member of the Mediation Committee until 25 April 2018, Marcus Thurand until 17 May 2018.

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 currently has the following members:

— Sally Anne Ashford (Chairperson)

— Laura Abasolo García de Baquedano (since 13 June 2018)

— Claudia Weber and

— Dr. Jan-Erik Walter.

Eva Castillo Sanz was a member of the Remuneration Committee until 25 April 2018.

The Remuneration Committee met five 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 is chairperson of the Nomination Committee. After the resignations of Eva Castillo Sanz and Enrique Medina Malo, the other members are Laura Abasolo García de Baquedano and Pablo de Carvajal González since 24 September 2018.

In the reported year, the Nomination Committee prepared- by email resolution - the election proposal for the Annual General Meeting on 17 May 2018 for the election of Julio Linares López who had been appointed by court in October 2017.

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 (HGB) in the Annual Report and on the company's website at **www.telefonica.de/management-declaration-2018** and in the Corporate Governance Report on the company's website at **www.telefonica.de/corporate-governance-report-2018**.

On 12 and 15 October 2018 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-2018**. Previous 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.

As of 31 December 2018, the Supervisory Board comprised six female and ten male members (i.e. 37.5% female and 62.5% male members). Thus the Supervisory Board still fulfills the requirements of Art 96 para. 2 German Stock Corporation Act (AktG) which the Supervisory also adopted for itself (a gender diversity quota of at least 30 %) which has to be fulfilled separately by shareholder and employee representatives following a shareholder representative resolution.

The gender diversity quota for the Management Board is 25% (two members of the 8 person Management Board are female), thus the Company met the minimum gender quota determined at 25% throughout the whole reporting period.

Review of the Financial Statements 2018

Pricewaterhous Coopers GmbH Wirtschaftsprüfungsgesellschaft audited the annual financial statements and the consolidated financial statements as well as the combined management report of Telefónica Deutschland Holding AG and the Group as of 31 December 2018 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 para 1 German Commercial Code (HGB). The auditor carried out the audit in accordance with section 317 German Commercial Code (HGB) considering German principles of proper auditing set by the Institute of Public Auditors in Germany (IDW).

The financial statement documentation of Telefónica Deutschland Holding AG and the Group, the separate non-financial declaration for Telefónica Deutschland Holding AG for the financial year 2018 as well as the respective auditor's reports and the Management Board's proposal for the distribution of profit were submitted to the Supervisory Board prior to the meeting on 18 February 2019 ("Bilanzsitzung"). The Audit Committee and the full Supervisory Board thoroughly reviewed the Annual Financial Statement

(Jahresabschluss), the Group financial statements, the combined Management Report for Telefónica Deutschland Holding AG and the Group, the separate combined non-financial declaration, the respective auditor´s reports and the Management Board proposal for the distribution of profit and discussed the documents in detail together with the auditor on 18 February 2019. The auditor also reported on scope, material aspects and results of his audit. There was no report on material weaknesses of the internal control system and the risk management system. Management Board explained in this meeting the risk management system besides the annual financial statement of Telefónica Deutschland Holding AG and the Group, the combined management report and the separate non-financial declaration. The Supervisory Board approved the auditor's findings in the audit reports and had no objections after its own assessment.

At its meeting on 18 February 2019, 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 2018 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Moreover, following respective recommendation of the Remuneration Committee, the prolongation of the management board service agreement and the appointment of Markus Haas until 31 December 2022 was resolved.

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, and
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 and discussed with in detail in the meeting on 18 February 2019 also with the auditor. Having reviewed the dependency report and the corresponding audit report the Supervisory Board agreed with results of the audit of the dependency report and as the result of its own assessment had no objections against the dependency report and the Management Board's declaration contained therein.

The Supervisory Board thanks the former chairperson of the Supervisory Board, Eva Castillo Sanz, for the long and trusting, successful, dedicated and outstanding work at the top of the Supervisory Board, inter alia during the company´s IPO and the merger with E-Plus Group. The Supervisory Board also thanks the former Supervisory Board members Marcus Thurand, Christoph Heil, Enrique Medina Malo and Jürgen Thierfelder as well as the retiring member Sandra Hofmann for their outstanding service in the previous years. Their commitment contributed considerably to the success of the company.

Munich, 18 February 2019

On behalf of the Supervisory Board

Laura Abasolo García de Baquedano
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-2018.**

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 and 15 October 2018 they last issued a declaration of compliance in accordance with section 161 German Stock Corporation Act (AktG). The full text of the compliance declaration may also be viewed on the company's website at **www.telefonica.de/declaration-of-compliance-2018.**

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

The German Stock Corporation Act (AktG) provides for a strict separation between management and controlling bodies on a personal level.

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 (Erklärung zur Unternehmensführung) in accordance with section 315d in connection with 289f of the German Commercial Code (HGB) on the Telefónica Deutschland website at **www.telefonica.de/management-declaration-2018.**

Taking into account the German Corporate Governance Code (GCGC), Supervisory Board established a Competence Profile that is described in detail below.

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 personal experience 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, 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 has at least two independent members (within the meaning of no. 5.3.2 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 fulfill 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 agreement) 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 2018 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-2018.**

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, there was also a so-called Capital Markets Day on 23 February 2018.

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. 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 corporate risks through constant communication with the relevant stakeholders. The risk management system is reviewed by the external auditor and is continuously improved.

You may find further details in the Section “Report on Risks and Opportunities” within the Annual Financial Statements.

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 optimisation of the compliance organisation 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 program focuses on behaviours protecting fair competition, avoiding corruption and conflicts of interests as well as on ethically appropriate behaviour. These topics are covered by mandatory online trainings, as are the areas of data protection, anti-discrimination and information security. Each employee is required to complete certain mandatory training sessions in regular intervals based on his or her job responsibilities. Clear guidelines and policies were established for the most important compliance matters.

The existing Compliance Management System is continuously enhanced in order to adjust it to the changing legal and economic conditions of business operations. The Management Board and the Supervisory Board (especially the Audit Committee which is 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 General Counsel area which ensures that the insider rules are complied with (including trainings and maintaining insider lists registering persons who act for the company and have authorised access to insider information in accordance with the Market Abuse Regulation, MAR).

Management as well as Supervisory Board deal with the topic compliance on a regular basis.

Transparency and communication

Shareholders may access information on the company on Telefónica Deutschland’s website. This includes press releases, corporate news and communications to the capital markets such as ad-hoc news. The company’s Articles of Association are also published on the website.

Relevant shareholdings of Management and Supervisory Board

Some members of the Management Board and the Supervisory Board hold shares of Telefónica Deutschland Holding AG. No member of the administration holds options on shares of Telefónica Deutschland Holding AG.

As per 31 December 2018, the Management Board held approximately 0.0054% 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 2018, the Supervisory Board held approximately 0.0001% 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 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 elected as auditor and group auditor for the financial year 2018 by resolution of the Annual General Meeting on 17 May 2018.

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 and 15 October 2018, 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. 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.

2. 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. The Management Board and the Supervisory Board are of the opinion that no misdirected incentives are created thereby.

3. 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 for several aspects of the variable compensation no 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.

4. 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.

5. 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.

6. 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 2018 at **www.telefonica.de/declaration-of-compliance-2018.**

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 program includes the main areas of anti-corruption with clear guidelines and procedures, competition law and the avoidance of ethically inappropriate behavior. 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 whistleblower system **(www.telefonica.de/ombudsmann)**.

The company's Data Protection Officer monitors compliance with data protection legislation. This is a top priority for the company. The department "Compliance, Corporate Security & Data Protection" and Internal Audit as well as the department General Counsel report directly to the Management Board.

Further details regarding the compliance organisation 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-2018.**

3. Composition and working procedures of the Management Board, Supervisory Board and the Supervisory Board's Committees

The Management Board of Telefónica Deutschland Holding AG comprises 8 members: Markus Haas, CEO (Vorstandsvorsitzender), Markus Rolle, CFO (Finanzvorstand), 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 "Arbeitsdirektorin").

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 German 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 Supervisory Board determined in December 2017 in accordance with section 111 paragraph 5 German Stock Corporation Act (AktG) a gender diversity quota of at least 25% for the Management Board, to be met by 30 June 2022, which was fulfilled during the entire financial year 2018 (two of eight members are female).

Also 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.

Such targets shall be considered by Supervisory Board for appointment and succession planning of members of Management Board and have been met throughout the reporting period as may also 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.**

As part of the diversity strategy and in accordance with section 76 para. 4 of the German Stock Corporation Act (AktG), the Management Board has set targets for the female quota of the management level below the Management Board, reporting level 1 (Berichtsebene 1), voluntarily. The target of 30% to be met by 30 June 2022 shall be achieved via the company's diversity strategy introduced on 1 January 2018. The diversity strategy showed first results in the reporting period, as of 31 December 2018 the share of female members of reporting level 1 was 21.3%. This means an increase of approximately 8% within a year (approximately 13% as of 31 December 2017).

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 Management Board for decision. Transactions and measures of particular significance are also subject to the prior approval by the Supervisory Board.

Management Board meetings are held regularly, generally once per week. Meetings may also be held by phone or video conference. Resolutions of the Management Board may also be passed outside of meetings, in particular in writing, by fax or e-mail.

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.

In the beginning of the financial year 2018, the Supervisory Board comprised the following members: Eva Castillo Sanz (Chairperson), Christoph Braun (Deputy Chairperson) and the Supervisory Board members Laura Abasolo García de Baquedano, Julio Linares López, Peter Erskine, Patricia Cobián González, Michael Hoffmann, Sally Anne Ashford, Enrique Medina Malo, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Thomas Pfeil, Marcus Thurand, Christoph Heil, and Claudia Weber.

In the beginning of the financial year 2018, Eva Castillo Sanz was chairperson of the Supervisory Board. She resigned from her office as chairperson and her memberships in the committees of the Supervisory Board on 25 April 2018 with immediate effect. On 3 May 2018, Laura Abasolo García de Baquedano was elected as chairperson of the Supervisory Board.

Moreover, Eva Castillo Sanz resigned as member of the Supervisory Board with effect to the end of 25 May 2018. María García-Legaz Ponce was appointed as her successor as member of the Supervisory Board by court resolution dated 7 June 2018.

Enrique Medina Malo resigned as member of the Supervisory Board with effect as of end of 24 July 2018, Pablo de Carvajal González was appointed by court as new member of the Supervisory Board with effect as of 25 July 2018.

The election of the employee representatives took place on 26 April 2018 as their office period ended with the end of the Annual General Meeting on 17 May 2018. Christoph Braun, Jan-Erik Walter, Thomas Pfeil, Joachim Rieger, Jürgen Thierfelder and Claudia Weber were re-elected. Martin Butz and Sandra Hofmann were newly elected to the Supervisory Board.

The term of office of Marcus Thurand and Christoph Heil respectively ended on 17 May 2018.

As of 31 December 2018, the Supervisory Board comprised the following members: Laura Abasolo García de Baquedano (Chairperson), Christoph Braun (Deputy Chairperson) and the Supervisory Board members Julio Linares López, Peter Erskine, Patricia Cobián González, Michael Hoffmann, Sally Anne Ashford, María García-Legaz Ponce, Pablo de Carvajal González, Martin Butz, Dr. Jan-Erik Walter, Joachim Rieger, Jürgen Thierfelder, Thomas Pfeil, Sandra Hofmann and Claudia Weber.

As of 31 December 2018, the Supervisory Board consists of six female and ten male members (i.e. 37.5% female and 62.5% male members). Therewith Supervisory Board continues to fulfill the requirements of section 96 para. 2 German Stock Corporation Act (AktG) as also determined by the Supervisory Board for itself (30% minimum gender diversity quota), such quota to be fulfilled separately by shareholder and employee representatives following a resolution by the shareholder representatives.

Supervisory Board is convinced that diversity is an important factor to enable its monitoring and steering responsibilities in the best interest of the company and has committed explicitly to diversity and equal opportunities in the company in accordance with the company's business principles. 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 German 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 internet site under **www.telefonica.de/corporate-governance-report-2018.**

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 were met in the reporting period 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 material 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 2018.

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, as of 31 December 2018 there are four committees of the Supervisory Board. The Supervisory Board may implement further committees if necessary. The Supervisory Board receives regular reports on the work of the committees.

The Audit Committee is inter alia responsible for preparing the decision of the Supervisory Board regarding the approval of the financial statements, discusses the quarterly and half-year reports with the Management Board, monitors 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

— Martin Butz (since 13 June 2018).

Christoph Heil left on 17 May 2018.

The Nomination Committee is responsible for proposing suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González is chairperson of the nomination committee. Following Eva Castillo Sanz' and Enrique Medina Malo's resignations, Laura Abasolo García de Baquedano and Pablo de Carvajal González have been further members since 24 September 2018.

The Mediation Committee with the responsibilities as defined in section 31 Co-Determination Act (MitbestG) consists of the following members:

— Laura Abasolo García de Baquedano (since 3 May 2018, Chairperson)

— Christoph Braun

— Julio Linares López and

— Sandra Hofmann (since 13 June 2018).

Eva Castillo Sanz belonged to the Mediation Committee until 25 April 2018, Marcus Thurand until 17 May 2018.

The members of the Remuneration Committee are:

— Sally Anne Ashford (Chairperson)

— Laura Abasolo García de Baquedano (since 13 June 2018)

— Claudia Weber and

— Dr. Jan-Erik Walter

Eva Castillo Sanz belonged to the Remuneration Committee until 25 April 2018.

More details on the composition and work of the Committees of the Supervisory Board are provided in the Supervisory Board Report.

Management Board **Supervisory Board**

15 February 2019

GLOSSARY

The glossary also contains abbreviations as used in the Group Management Report.

ADA	Advanced Data Analytics
AktG	Aktiengesetz (German Stock Corporation Act)
ARPU	Average Revenue per User
Art.	Article
Augmented Reality	Computer Assisted Reality Enhancement
Bitkom	German Federal Association for Information Technology, Telecommunications and New Media, Berlin
BMWi	German Federal Ministry for Economic Affairs and Energy
BNetzA	Bundesnetzagentur
BOLO	Contribution-based benefit regulations of the Essen Association
bp	Basis points
Brexit	British Exit – the act of the United Kingdom leaving the European Union
Broadband	Refers to telecommunication in which a wide band of frequencies is available to transmit information
CAP	Capping limit
CapEx	Capital Expenditure: investments in property, plant and equipment and intangible assets excluding investments in mobile frequency licenses, business combinations and finance leases
CapEx/Sales ratio	Investment ratio - reflects the percentage share of investments in revenues
Carrier	Telecommunication network operator authorised by the federal network agency
Churn	Loss of customers
Cloud services	Dynamic infrastructures, software and platform services, which are available online
CSI	Customer Satisfaction Index
DAX	German Stock Index
DBO	Defined Benefit Obligation
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
EV	Essen Association
ExComm	Executive Committee
FCF	Free cash flow
FDD	Frequency division duplex
FTE	Full-time equivalent
FTR	Fixed network Termination Rates
FttB	Fibre To The Building or Fibre To The Basement. In telecommunications FttB means that the fibre-optic cable is terminated in the user's house (basement).
FttH	Fibre to the Home. In telecommunications FttH means that the fibre-optic cable is terminated right in the user's home or apartment.
GB	Gigabyte
GCGC	German Corporate Governance Code
GDP	Gross domestic product
GfK	Gesellschaft für Konsumforschung (consumer research association)
GHz	Gigahertz

Handset	Mobile phone
HGB	Handelsgesetzbuch (German Commercial Code)
IAS	International Accounting Standards,
IASB	International Accounting Standards Board
ICS	Internal control system
IDW	Institute of Auditors in Germany e.V., Düsseldorf
IFRS	International Financial Reporting Standards
IoT	Internet of Things
ISIN	International Securities Identification Number
IT	Information Technology
Joint Venture	A joint agreement under which the parties having joint control have rights to the net assets of the agreement
KPI	Key Performance Indicator
KPN	Koninklijke KPN N.V., The Hague, Netherlands
LTE	Long Term Evolution: further development of the UMTS/HSPA mobile communications standard
M2M	Machine-to-Machine communication: automatic exchange of information between devices
MBA	Mobile Bitstream Access
Mbit	Megabit
MHz	Megahertz
ms	Milliseconds
MSR	Mobile service revenue
MTR	Mobile network termination rates
MVNO	Mobile Virtual Network Operator: Virtual network operator
Net Adds	Net new customers: new customers for the period less those customers leaving are designated as net additional customers
NPS	Net Promoter Score
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 Amortisation
OpCF	Operating Cash Flow
OTT	Over-the-top – IP-based and platform-independent services and application (WhatsApp, Facebook, etc.)
PIP	Performance and Investment Plan
Prepaid/Postpaid	In contrast to postpaid contracts, prepaid contracts purchase the credit balance in advance without a fixed contractual commitment
PSP	Performance Share Plan
RCF	Revolving Credit Facility
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 which identifies the user within the network
smart watch	A mobile device which consists of an electronic watch with additional computer functions, attached to a bracelet.
Smartphone	Mobile phone with extensive computer and internet functionalities
SME	Small- and Medium-sized Enterprises
SMS	Short Message Service
SoHo	Small office/Home office
SOX	Sarbanes-Oxley-Act: US federal law to improve the reliability of reporting
Tablet	A wireless, portable personal computer with a touch screen
TDD	Time division duplex operation
Telefónica Deutschland	Telefónica Deutschland Holding AG, Munich, Germany

Telefónica Deutschland Group	The companies included in the Consolidated Financial Statements of Telefónica Deutschland
Telefónica, S.A.	Telefónica S.A., Madrid, Spain
TKG	Telekommunikationsgesetz (Telecommunications Act)
Translation risk	The risk arising from the translation of accounting items at a later reporting date
TSR	Total shareholder return (return on shares)
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, Berlin
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.
Virtual Reality	Computer-generated representation of a world (in real time)
VZBV	Federation of German Consumer Organisations, Berlin
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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www.telefonica.de/annualreport

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